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M. Lipton

Takeover Response Checklist

In the seven years since the revival of takeover activity in 1994, one-third of the U.S. companies that were the target of a hostile bid of over $100 million remained independent; one-third were sold to a third party; and one-third were acquired by the raider. These statistics bring home the critical importance of adequate preparation to deal with a hostile takeover bid.

New accounting rules, effective next month, requiring purchase accounting for all acquisitions and substituting impairment writedown of goodwill for periodic amortization of goodwill and new SEC rules making it much easier to do a hostile exchange offer, will eventually be a significant stimulant to takeover bids.

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, a consent solicitation or to negotiate a merger. 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 or the market and however they 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. Create 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. Ensure ability to convene special meeting of board within 24 to 48 hours

    c. Continuing contact and periodic meetings are important

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

    e. Warlist

2. Prepare Instructions for Dealing with:

    a. Press

    b. Stock Exchange

    c. Directors

d. Employees

e. Customers/suppliers/banks

f. Institutional investors and analysts

g. Public officials

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 lawyer (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 (not valid in Delaware)
- Purported antidotes ineffective
- Fleming case (bylaw amendment)
- Institutional pressure for chewable pill
- Tide Pill (review by committee of independent directors)

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 prospects vs. short-term price
- 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

f. Restructuring – stock repurchase, sale of division, spinoff, tracking stock

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. Role of arbitrageurs and hedge funds

6. Prepare Board of Directors to Deal with Takeovers

a. Maintaining a unified board consensus on key strategic issues is essential to success.

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

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

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

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

f. 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

g. 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 tracking stock alternatives

   c. Perform semi-annual review

   d. Know your raiders — advance preparation for dealing with a specific potential raider may be the key to a successful defense; impact of new purchase accounting rules

   e. 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 tracking stock 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. The CEO should be the sole spokesperson for the company on independence, merger and takeover

b. Handling casual passes (bearhugs)

c. Handling offers

d. Communications with officers and board of directors

e. 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 — cash or stock

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:

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 $50M 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. Current antitrust enforcement policies do not restrain mergers except where there is a significant increase in concentration, and even then the agencies have been receptive to divestiture, licensing and business restrictions to cure problems.

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 whether trading halt would be beneficial (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 should 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 and continues to be good strategy and good law
- 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)
- 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
- 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

2. Merger of Equals

   a. Mergers of equals have become an increasingly important alternative form of business combination.

   b. Early, proactive efforts to pursue MOEs are necessary, as they are generally impossible to implement as a takeover defense.

   c. MOEs offer an alternative to an outright sale in which two organizations of similar size can combine their organizations in an effort to provide shareholders with greater long-term values.

   d. Management and other "social" issues is the key to an MOE's success or failure; these issues can be particularly challenging to address when combining companies with different corporate cultures.

   e. A variety of contractual and legal structures are available to implement agreements on social issues, although basic trust and common objectives are key.

   f. Careful planning is critical to avoid placing one or both parties "in play" prior to the announcement of the transaction and to anticipate possible shareholder concerns.

   g. Lock-up protections are appropriate to protect the transaction once it is announced. The record must show the MOE is not intended to be a sale of either company.

   h. MOEs can be "fair" even though higher short-term value could be obtained in an outright sale of the company.

3. Joint Ventures and Strategic Alliances

   a. Strategic alliances are being pursued aggressively, often with significant control ramifications.

b. These transactions raise complex tax, accounting and sale of control considerations, which must be carefully analyzed against the backdrop of alternate strategic options.

c. The transactions often present all the complexities of a full acquisition with the added complexity of shared governance and the need to construct an inherently imperfect exit mechanism.

d. Short-term objectives need to be carefully balanced against potential longer-term ramifications.

4. 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

c. Exploration by CEO of possible sale or merger (including strategic merger of equals) should only be undertaken after consultation with expert advisers.