MEMORANDUM

TO: Members of the General Corporation Law Section of the Delaware State Bar Association

FROM: E. Norman Veasey

RE: Delaware Takeover Legislation

DATE: November 13, 1987

I spoke with Gil Sparks yesterday and read to him the essence of the enclosed memorandum. Gil agreed that I should send it to members of the Council. He also said that he would talk with Al Sommer today and advise the Council and me of Al's further comments, if any. Because of the confidentiality of the Subcommittee's drafts, it has not been possible for me to determine if Al and others outside of Delaware believe that the Subcommittee's current draft would be found to have "meaningful outs" by those on the Hill who are influential in shaping the federal legislation.

My own view, although I did not feel free to express it to Al because of the confidentiality, is that the current draft does not provide "meaningful outs" and I think it is essential that the Council modify it before it goes out to the Section and others for comment. In the past our Bar has been very responsible in the handling of important and controversial legislation. In my view we took a correct and moderate step in Section 102(b)(7). We received very high marks around the country for our handling of the Indiana-type statute. I have associated myself publicly with Lew Black's analysis published in The Wall Street Journal on Friday, July 10, 1987 entitled "Why Delaware Is Wary Of Antitakeover Law" (see attached). I hope we will continue to be cautious and even-handed on the substance of takeover legislation and certain that our process for obtaining input and having full discussion continues.

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Enclosures
cc: Messrs. Crompton, Hanrahan, Herndon, and Silverstein (w/enclosures)

MEMORANDUM

TO: File

FROM: E. Norman Veasey

RE: Delaware Takeover Legislation/Federal Preemption

DATE: November 12, 1987

At the 19th Annual Securities Institute at which I was one of the speakers, there were presentations about pending federal legislation and the status of state legislation. Al Sommer spoke about the Proxmire Bill in the Senate and Consuela Washington of the House staff spoke about the Dingle-Markey Bill. Steve Shapiro of Mayer, Brown & Platt spoke about state legislation. It was generally known that Delaware was going to do something soon but I declined to say what it would be because I understand we are under an embargo not to provide that information. Everybody is waiting to see what Delaware will do. Both Al Sommer and Consuela Washington said that if Delaware goes too far, such action will "fuel the fires" of preemption. Steve Shapiro spoke mostly about the balkanized activity in the various states and about the constitutional issues.

I talked again with Al Sommer on November 10. He indicated that Congress is quite preoccupied with the market issues following the October 19th crash, but he confirmed that there is great interest in what Delaware plans to do. There is strong sentiment in Congress against balkanization caused by states with local interests protecting jobs where Delaware or some other state is the state of incorporation. Many people agree with the outcome of the Telex decision. Telex may force some companies to consider reincorporating in a "more hospitable" state where there are large operations and many jobs. Thus, the pressure for Delaware to "do something".

Sommer said that he has heard considerable criticism of the New York statute being a "show stopper". He has not heard much about redemption statutes. If Delaware were to adopt a New York type statute, there might be problems unless it provided "meaningful outs". The Indiana type statute is milder and perhaps more palatable than the New York statute in the eyes of those favoring preemption but he recognizes we are inclined against the Indiana-type statute.

I did not tell Sommer what is likely to come out of Delaware. In fact I told him that we were all precluded from giving out that information at this time, but I asked him whether he thought it would be helpful to have a reasonable period to float a trial balloon so that we could measure the sentiment on the Hill and in other places. He thought that was essential and volunteered to talk with the leaders on the Hill if I thought that was a good idea (which I do). I told him we could expect that some provision would emerge from Delaware next week (probably toward the end of the week) and that I assumed that it would be sent out for comment. I told Sommer I would get back to him and send him the material as soon as I was free to do so.

I don't know what Marty Lipton's position is likely to be, but I note that in his paper prepared for our Dynamics III program, he commented unfavorably on the forced redemption statute proposed last summer, as follows:

> In mid-1987, an amendment to the Delaware statute was proposed that would permit Delaware corporations to redeem common stock at the lesser of the fair value or the average price paid by the acquiror during the previous year whenever a two-thirds majority of the independent outside directors and a two-thirds majority of the full board conclude (1) that the holder intends to obtain a short-term gain from greenmail or to cause the corporation to enter into a transaction that is not in the long-term interests of the corporation and its stockholders or (2) that the holder's

ownership of the stock is causing or is likely to cause a material adverse impact on the corporation's business or prospects, including the impairment of the corporation's relationships with its customers or its ability to maintain its competitive position.

This proposal would expand the redemption right presently available to Delaware corporations which have a governmental license or franchise to conduct its business conditioned upon some or all of the holders of its stock possessing prescribed qualifications, to have a charter provision making its stock subject to redemption to the extent necessary to prevent the loss of such license or franchise or to reinstate it. The proposal is loosely based upon a provision in the Connecticut insurance laws that makes the stock of Connecticut insurers subject to redemption at its fair price if the board of directors determines that the stockholder being redeemed fails to meet the prescribed licensing qualifications or otherwise fails to obtain necessary regulatory approvals.

The proposed statute, if passed, could expose directors to substantial personal liability that, as an alleged breach of their duty of loyalty, would not be shielded even if the corporation's charter had been amended to conform with the recent Delaware legislation regarding director and officer liability. See Section V.D.1. In addition, in view of the current interest in one share-one vote and the SEC's "all holders" rule-making response to Unocal's exclusionary self-tender offer, it seems inevitable that a Delaware forced redemption statute would generate substantial controversy at the SEC and in Congress and could even impel Congress to seek to preempt a broad range of state statutes in this area. See Sections III.A.4.c., III.D.5.c. and VI.C.13.

(Emphasis added). Lipton, Fogelson, Brownstein and Robinson, **MERGERS AND ACQUISITIONS: Developments in Takeover Techniques and Defense**, prepared for "Dynamics of Corporate Control III", a National Institute to be held December 3-4, 1987, New York City, pages 228-29.

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Why Delaware Is Wary of Anti-Takeover Law

By Lewis S. Black Jr.

Since the U.S. Supreme Court in April upheld an Indiana anti-takeover law that two lower courts had thrown out, four other states have pushed to more than 20 the number of these statutes across the nation.

These are "second-generation" laws, so called because they are written to get around a 1982 Supreme Court decision striking down an Illinois tender-offer law and, effectively, the 37 other such statutes in force at that time.

With the upholding of the Indiana legislation, attention focused on Delaware. More than half of the Fortune 500 companies and more than 40% of New York Stock Exchange companies are incorporated there. The Corporation Law Section of the Delaware Bar, which has responsibility for drafting amendments to the Delaware law, was asked to fashion an Indiana-type statute before the Legislature adjourned in June.

However, after 1½ months of intensive study, the bar committee decided not to recommend such a law. Did the train leave without Delaware? Did the chief incorporating state miss a golden opportunity to reclaim a role for the states in takeovers?

Endless Game of Catch Up

Although Delaware prides itself on being a leader in corporation law, it has always been wary of laws regulating tender offers. For one thing, such laws have never fit well in corporation statutes. For another, they don't work. Efforts to regulate tender offers at the federal level under the Williams Act have distorted the process. Since the Williams Act was enacted in 1968, the Securities and Exchange Commission (and the states, through such acts as the now-validated Indiana law) has played an endless game of catch up, adopting rules that seem to fix one problem only to give rise to another.

Even with this background, many members of the Delaware Corporation Law Section initially favored adoption of an Indiana-type statute. The Supreme Court majority had said that the statute was good for stockholders. Moreover, the Indiana act, like other second-generation state tender-offer laws, does not prohibit or even regulate tender offers. Its principal impact is to give stockholders the right to decide whether "control shares" acquired by a bidder will have voting rights. Hence, it seemed less intrusive than statutes adopted in such states as New York and Ohio that are generally regarded as posing greater deterrents to potential offerors.

But as the Delaware committee worked on, the initial support evaporated. The group uncovered a number of problems as it tried to forecast how the statute would work in practice. Moreover, its own misgivings were echoed by practicing lawyers inside and outside of Delaware, as well as corporate counsel and members of the academic community who reviewed drafts of the statute. Indeed, the bar committee was surprised at the large number of corporations that urged caution.

The committee finally concluded unanimously to hold off on action for several reasons:

It seriously questioned whether the Indiana statute would even do what it is intended to do. The statute's principal deterrent to hostile offers is the requirement of a shareholder vote in 50 days on whether control shares will have voting rights. Since it is likely that tender offers would be conditioned on a favorable vote, this would, indeed, lengthen the duration of tender offers to 50 calendar days from the 20 business days required under the Williams Act.

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But wouldn't the result be a stockholder plebiscite on every offer, and wouldn't the stockholder vote always favor the bidder or any new bidder that offered a greater premium? It did not seem to the committee to matter that the Indiana law precluded the bidder (as well as management) from voting. It seemed likely that institutions would vote for a short-term profit. So would arbitragers who could acquire shares before the record date for the stockholders meeting or purchase shares with proxies attached.

It is argued that 50 days would give a target management more time to take defensive action or to find a white knight. But it is unclear that courts would permit defensive action during the proxy solicitation mandated by the statute. Courts might well prohibit either side from taking any action to prejudice a fair vote, including adoption of shareholder-rights plans, sales of stock, corporate restructurings and other devices used to defend against unwanted takeovers. And, since every control-share acquisition would now involve a proxy contest, it was not clear what the position of the SEC would be on action by either side that might affect the vote or require changes in proxy materials.

The Delaware committee was also skeptical of the claim that the mere existence of a 50-day wait would deter tender offers. The market's usual creativity in connection with takeovers has extended to financing matters, as well, not only with junk bonds but with investment bankers providing bridge loans to finance takeovers.

In addition, the committee was impressed by those who counseled that the Indiana statute affords a ready means to put companies into play. Almost anyone who wants to do that, or even to harass management, could simply notify the company of his intention to make a control-share acquisition and trigger the statutory stockholder plebiscite. The ensuing meeting notice and other publicity provide a cheap means to publicize the company's availability for sale.

Others noted that Indiana-type legislation might have a particularly short shelf life. A number of bills pending in Congress would extend the time tender offers must remain open under the Williams Act. One by Reps. John Dingell (D., Mich.) and Edward Markey (D., Mass.) would extend the time to 60 days. One commentator on the proposed Delaware law said that its incidental extension of tender offers to 50 days was a poor trade for the stockholder plebiscite the law required, and a net loss if Congress extended the time for tender offers to 60 days, anyway.

Other activity at the federal level also has the potential to make Indiana-type statutes an anachronism. The Dingell and Markey legislation would impose a one-share, one-vote standard on all shares listed on national exchanges or quoted on NASDAQ, and the SEC has proposed a rule to prohibit corporate action that would disproportionately reduce the voting power of shares. Such provisions might preempt the provisions of the Indiana law that limit the voting rights of control shares.

A host of other problems emerged in the drafting process. Some Indiana provisions seem to permit greenmail, and their viability was called into question in light of legislation pending in Congress that would prohibit greenmail. Technical problems abounded. It appeared that the Indiana statute does not grandfather certain existing control-share positions. Would Delaware's adoption of such a statute inadvertently confiscate the control premium attached to existing blocks? Should the statute cover all corporations, or should stockholders or directors be permitted to opt in or opt out? Should an effort be made to preclude the decision on every tender offer from turning on the votes of arbitragers?

In the end, it was decided that these questions could not be resolved responsibly in time, and that court tests to come may yet alter the picture. Study will continue up to the reconvening of the Legislature.

Delaware's decision will undoubtedly influence other states that were poised to adopt Indiana-type legislation. It is likely that the potential for backfire that the Delaware lawyers saw will also cause corporations to shy away from pressing for the adoption of such legislation in the states where they are incorporated or from considering moving to Indiana or other states that have a control-share law.

Not the Last Round

In the near future a track record should develop that will permit responsible predictions of how courts will view takeovers when an Indiana-type law is in place. Further instruction will come out of the decision on Ohio's more aggressive tender-offer statute, which had been held unconstitutional but was remanded by the Supreme Court for further consideration in light of its Indiana decision.

Delaware's flirtation with tender-offer legislation is certainly not the last round in efforts to rationalize the takeover phenomenon, now in its third decade. State corporation law developed in this country on a relatively laissez-faire model. The corporation law that is developing in Congress, and more notably over time by SEC rulemaking, fits an activist, regulatory model. Whether shareholders will be better served if Congress takes the opportunity signaled by the Supreme Court and leaves the tender-offer ball in the states' court remains to be seen.

Mr. Black is a member of the Council of the Corporation Law Section of the Delaware Bar. He is also chairman of the American Bar Association's Federal Regulation of Securities Committee.