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Takeover Response Checklist

The high level of mergers reached in 1997 continued through the first half of 1998. Indeed, announced domestic mergers in the first half of 1998 exceeded the total for all of 1997. 1997 was the third consecutive year of record-breaking merger activity. There were 10,700 announced mergers in the United States, representing an aggregate value of $920 billion. Worldwide merger values totaled $1.7 trillion. The value of mergers in 1997 represented a 40% increase over 1996. (See Table I.) The value of hostile deals in 1997 was $127 billion, a 74% increase over 1996. (See Table II.) In the first half of 1998 there were mergers in the United States with an aggregate value of $973 billion; with 108 deals valued at $1 billion or more. The following is a brief review of the factors affecting current merger and takeover activity:

Accounting. Pooling continues to be available, although under increasing pressure from the FASB and the SEC. In many cases, particularly with large strategic acquisitions, the market has been as receptive to purchase accounting, combined with a large stock repurchase program, as it is to pooling. In other cases where pooling is not available the market has been receptive to valuation based on cash flow, instead of book earnings.

Antitrust enforcement, notwithstanding Staples/Office Depot, Lockheed Martin/Northrop Grumman and the differentiated-product theory in vogue at the FTC, has not changed significantly. FTC and DOJ continue to recognize that markets are now global and have been willing to work out divestitures and licensing to solve problems, although the FTC is more frequently insisting on parties finding a buyer or licensee prior to consummating the merger. Increasingly the economic analysis of the merger is the most important part of the presentation to the antitrust authorities. Consistency between the analysis presented to the government and internal studies and the presentations to the board of directors and Wall Street is of critical importance.

Arbitrageurs together with hedge funds have aggregate capital available for arbitrage sufficient to be a major factor in even the biggest mergers and arbitrage continues to be a key factor in mergers and takeovers.

Currencies. Worldwide cross-border mergers have increased dramatically. However, acquisition of U.S. companies by non-U.S. companies has not expanded at the same rate. Domestic economic factors have had more of an effect on Japanese and German companies' interest in U.S. acquisitions than the significant increase in the dollar in relation to the yen and mark. The Asian crisis has resulted in an increase in merger activity in the region and may well result in significant acquisitions by U.S. companies.

Efficiency gains from reducing excess capacity in the defense, banking, utility, healthcare, paper, transportation, and natural resource industries account for the major part of current merger activity. Unlike the conglomerate merger wave of the 1960's and the highly-leveraged bust-up

wave of the 1980's, much current merger activity is strategically motivated, soundly based and appears to be having a positive effect on the economy.

Financial Institutions. The 1990's have been an era of seismic change in the financial institutions industry. Size has become an increasingly important measure of competitive strength among leading domestic and international competitors, specially where size is combined with a leading market share. Multi-billion dollar mergers and acquisitions were commonplace in 1997 and now in 1998 we have the Travellers–Citicorp merger creating a $130 billion market capitalization institution. The market has generally been receptive to these large transactions, and seems to accept the proposition that size can provide significant competitive advantages enabling acquirors to achieve cost synergies by eliminating excess capacity, achieve revenue enhancements through cross-selling a broader product line, and manage the sizeable investments in technology needed to maintain a competitive advantage. Buoyed by a strong stock market and a rise in acquiror market valuations, the multiples paid in recent transactions have reached record levels (ranging from approximately 3.5 to over 5 times book value and from 20 to 25 times latest twelve months earnings per share).

Financing for acquisitions is readily available, with banks competing to arrange multi-billion dollar loans on short notice. The debt markets are providing both liquidity at size and favorable rates. LBO and investment funds are awash with cash and actively seeking and bidding for deals.

Institutional investors and other activist shareholders have had considerable success in urging (in some cases forcing) companies to restructure or seek a merger. Shareholder pressure and the enhanced ability of shareholders to communicate among themselves and to pressure management and boards has had a significant impact on the willingness of companies to merge or restructure.

Joint venture activity continues to grow. There have been major consolidations of refining and marketing operations of oil and gas companies for the purpose of reducing costs by eliminating overcapacity. Joint venture activity continues in other areas such as pharmaceuticals.

Litigation has not had a meaningful impact on deals. The courts are less receptive to acquisition transaction strike suits. The general acceptance by courts of the "just say no" defense has also not had as meaningful impact on hostile tender offers as it would but for the success of the tactic of combining a tender offer with a proxy fight.

Major companies are increasingly willing to make hostile bids to accomplish a strategic objective like the IBM bid for Lotus and the Johnson & Johnson bid for Cordis or to prevent a competitor from gaining an advantage like Norfolk Southern's bid to break up the CSX-Conrail merger and the bids by WorldCom and GTE for MCI, and the bid by Glaxo-Wellcome for SmithKline Beecham immediately after SmithKline's disclosure of merger discussions with American Home Products.

Poison pills continue to be the most effective defense against a hostile takeover. They have been proven not to adversely affect market value when adopted and to significantly enhance the ability of boards of directors to either "just say no" or to get the best price. Institutional investor opposition to the pill and successful proxy resolution attacks, such as the Fleming and Harrahs situations, have given new life to pill opponents. On balance the pill continues alive and well. Indeed a

dead-hand pill was sustained under Georgia law and under appropriate circumstances and with reasonable limitations might be used by companies incorporated in other states.

Real estate merger activity has increased substantially. The ongoing shift from private financing to public financing in the commercial real estate markets which is evidenced by the marked growth in the public REIT industry has brought with it pressure to consolidate and make more liquid the ownership of commercial real estate. Existing public REITs are seeking to grow through acquisitions in order to increase stock liquidity and access to capital, while at the same time pension funds, insurance companies and other private investors are seeking to swap their properties for more liquid stock in publicly traded REITs.

Regulation (deregulation) has had a very significant impact. Examples are interstate banking and the relaxation of restrictions on banks engaging in the investment banking business. Telecommunications, healthcare and utilities are other areas that have also seen a significant increase in acquisitions as a result of changing regulations.

Stock market volatility has not had a discernible impact on acquisitions. The market remains very receptive to synergy stories. A key factor in major mergers is the analyst conference immediately after the announcement and the follow-through road show.

Taxes. The 1997 amendment to the tax law to kill the Morris Trust spin-off-merger transaction has largely eliminated new Morris Trust deals. In addition, there is a congressional study of tax-free spin-offs in general and the possibility of legislation in this area as well.

Technology. Rapid changes in technology have sparked an increasing number of mergers. Again banking is a cogent example. Also the inflated stock prices of high-tech companies have given them an acquisition currency that the market has been willing to accept as face value. There continues to be increasing merger activity among high-tech companies.

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The present takeover environment warrants reexamination of strategic plans, takeover response preparation and senior managements' and directors' understanding of current legal and tactical thinking with respect to takeovers.

This outline provides a checklist of matters to be considered in putting a company in the best possible position to respond to a takeover bid, a proxy fight or a consent solicitation. Not all the matters in this outline are appropriate for any one company. Takeover defense is an art, not a science. It is essential to be able to adopt new defenses quickly and to be flexible in responding to changing takeover tactics. Whatever the state of the law may be and however it may change, in order to achieve the best result in a takeover situation a company must have effective defenses and keep them up to date.

Advance Preparation

1. Assemble Team to Deal with Takeovers

    a. Small group (2-5) of key officers plus lawyer, investment banker, proxy soliciting firm, and public relations firm

    b. Create war list of telephone numbers of the team

    c. Ensure ability to convene special meeting of board within 24 to 48 hours

    d. Continuing contact and periodic meetings are important

    e. A periodic fire drill is the best way to maintain a state of preparedness

2. Prepare Instructions for Dealing with:

    a. Press

    b. Stock Exchange

    c. Directors

    d. Employees

    e. Customers/suppliers

    f. Institutional investors

3. Review Structural Defenses, Consider Implementing Additional Defenses If Necessary

    a. Bear in mind:

        ° In many cases a structural defense will be possible only if there has been careful advance preparation by the Company and its investment banker and counsel (see 7 and 8 below)

        ° While staggered election of the board of directors and supermajority merger votes or other shark repellents have proved not to be effective in defeating any-and-all cash tender offers, they may be effective in deterring the other types of takeovers (including proxy fights) and are worth having, if obtainable (but consider negative reaction of institutional investors).

    b. Charter and bylaw provisions

        ° Staggered board

- Ability of stockholders to act by written consent
- Advance notice provisions
- Ability of stockholders to call a special meeting
- Ability of stockholders to remove directors without cause
- Ability of stockholders to expand size of board and fill vacancies
- Supermajority voting provisions (fair price, etc.)
- Authorization of sufficient common and blank-check preferred stock
- Cumulative voting
- Preemptive rights
- Constituencies

c. "Poison pill"

- "Dead Hand" provision
- Purported antidotes ineffective
- Fleming case

d. Structure of loan agreements and indentures

e. ESOP arrangements; plans to increase employee ownership

f. Options under state takeover laws

- Control share
- Business combination
- Fair price
- Pill validation
- Constituencies
- Long-term vs. short-term
- Disclosure

4. Consider Additional Advance Preparation

   a. Advance preparation of earnings projections and liquidation values for evaluation of takeover bid and alternative transactions

   b. Amendments to stock options, employment agreements, executive incentive plans and severance arrangements ("golden parachutes")

   c. Amendments to employee stock plans with respect to voting and accepting a tender offer

   d. Protection of overfunded pension plans

   e. White knight/white squire arrangements

      ° Advance contact with potential white knights can lead to misunderstanding and takeover bid in certain cases

      ° Standstill agreement may be detrimental to shareholders (disliked by professional investors who may stir up takeover activity)

      ° Issue as to legality of standstill agreement if not supported by independent business purpose such as exchange of technology or need for capital

      ° Employee trusts may be effective in certain cases

      ° Consider swap of voting stock and mutual standstill agreements

      ° Consider white squire funds

   f. Restructuring -- sale of division, spinoff, tracking stock (Morris Trust spin-off-merger eliminated)

5. Shareholder Relations

   a. Review dividend policy, analyst presentations and other financial public relations

   b. Prepare fiduciary holders with respect to takeover tactics designed to panic them

   c. Plan for contacts with institutional investors (including maintenance of an up-to-date list of holdings and contacts) and analysts and with media, regulatory agencies and political bodies

d. Remain informed about activist institutional investors and about corporate governance and proxy issues

e. Consider the role of arbitraguers and hedge funds

6. Prepare Board of Directors to Deal with Takeovers

a. Schedule periodic presentations by lawyers and investment bankers to familiarize directors with the takeover scene and the law and with their advisors

b. Company may have policy of continuing as an independent entity

c. Company may have policy of not engaging in takeover discussions

d. Directors must guard against subversion by raider and should refer all approaches to the CEO

e. Avoid being put in play; psychological and perception factors may be more important than legal and financial factors in avoiding being singled out as a takeover target

f. Review corporate governance guidelines and reconstitution of key committees

7. Preparation by Investment Banker

a. Maintain up to date due diligence file and analysis of off-balance sheet values

b. Consider recapitalization, spin-off and liquidation alternatives

c. Perform semi-annual review

d. Communication of material developments and regular contact is important

8. Preparation by Lawyer

a. Review structural defenses such as poison pill

b. Review charter and bylaws; ensure they reflect “state of the art”

c. Review business to determine products and markets for antitrust analysis of a raider

d. Understand regulatory agency approvals for change of control

e. Consider impact of change of control on business

f. Consider disclosures that might cause a potential raider to look elsewhere

g. Consider recapitalization, spin-off and liquidation alternatives

h. Consider amendments to stock options, executive compensation and incentive arrangements and severance arrangements, and protection of pension plans

i. Consider ESOPs and other programs to increase employee ownership

j. Regular communication and periodic board presentations are important

9. Prepare CEO to Deal with Takeover Approaches

a. Handling casual passes

b. Handling offers

c. Communications with officers and board of directors

d. Company may have policy of not commenting upon takeover discussions and rumors

Responding to Bidder Activity

1. Types of Activity

a. Accumulation in the market

b. Casual pass/non-public bear hug

c. Public offer/public bear hug

d. Tender offer

e. Proxy contest

2. Responses to Accumulation in the Market

a. Monitor trading

b. Maintain contact with specialist

c. Look for bidder Schedule 13D and Hart-Scott-Rodino filings:

-- 13D: within 10 days of crossing 5% threshold

-- HSR: prior to crossing $15 million or 10% threshold

d. Board has duty to prevent transfer of control without premium

e. Monitor/combat disruption of executives, personnel, customers, suppliers, etc.

f. Monitor uncertainty in the market; change in shareholder profile

g. Consider immediate responses to accumulation:

° Poison pill can be structured so that flip-in takes effect at 10% to 15% threshold (N.Y. corporations 20%)

° Litigation

° Standstill agreement

3. Effect of Hart-Scott-Rodino Antitrust Act and Antitrust Enforcement Policies

a. Hart-Scott should prevent dawn raids on big companies but under Hart-Scott a raider in some cases still can buy up to $15M even if more than 15%, and there is a 10% investment exception that has been misused by raiders

b. A raider cannot complete its purchases until the requisite waiting period has expired:

° Cash tender offer: 15 calendar days
° All other situations: 30 calendar days

c. While the Clinton Administration has more aggressive antitrust enforcement views than the Reagan-Bush Administrations as to vertical mergers and as to horizontal mergers affecting innovation markets or causing unilateral effects proscribed under the merger guidelines, the current approaches in the Clinton Administration and Congress generally do not deter big conglomerate acquisitions

4. Responses to Casual Passes/Non-Public Bear Hugs

a. No duty to discuss or negotiate

b. No duty to disclose unless leak comes from within

c. Response to any particular approach must be specially structured; team should confer to decide proper response

d. Keep the board advised

5. Response to Public Offers/Public Bear Hugs

a. No response other than "will call you back"

b. Call war list and assemble team; inform directors

c. Call special board meeting to consider bidder proposal

d. No press release or statement other than "stop-look-and-listen"

e. Consider trading halt (NYSE limits halt to short period)

f. Determine whether to meet with raider (refusal to meet may be a negative factor in litigation)

g. In a tender offer, Schedule 14D-9 must be filed within 10 business days and must disclose:

- Board's position (favor; oppose; neutral) and reasoning
- Negotiations
- Banker's opinion (optional)

6. Special Meeting of Board to Consider Offer

a. Board should be informed of the following:

- Board has no duty to accept or negotiate a takeover offer
- A premium over market is not necessarily a fair price; a fair price is not necessarily an adequate price
- The "just say no" response was approved in the Time Warner case and reaffirmed in the Paramount and Unitrin cases
- Where outside directors are a majority, there is no need for a special committee to deal with takeovers
- Board must act in good faith and on a reasonable basis; business judgment rule applies to takeovers (modified rule applies in Delaware, where defensive action must be proportional to threat)

- Front-end-loaded, two-tier offers and partial offers present fairness issues which in and of themselves may warrant rejection and strong defensive action

b. Presentation:

- Management -- budgets, financial position, real values (off-balance sheet values), new products, general outlook, timing

- Investment banker -- opinion as to fairness or adequacy, assessment of bidder, quality of bidder's financing, state of the market and the economy, comparable acquisition premiums, timing

- Lawyer -- terms and conditions of proposal, legality of takeover (antitrust, compliance with SEC disclosure requirements, regulatory approval of change of control, etc.), bidder's history, reasonable basis for board action

c. Board may consider:

- inadequacy of the bid

- nature and timing of the offer

- questions of illegality

- impact on constituents other than shareholders

- risk of nonconsummation

- qualities of the securities being offered (if bid is not all cash)

- basic shareholder interests at stake, including the past actions of the bidder (greenmail, etc.)

- strategic alternatives

Strategic Alternatives

1. Remaining Independent

a. "Just say no" defense is available as a legal matter, but may not be available in practice

- Refuse to redeem poison pill

- Wage proxy fight to keep control of board (if board is staggered, bidder cannot get control and redeem pill without two annual meetings)

b. Consider white squire arrangements

c. Consider actions which decrease the Company's attractiveness as a takeover target

- New acquisitions (e.g., to create antitrust problems for bidder or increase size of transaction for bidder)
- Asset sales or spin-off
- Share repurchases/self-tender
- Issue targeted stock
- Recapitalization
- Note that most of these actions will prevent pooling of interests treatment for future transactions, possibly making it more difficult to enter into a friendly transaction

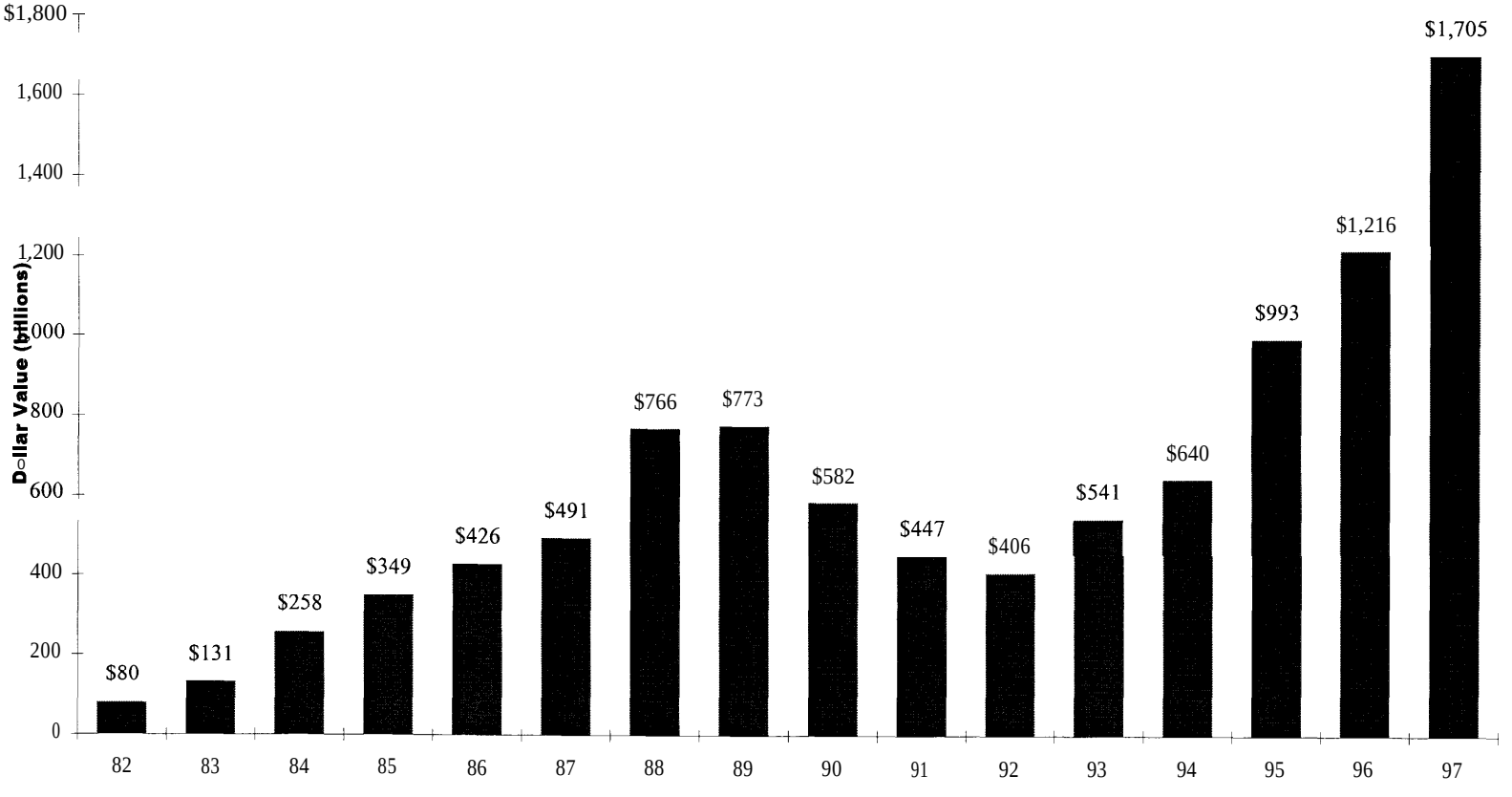
2. Sale of the Company

a. Options:

- Locate white knight
- LBO/MBO
- Auction
- Sell significant subsidiary or division ("crown jewel" or other)
- Negotiate with bidder

b. Bear in mind: if Revlon duties are triggered, board will not be able to reverse course

Announced Worldwide Merger Activity



Source: Securities Data Company

Table I

Announced Worldwide Hostile Deals

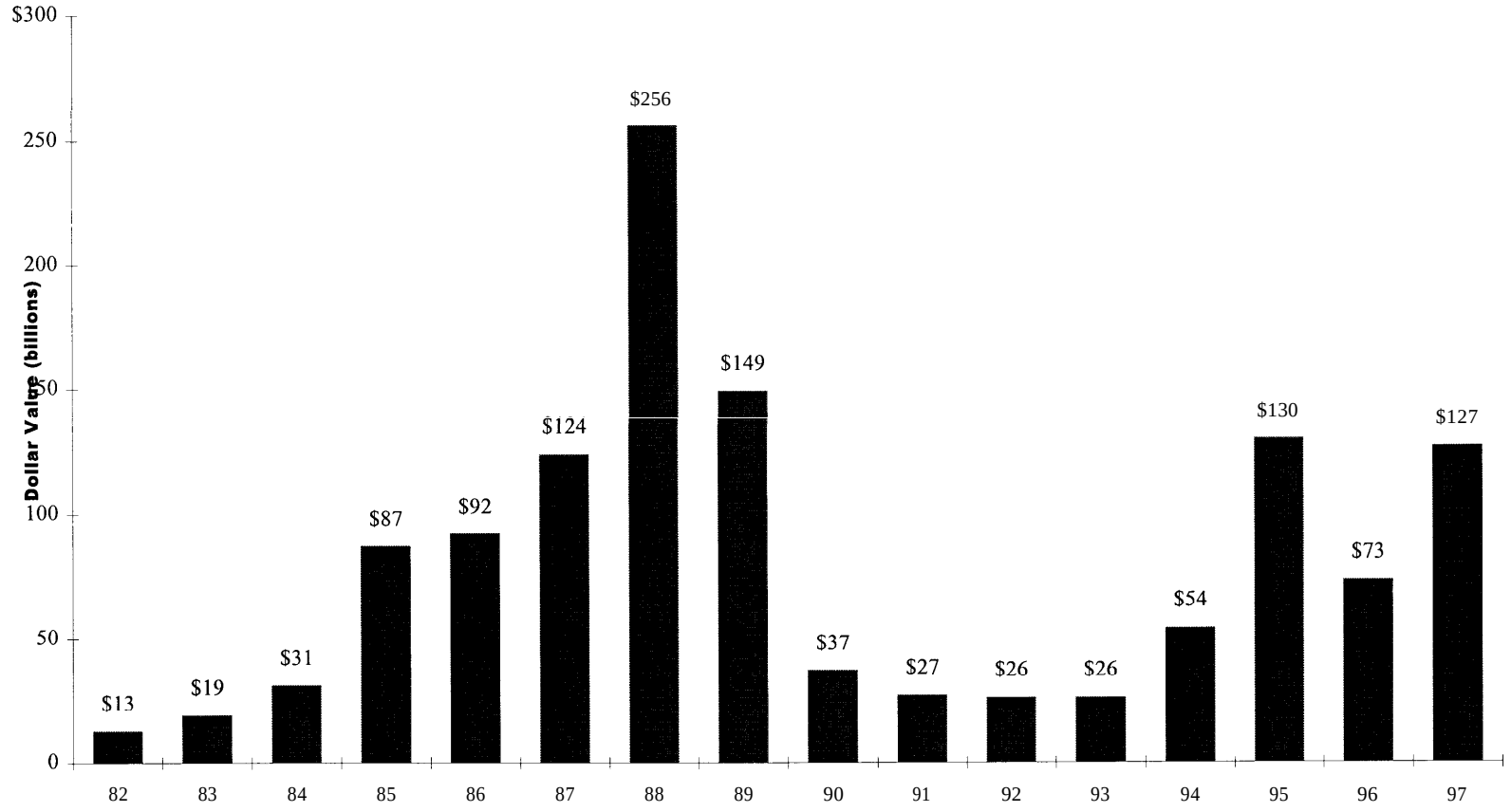


Table II

Source: Securities Data Company