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W. Arthur Cullman

HAPPY TOGETHER?
The MPT Story

MPT stands for mergers, people and takeovers. What is happening to executives in the flexibility of governance in American businesses as what has been described as "merger mania" rolls on into the middle of 1986. The size, shape, and success of mergers has been the subject of many different articles, talks, and, distressingly, failures and suicides. I cannot cover the whole firmament and I cannot be objective because so many people, who are well known to me, have been caught up in this activity. I will, however, start off by quoting one of my colleagues, a very respected professor of business policy at the University of Chicago. Paul M. Hirsch perceives that there is an uncomfortably close parallel between the restructuring by many top executives to defend their corporations' raiders and the Viet Nam officers crazed explanation "we had to destroy the village to save it". Hirsch thinks that the "brutal" restructuring by managements who fear worst fate at the hands of the take over artists is practically blackmail.

Although there is very little data available about what senior executives do after a merger, my personal observations are similar to those reported by an executive search firm. Officers at target firms in the 150 largest take overs from 1982 to 1984 were interviewed and, within a year, almost half had sought other jobs. That percentage is over double the 20% who had looked elsewhere in a similar study made in 1981. These findings certainly show that not all executives find happiness with their marriage to another firm.

April 1986 is a very intriguing time to discuss the long term effect of the very strong merger movement which has been observed for more than three years. There are very intelligent people with widely varied viewpoints. There are no conclusive arguments about the value to society of the growing number of mergers. I will, however, indicate my opinion in my conclusion.

Let us look for a moment at seemingly opposite attitudes about the value of takeovers to the economy as a whole. Andrew C. Sigler, CEO of Champion International Corporation and Chairman of the Business Roundtable on Corporate Responsibility, wants government to stem the raider tide. He recently told the Securities and Exchange Commission that the wave of takeovers is threatening the nation's economy. The call for help from government from a leading institution - the Business Roundtable - representing many of the largest corporations in the country is an indication of a major strain that has developed. No longer do shareholders, boards of directors, and management have common purposes. For many years something called the "business judgement rule" or "prudent man concept" has governed the deliberations of boards of directors of public companies in initiating or responding to takeover proposals. A judicial rule seems to have developed over the years. Cases have produced adequate precedents so that the courts do not second guess directors exercising their business judgement. It is the rule of law that the directors' business judgement cannot

be over ruled unless there is significant evidence of gross negligence, bad faith or conflict of interest. In other words, in takeover battles, courts afford boards of directors a clear presumption that their actions, even if extreme, will be considered as being in the best interest of the shareholders. Along with Andrew Sigler, presumably speaking for major business management, is Peter E. Drucker - a well known writer, professor, and consultant. He argues that "fiduciaries", pension funds, endowments, trust departments, and insurance companies which actually vote shares in large public companies and make decisions on tender offers are very much to blame. He states that the "fidiciaries" will accept takeover bids at virtually any market premium regardless of their view of the long term value of the company. In other words, they are not interested in the long term value of the company but to the long term values that they can create as managers of the funds for others. Drucker has expressed the interesting view that "a good many experienced business leaders now hold takeover fear to be the main cause of the decline in America's competitive strength in the world economy."

An almost diametrically opposite view is taken by others including Harold Geneen, the retired Chairman of ITT, and Professor Warren A. Law of the Harvard Business School. Geneen indicates that boards of directors of large public corporations do not generally consider investors' interest as paramount and usually vote to support management whenever there is a conflict. Whether this observation is accurate or even applicable to a cross section

of publicly held companies is obviously debatable. The point is that responsible people are raising serious questions about the actions of outside directors in takeover contests. Professor Law contributes an interesting idea to this debate. He points out that the problem of maximizing shareholder values in the context of takeover bids is complicated. Most public companies faced with a bid are likely to have at least three different groups of shareholders. The first group contain the long term shareholders, probably including many past and present employees; a second group is dominated by institutional holders or fiduciaries as Peter Drucker calls them. A third includes the ARBS, the new term for the arbitragers, who are financially short-term stakeholders, so called "Wall Street Wizards" who strictly want to make money on deals and do not want power in the corporate world. The typical speculator belongs among this group.

The question Law raises is, even with the best of good faith and intentions, how should directors act in the best interests of these different sets of shareholders? While all the information is not in yet, an analysis prepared by Forbes Magazine indicates 39 hostile takeover bids have been successfully defended over the past ten years. In these cases shareholders have been better off keeping their shares rather than selling them in 44% of the cases on a time value adjusted basis.

When conversation equates the merger movement with a "happy marriage", there are some areas that frequently come under discussion. I have identified them as 1) personal greed

2) word of mouth values and 3) director responsibilities. There are many examples in all these areas but highlighting a couple may provide some insights. The major facts about the Revlon case are not very simple. The major findings, however, are simply that Michele C. Bergerac received a "golden parachute" of severance and options worth approximately $36,000,000. This was a sweet pill for Bergerac who in 1974 was paid $1,500,000 as a bonus to just join Revlon. The maneuvering for Revlon by a group of people working for Pantry Pride indicates the difficulties of cutting through the tangle of claims and counter claims to appraise the real objectives of the opposing sides.

Revlon began in a back room on the west side of New York in the harsh depression year of 1932 with a $600 stake. It was a brainchild of the two Revson brothers, Charles and Joseph, and a chemist, named Charles Lackman - best remembered for the L in Revlon. When the takeover took place, Revlon was selling more than a billion dollars worth of cosmetics in 130 countries along with a similar amount of health care products. Another very vital factor is that the cast of characters includes some of the most respected names in the world of securities and law. The firm of Morgan Stanley was an advisor to Mr. Perelman of Pantry Pride. The firm of Lazard Freres, whose senior partner is Felix Rohatyn, known for his saving of New York City from a fiscal crisis, was helping to defend Revlon. A law firm whose partner is famed for representing a hostile takeover client worked for Pantry Pride and Perelman on one side. An international law firm and

head quartered in New York named Paul Weiss Rifkind, Wharton and Garrison was on the other side. The Rifkind in that name, a former judge, was a member of the Board of Directors of Revlon. The opening sparring happened when Mr. Perelman in mid-June 1984 called Mr. Bergerac and indicated if Bergerac supported him, he would greatly improve his life style. Mr. Bergerac's response was very chilly. Perhaps, Mr. Perelman at that point did not know how difficult it might be to improve Michele Bergerac's life style. He had a lavishly outfitted Boeing 727 with kitchen, bedroom, living room, backgammon board and for big game hunting a gun rack. He had a chauffeur-driven limousine, his private dining room, butler and two secretaries and was not in need to have his life style greatly improved.

Thereafter, subsequent to the meeting between Bergerac and Perelman, the Revlon Board created "a poison pill" which required buyers to buy additional securities that did not previously exist or priced them so high to create additional costs. Revlon bought back ten million shares of its own stock for 575 million dollars, thereby adding substantially to its debt.

The Pantry Pride group arranged to borrow money, raised its bid to 53 after it concluded that Revlon was close to a deal with someone else. This turned out to be a fact.

Revlon's idea came with the help of Felix Rohatyn. During the six days allowed Rohatyn found a small investment house which would buy the cosmetic side of the business $900,000,000 and a leading buyout organization Frostmann, Little and Company who

agreed to buy the rest for about $1,400,000,000 (or 1 billion 4 hundred million). All the money would be put up before the deadline. When he learned about this arrangement, Perelman indicated that he would raise whatever Frostmann Little offered by 25 cents a share. The bidding got very lively and raised the bids to $58 a share with certain specialized terms and conditions. If you feel it was entirely a deadly serious problem let me just mention that in Revlon's office people were wearing T-shirts reading "It ain't over till the fat lady sings". Soon, thereafter, the same T-shirts were being used by the lawyers on Perelman's side.

This case went to court and was decided by Justice Walsh who was named less than a month before at age 55 to become a Delaware Supreme Court Justice. In the Chancery Court it was ruled that Revlon's directors had breached their fidiciary duty by giving Frostmann Little the right to buy two key operations. In effect, the judge seemed to be attempting to indicate that it is illegal for directors to construct too many roadblocks and to chill bidding rather than making bidding possible. Justice Walsh stopped the sale by injunction, and Perelman's friends broke out the champagne.

This case may be a good example of the greed. Since in addition to Mr. Bergerac securing his astounding 36 million dollar "golden parachute", the advisory fees to lawyers and investment bankers are expected to exceed $100,000,000. Again the apparent greed of people who are "not hungry" is astounding. Although the Revlon example may not be typical, it demonstrates some of the lengths to which people go in order to secure their desires.

One other almost unbelievable instance is extraordinary because it pays the Chairman of the merged company $3,700,000 if he leaves the company within $10\frac{1}{2}$ months. Peabody (originally a coal mining company) was acquired by the Pullman Company for $116,000,000 in stock, and the proxy statement to shareholders indicated that the payment remaining on the CEO's employment contract was $3.7 million. The employment contract which runs through September 1990 includes cost of living adjustments and assumes that the CEO had quit effective October 1985. The CEO of Peabody, Mr. John E. McConnaughy, Jr., presumably prodded by stockholders, issued a statement saying that the proxy statement speaks for itself, and Mr. McConnaughy has $10\frac{1}{2}$ months to make his determination.

It was relatively early in history of the United States that the phrase "that the man's word is his bond" was developed. It has, however, been used from that time on, and, in many industries and kinds of activities, this concept is part of the American way. A very large lawsuit is presently under scrutiny because it provides a payment of over $11,000,000 to Pennzoil by the Texaco Company. Many people are aware of the essence of this case, but it is vital to note that Pennzoil's suit was inspired by a handshake when Pennzoil's Liedke and Getty Oil's scion, Gordon Getty, shook hands on a merger. Pennzoil agreed to pay $5.4 billion to buy 43% of Getty. The two companies announced their merger to the press, signed a memorandum of agreement, and even had a champagne toast. However, before the paper work on this merger was completed Texaco Chairman John McKinley approached

Getty with an offer worth $10.2 billion for the entire company. On January 6th Getty's Board of Directors accepted this offer. Although Getty, not Texaco, was the real "Indian giver", it was not sued because Texaco in the merger contract agreed to assume liability for any legal actions rising from the purchase. Pennzoil's lawyers argued that Texaco must have been aware that they were doing something wrong to offer that inducement to Getty. Pennzoil's attorney is quoted as saying Texaco purchased this lawsuit when they wrote an insurance policy for the Getty people. When the review of the jury's decision was announced in early December 1985 the judges indicated that the jury's decision will stand -Texaco is ordered to pay Pennzoil $10.5 billion in damages for snatching Getty Oil away from Pennzoil. The interest payments on this amount will be approximately $3 million per day.

Although the end of the talks between John Welch of GE and Thorton Bradshaw of RCA were successful - an announced merger - it was a matter of the words of these two people. The person who brought them together was Felix Rohatyn, the partner of Lasard Freres mentioned earlier as the Revlon defender and the savior of New York City from financial disaster. Both Welch and Bradshaw were invited for a drink in Rohatyn's New York apartment and they talked about a variety of things. The meeting of minds and the chemistry of the people seemed right, and, after a couple of weeks the two companies agreed that RCA would be sold to GE for a total of $6.28 billion.

It may be interesting to note that RCA was originally a partial brainchild of Franklin D. Roosevelt. In 1919, when FDR was Assistant Secretary of the Navy, GE was encouraged to help create the Radio Corporation of America to make sure that the US was not left behind in the field of wireless communications. GE worked closely with RCA and owned the majority of RCA stock during the early days of the development of radios. The two firms were forced to separate by government trust busters in 1932 and since then the firms have, at various points in time, become relatively fierce rivals. This reunion of GE and RCA finds GE having "rocked with the punches" and RCA having missed many of the boats.

In a more personal situation I want to mention that, over the past five decades, I have tracked a story which uses the idea of word of mouth and has ended up with a rather disillusioned individual. A young Harvard graduate who was interested in both medicine and marriage chose to marry. His wife's family had a business which he felt forced to join rather than undergoing cost and time of medical school. He did well in the business and continued his interest in medicine. As the company grew, he found that a cardinal management responsibility could not be met. He could find no successor who had the wherewithall and the skill to manage the business. He sought an acquirer and evaluated many major companies whose interests were aroused as soon as it was known that this company was available. He finally chose a company which he felt had great integrity and the kinds of people he would enjoy working with for the next several years. He sold the company at a "good price" and had a non-competition

and consulting contract for five years. The company never called him to do anything as a consultant. His calls to ask whether there were things of interest that he should be working on were, basically, not returned; so he became disenchanted with the organization and became a relatively unhappy person. He was unable to work in the industry he knew and where people knew and loved him because of the non-compete clause. He could make no contribution and had no relationships in the organization which had acquired his Company. To this observer this is but one of many, many disillusioned CEOs who were indicated earlier in this presentation. It is very rare for CEOs to have as much interest and success after merger as prior to their acquisition.

Decisions made by boards of directors, the governance body of most major organizations, are central to merger and the acquisition activities. Although it is estimated that over ten mergers occur every working day at the present time - early 1986 - directors are examining takeover threats rather calmly according to a survey by Zehnder, International, a consulting organization based in Zurich, Switzerland. About half stated that their CEOs are extremely well prepared and another 40% consider themselves reasonably well prepared to handle corporate sharks or hostile takeovers. In addition, twenty percent (20%) say the likelihood of a takeover is a reasonable possibility. 54% think that takeovers are neither good nor bad, they are just expressions of market forces. This survey was completed prior to the end of September.

By the end of 1985 final decision by the Delaware Supreme Court held the Board of Directors of TransUnion Corporation personally liable for their decision to sell the Company after a mere 20 minutes discussion. The Delaware Supreme Court in the VanGorKen or TransUnion case really exploded a bomb! According to an article by Attorney Bayless Manning (of Paul Weiss etal) the essence of it is as follows:

> "Stated minimally the Court there pierced the business judgement rule and imposed individual liability on dependent (even eminent) outside directors of TransUnion Corporation because, roughly, the Court thought they had not been careful enough and had not inquired enough before deciding to accept and recommend to TransUnion shareholders a cash out merger at a price per share that was less than the intrinsic value of these shares."

This rather long, unusal legal statement is an attempt to summarize the findings in the TransUnion case or VanGorken case as it has been called. There are some extremely important, at least to me, implied consequences of this particular case. Are judges supposed to become so knowledgeable in business they can "in a relatively brief period of time"decide whether prudent business judgement was used and therefore whether the directors are guilty? What is the proper length of time and amount of paper that should be read and studied by a director prior to coming to a meeting to vote on a manner of importance such as selling the organization or setting the price? In a broader context, the impact of the VanGorken case and several that are substantially similar pose the following additional questions:

What things are directors required to do on their own initiative? What things may directors delegate while retaining the ultimate responsibility and how should delegation be monitored? What issues should directors specifically decide and how do they inform themselves and to what degree and by what procedure? What is a "legal standard" of prudence that governs a board member's performance? How apparently "aberrational" may a directorial decision be and still be secure against second guessing on the merits by some court? Commenting on the same decision, Manning says "The court did not quite flaunt the basic principle of business judgement doctrine, although it did come close. It did not quite substitute its own business judgement for that of the directors. The court ultimately says not that the directors made a wrong judgement on price but the directors were so unprepared and acted so quickly they could not and did not really make a sound judgement." To my mind the question of how much preparation or time is needed is really part of business judgement, and, therefore, I do not agree with the above quotation. I am very much aware of the fact that premium rates for directors and officers' insurance have soared within the past many months. Directors and officers' insurance has become almost unavailable as insurers have dropped out of the field and policies have not been renewed. A sample of this is a tenfold increase in the premium paid for directors and officers' liability by a major retailing organization - not the Limited - whose CEO I chatted with in the winter of 1986.

As of March 1986 it is unclear whether or not the VanGorken decision will make it extremely risky for outside directors to accept invitations to serve a corporation. The pendulum, however, as usual, is swinging back. Household International is a company that includes Household Finance. National Car Rental, Vons Grocery, and other organizations. Household's Board of Directors was uneasy with the thought that it might be vulnerable to a hostile takeover effort. The Board evaluated different "poison pill" measures and finally decided on some. One of the Household International Directors sued the Company on the basis that the "poison pills" were too strong and might hurt the stockholders. Although the directors were exonerated in this particular case and the adoption of the "poison pill" plan was approved by the Delaware Supreme Court, the court held that it might be illegal if implemented in the context of a specific takeover effort as a breach of corporate directors' fidiciary duties." In effect, what the courts seem to be doing is putting off the decision. This particular decision concludes with this admonition: "The ultimate response to an actual takeover bid must be judged by the directors' actions at that time and nothing we say here relieves them of their basic fundamental duties to the corporation and the stockholders."

It is difficult to summarize the activities and implications thereof when change is so rapid and rampant. However, to this observer it seems that the following quotation summarizes my feelings as of March 1986. Allen Sloan, writing in Forbes Magagine in

March 1985 stated "to the extent that the leadership of American business is difficient in zeal and ability, the takeover artist is a questionable replacement. The leading predators like to portray themselves as champions of the shareholders and enemies of slothful management, but this pose is so self-serving as to be ridiculous. If many stocks still sell at low multiples compared with previous years, the reason is much more likely a consequence of high interest rates than of lousy management. With long term interest rates running double the level they were twenty years ago why should any rational investor pay as much for a dollar of corporate earnings as he was willing to pay when the rates were 5 to 6%?"

Of course, there have been changes in the Dow Jones Industrial Average since this was written to be published under date of March 11, 1985. On February 27, 1986, the Dow Jones closed for the first time ever above 1,700. (And as of early April 1986 has closed above 1800.) This, to a certain extent, shows that the investor is willing to pay more for a dollar of corporate earnings than he was willing to pay when the prime rate was 5 to 6%. However, the short term differences in the market should not be looked on as a trend that will continue over a period of several years or a decade.

One effect of the "merger mania" of the past couple of years is to reduce the number of chief executive officers reducing, statistically, the chance of getting a very good one when one is needed. By the same token, it is reducing the number of people employed in ...dle and upper managements as "restructuring" makes organizations leaner and larger.

An important consequence of the merger activities is the reduction of the number of units which must be taken over by a leader dedicated to control our system of government and enterprise. On balance this potential of losing flexibility frightens many observers, including this one, since we have yet to find a system that is nearly as good as private capitalism despite all its flaws in supporting the values that we hold dear.

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