

Hughes Hubbard & Reed LLP

A Legal Road Map For Investing in Publicly-Traded Corporations

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In today's economic climate -- with takeover activity on the upswing and continued market uncertainty creating opportunities for potential investors -- stock accumulation programs merit renewed attention. A potential buyer (the "Purchaser") considering this strategy should explore two different, but related, questions: (1) What are the tactical advantages and disadvantages of a stock accumulation program? (2) What are the key legal considerations?

This publication addresses both questions. As set forth in Part I below, our analysis assumes that the Purchaser is acquiring an interest in a publicly-traded U.S. corporation (a "Public Company") through open market and/or negotiated purchases of stock. Other means of acquiring an interest in a Public Company (e.g., tender offer, purchase of stock directly from the Public Company) raise many of the issues discussed below but can involve additional legal requirements. In addition, although we identify defensive measures which can impede stock accumulations, we do not address in-depth the strategies that might be implemented by a Public Company in response to a perceived takeover threat.

Parts II - XIII of this publication provide an overview of the principal legal and tactical considerations affecting investments in Public Companies, including some special considerations applicable to a Purchaser which is either organized outside the United States or controlled by a non-U.S. entity. These considerations would require further review in light of the facts of a particular transaction, which might also give rise to other issues not addressed in this publication.

This publication is for informational purposes only and is not intended as legal advice. For more information about the matters discussed in this publication or our M&A practice, please contact one of the Co-Chairs of our M&A Group:

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I. TECHNIQUES FOR INVESTING IN A PUBLIC COMPANY

Open market and/or negotiated purchases are frequently desirable in the acquisition context for several reasons:

(1) If the Purchaser intends to acquire a Public Company, purchasing shares in the open market prior to disclosure of the Purchaser's identity and intention may help minimize the cost of the acquisition by eliminating the need to pay a premium for those shares. (For the reasons discussed on pp. 15 - 16, negotiated block purchases are probably not likely to have this result.) Because purchases are made through brokers, large purchases are possible without attribution to the Purchaser. However, depending on the nature of the trading market for the stock and the size and speed of the Purchaser's purchases, these transactions may themselves drive up the price of the shares (which may still be below the price the Purchaser is willing to pay in a subsequent tender offer or merger) and fuel speculation that the Public Company is "in play", even though the identity of the potential bidder has not been disclosed. Block purchases create a greater risk of leaks and identification of the Purchaser as a buyer.

(2) If the Purchaser intends to acquire the Public Company and prefers to negotiate a friendly transaction, the fact that it owns a material stock interest can help put pressure on the Public Company's Board of Directors to agree to the transaction and deter potential competitors. On the other hand, if the Purchaser's stock interest is perceived as hostile (which it generally is), then, notwithstanding the Purchaser's stated desire to do a friendly deal, the Public Company may be more inclined to take defensive action designed to repel the Purchaser's efforts.

(3) If the Purchaser intends to wage a proxy fight seeking control of the Public Company's Board and/or a major change in corporate policy (such as a restructuring program), the Purchaser's stock interest would render the success of the initiative more likely than would otherwise be the case. State takeover statutes and defensive measures such as "poison pills" may, however, effectively cap the Purchaser's ownership interest at a relatively low percentage (e.g., 10%), although they would not preclude the Purchaser from soliciting proxies from other stockholders. See pp. 17 - 21.

(4) Whether or not the Purchaser intends to acquire the Public Company, the Purchaser's stock interest may be a contributing factor in causing the Public Company's Board to initiate a transaction that would result in the Purchaser selling its shares at a profit. Such a transaction could take the form of (i) the sale of the Public Company to a friendly third party (a "white knight"), (ii) the entry by the Public Company into a restructuring transaction, such as a stock repurchase or recapitalization, that would have the effect of cashing out some or

all of the Purchaser's shares at a desirable price or (iii) the negotiated purchase by the Public Company of the Purchaser's shares.¹

In considering the foregoing factors, it is important to recognize that, whatever the Purchaser's goals, their realization will be heavily dependent on the Public Company's -- and the financial markets' -- perception of the Purchaser as a credible threat to the Public Company's existing management. Once the Purchaser has begun to acquire shares, credibility essentially requires that the Purchaser be willing to pursue the transaction on a hostile basis in order to protect its position, even if the Purchaser would prefer to negotiate a friendly acquisition. The worst result from the Purchaser's point of view would be for the Public Company to reject the Purchaser's overtures without proposing some sort of alternative transaction; in that case, the Purchaser would not be in a position to influence the Public Company's management in an effort to maximize share value and the absence of takeover speculation could trigger a decrease in price (which might be exacerbated if the Purchaser sought to liquidate its position).

For purposes of this publication, we have assumed that (i) the Public Company would neither initiate nor participate in the transaction under consideration, (ii) the Purchaser would determine not to disclose its investment until required by applicable law and, accordingly, would seek to accumulate shares in advance of such disclosure and (iii) the Purchaser would not at the outset initiate a transaction, such as a tender offer, which, if successfully consummated, would result in the Purchaser owning a majority interest in the Public Company. Accordingly, our analysis focuses on the following techniques for investing in the Public Company:

- (1) open market purchases -- that is, purchases made at the market price and effected on a securities exchange or in the over-the-counter market; and
- (2) negotiated block purchases -- that is, purchases made on terms which are privately negotiated between the buyer and seller. (Under certain conditions, these purchases may be effected on an exchange.)

The following chart identifies the principal filing and disclosure requirements and other legal consequences associated with open market and negotiated purchases of Public Company stock. These requirements and other major legal considerations are discussed in greater detail in Parts II - XIII.²

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1. Stock repurchase transactions by a Public Company raise corporate, tax and other issues that are outside the scope of this publication.
 2. In the event that the Purchaser is a subsidiary of another entity, certain of the legal considerations discussed below would apply to its parent company.

THRESHOLD REQUIREMENTS	
Ownership Level³	Consequences of Ownership
\$53.1 million worth of stock and/or assets⁴	Before purchasing additional shares, must file under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”) and satisfy waiting period requirement -- generally, 30 days (15 days for an all-cash tender offer) although early termination of the waiting period is possible. Although filing is a nonpublic document, a notice must be given to the Public Company. Additional HSR Act filings and waiting periods required if, as a result of additional acquisitions, aggregate holdings would equal or exceed \$106.2 million or \$530.7 million. See pp. 8 - 12.
5%	<p>After exceeding 5%, must file with the Securities and Exchange Commission (“SEC”) a disclosure statement (i) on form Schedule 13D within 10 days after exceeding 5% or (ii) provided the Purchaser is not seeking to acquire or influence control of the Public Company, on form Schedule 13G (x) in the case of certain institutional investors, within 45 days after the end of the calendar year in which the threshold is crossed (or within 10 days after the first month in which the investor’s beneficial ownership exceeds 10%) and (y) in the case of certain passive investors, within 10 days after exceeding 5%. See pp. 5 - 7.</p> <p>Certain state takeover statutes may purport to (i) regulate open market and negotiated purchases exceeding 5% or (ii) otherwise restrict the Purchaser’s ability to subsequently acquire 100% control of the Public Company. See pp. 17 - 19.</p> <p>For foreign Purchasers, statutes applicable to foreign investment in the U.S. should be evaluated to consider whether they are relevant to a particular acquisition. See pp. 23 - 25</p>
10%	<p>Within 10 days after exceeding 10%, must file with the SEC a Form 3 disclosing share ownership. Subsequent purchases and sales of the stock by the 10% owner would be subject to the short-swing profit provisions of Section 16(b) of the Securities Exchange Act of 1934. See pp. 12 - 13.</p> <p>Certain state takeover statutes may purport to (i) regulate open market and negotiated purchases exceeding 10% or (ii) otherwise restrict the Purchaser’s ability to subsequently acquire 100% control of the Public Company. See pp. 17 - 19.</p> <p>If the Public Company has adopted a “poison pill” with a 10% trigger, buying shares above this level would have severe consequences for the Purchaser. Shark-repellent charter and by-law provisions may also have consequences above the 10% level. See pp. 19 - 21.</p> <p>Certain U.S. statutes may require prior approval by a regulatory agency for additional purchases of stock of the Public Company in a regulated industry. (Applicable percentages vary.) If the Public Company has overseas operations, foreign statutes may also be applicable. See pp. 19 and 26.</p> <p>For foreign Purchasers, statutes applicable to foreign investment in the U.S. should be evaluated to consider whether they are relevant to a particular acquisition. See pp. 23 - 25.</p>

3. Percentages are of outstanding shares.

4. Assuming a “passive investment” or “non-control partnership” exemption is not available. See pp. 10 - 12. Determining whether purchases of stock have reached the minimum transaction threshold requires a special two-part calculation. See pp. 9 - 10.

The HSR jurisdictional thresholds set forth in this table reflect adjustments for changes in GNP which took effect on March 2, 2005. These thresholds are subject to further adjustment on an annual basis for changes in GNP. See p. 8.

Ownership Level	Consequences of Ownership
15%	<p>Certain state takeover statutes may purport to (i) regulate open market and negotiated purchases exceeding 15% or (ii) otherwise restrict the Purchaser's ability to subsequently acquire 100% control of the Public Company. See pp. 17 - 19.</p> <p>If the Public Company has adopted a "poison pill" with a 15% trigger, buying shares above this level would have severe consequences for the Purchaser. Shark-repellent charter and by-law provisions may also have consequences above the 15% level. See pp. 19 - 21.</p> <p>Certain U.S. statutes may require prior approval by a regulatory agency for additional purchases of stock of the Public Company in a regulated industry. (Applicable percentages vary.) If the Public Company has overseas operations, foreign statutes may also be applicable. See pp. 19 and 26.</p> <p>For foreign Purchasers, statutes applicable to foreign investment in the U.S. should be evaluated to consider whether they are relevant to a particular acquisition. See pp. 23 - 25.</p>
20% or more	<p>Certain state takeover statutes may purport to (i) regulate open market and negotiated purchases exceeding 20% (or voting rights in respect thereof) or (ii) otherwise restrict the Purchaser's ability to subsequently acquire 100% control of the Public Company. See pp. 17 - 19.</p> <p>If the Public Company has adopted a "poison pill" with a 20% (or greater) trigger, buying shares above this level would have severe consequences for the Purchaser. Shark-repellent charter and by-law provisions may also have consequences above the 20% level. See pp. 19 - 21.</p> <p>Certain U.S. statutes may require prior approval by a regulatory agency for additional purchases of stock of the Public Company in a regulated industry. (Applicable percentages vary.) If the Public Company has overseas operations, foreign statutes may also be applicable. See pp. 19 and 26.</p> <p>For foreign Purchasers, statutes applicable to foreign investments in the U.S. should be evaluated to consider whether they are relevant to a particular acquisition. Among other things, certain statutes may limit the total permissible foreign ownership in the Public Company. (Applicable percentages vary.) See pp. 23 - 25.</p> <p>Additional HSR Act filings and waiting periods required (i) at the 25% level if holdings would equal \$1.0613 billion or more and (ii) at the 50% level if holdings would equal \$53.1 million or more. See pp. 8 - 12.</p> <p>"Passive investors" who have filed a Schedule 13G will lose their Schedule 13G eligibility and must file a Schedule 13D upon reaching 20%. See pp. 5 - 7.</p> <p>Equity accounting applies to a minority investment where a "significant influence" is acquired -- such influence is presumed at the 20-50% level. Under the equity method of accounting, (i) an investment is initially recorded at cost and adjusted thereafter for changes in the Purchaser's share of net assets of the Public Company and (ii) the Purchaser's income statement reflects its share of the results of operations of the Public Company.⁵</p>

5. Although accounting considerations are beyond the scope of this publication, they often play an important role in structuring investments and takeovers.

II. SCHEDULE 13D

Section 13(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) and the rules promulgated thereunder provide, in general, that any person⁶ (or group of persons) who becomes, directly or indirectly, the “beneficial owner” (as defined below) of more than 5% of any class of equity security of a Public Company must, within 10 days thereafter, file a statement known as a “Schedule 13D” with the Securities and Exchange Commission (the “SEC”) and send a copy to the Public Company and to any exchange on which the securities are traded. Any material change in the information reported in the Schedule 13D requires the prompt filing of an amendment; in the event of additional purchases of Public Company stock, the acquisition of 1% or more of the outstanding shares would be material and a lesser increase could be material, depending on the facts and circumstances. Since there is no need to file until 10 days after the 5% threshold is first crossed, additional shares of the Public Company may be purchased during the 10-day window before the Schedule 13D is filed.

In certain circumstances, a 5% holder may file a Schedule 13G which requires far less disclosure than a Schedule 13D. Schedule 13G, however, generally is available only (i) to certain institutional investors (“Qualified Institutional Investors”) (e.g., broker-dealers, registered investment companies, registered investment advisers, banks, insurance companies and certain employee benefit plans) that have acquired shares in the ordinary course of business and without any purpose or effect of changing or influencing the control of the Public Company and (ii) investors (“Passive Investors”) that own more than 5% but less than 20% of any class of equity security of the Public Company and that have acquired such securities in the ordinary course of business and without any purpose or effect of changing or influencing the control of the Public Company.

If a Qualified Institutional Investor is entitled to file a Schedule 13G, the initial filing must be made within 45 days after the end of the calendar year in which the 5% threshold is crossed (or within 10 days after the first month in which the investor’s beneficial ownership exceeds 10%). However, a Passive Investor that is entitled to file a Schedule 13G must file within 10 days after the 5% threshold is first crossed.

A Passive Investor will lose its Schedule 13G eligibility, and has 10 days to file a Schedule 13D, if it acquires 20% or more of the affected class of securities. The Passive Investor will then be subject to a “cooling-off” period that begins when the 20% threshold is reached and continues through the 10th calendar date after the filing of the Schedule 13D. Similarly, a Passive Investor (and a Qualified Institutional Investor) will lose its Schedule 13G eligibility, and has 10 days to file a Schedule 13D, if it determines that it holds the securities with a disqualifying purpose or effect. It will then be subject to a “cooling-off” period starting on the date of the change in investment purpose and continuing through the 10th calendar day after the filing of the Schedule 13D. During the “cooling-off” period the investor will be prohibited from voting or directing the voting of the securities or acquiring additional beneficial ownership of

6. As used in this publication, the term “person” refers to corporations and other entities as well as natural persons.

any of the Public Company's equity securities. A Passive Investor (or Qualified Institutional Investor) that has lost its eligibility to file on Schedule 13G may reestablish its eligibility and once again file a Schedule 13G by certifying its qualifying purpose or reporting that its beneficial ownership has fallen below 20%, as the case may be.

Disclosure Requirements

A Schedule 13D contains information about the Purchaser, any persons that control the Purchaser and their respective managements.

(1) If the Purchaser is a partnership, the information called for by the Schedule must be furnished with respect to (i) each partner (in the case of a general partnership) or each partner who is denominated as a general partner or who functions as a general partner (in the case of a limited partnership) and (ii) each person controlling such partner.

(2) If the Purchaser is a corporation (or if any of the persons referred to in the lead-in sentence above is a corporation), the information called for by the Schedule must be furnished with respect to (i) each director and executive officer of such corporation, (ii) each person controlling such corporation and (iii) each executive officer and director of any corporation or other person ultimately in control of such corporation.

The Schedule 13D must disclose, among other things, (i) certain background information about the persons identified above, (ii) the purpose of the transaction and any plans or proposals which such persons may have relating, among other things, to the acquisition or disposition of securities of the Public Company, an extraordinary corporate transaction (such as a merger) involving the Public Company, any change in the present Board of Directors or management of the Public Company or any other material change in the Public Company's business or corporate structure, (iii) the source and amount of funds or other consideration used or to be used in making the purchases, (iv) the number and percentage of shares beneficially owned by each person identified above (including a description of all transactions by each such person in securities of the Public Company in the past 60 days) and (v) any agreements or relationships among any such persons or between any such person and any other person with respect to any securities of the Public Company.

The "purpose and plans" disclosure in a Schedule 13D is typically the most sensitive aspect of the filing and, in a hostile context, is frequently litigated. In particular, if the Purchaser (or any of the other persons referred to above) intends to seek control, or otherwise influence the management, of the Public Company, that fact must be disclosed. In cases where the Purchaser does not presently have a control intention but is undecided as to a future course of action, the purpose disclosure is typically drafted to afford the Purchaser maximum flexibility with its investment, including seeking to acquire control should its intention change.

Like Schedule 13D, Schedule 13G includes disclosure of the type and amount of the investor's beneficial ownership; however, the "purpose and plans" disclosure and other textual disclosures are not applicable to the Schedule 13G.

Beneficial Ownership

Rule 13d-3 under the Exchange Act sets forth guidelines for determining whether a person is a beneficial owner of a security for purposes of Section 13(d). For example:

(1) A person is the beneficial owner of a security when, through any contract, arrangement, understanding, relationship or otherwise, such person directly or indirectly has or shares (i) voting power, which includes the power to vote, or to direct the voting of, the security, and/or (ii) investment power, which includes the power to dispose, or to direct the disposition, of the security.

(2) A person is deemed to be the beneficial owner of a security if such person has the right to acquire the security within 60 days by any means (including through the exercise of an option, warrant or right, or the conversion of a security). Notwithstanding the 60 day requirement, if a person acquires a right to acquire a security with the purpose or effect of changing or influencing control of the Public Company (or in connection with or as a participant in any transaction having such purpose or effect), such person is deemed to be the beneficial owner of the underlying security immediately upon the acquisition of such right.

Under Rule 13d-3, shares which are subject to options, warrants, rights or conversion privileges held by a person as described in paragraph (2) above are deemed to be outstanding for the purpose of computing the percentage of the Public Company's shares beneficially owned by such person (but are not deemed outstanding for the purpose of computing the percentage beneficially owned by any other person). That is, a stockholder's percentage interest is determined by dividing (i) the sum of (x) the outstanding shares such person beneficially owns and (y) any additional shares such person has the right to acquire pursuant to paragraph (2) above by (ii) the sum of (x) the Public Company's outstanding shares and (y) any additional shares such person has the right to acquire pursuant to paragraph (2) above.

Section 13(d) Group

Rule 13d-5 under the Exchange Act provides that when 2 or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of stock of a Public Company, the "group" formed thereby is deemed to have acquired all the stock beneficially owned by such persons, and each group member is obligated to file a Schedule 13D. This obligation may be satisfied by a single, joint filing on the part of the group or by a separate Schedule 13D filing by each of the group members. The determination of whether a Section 13(d) group exists is dependent on the facts and circumstances of the particular case, but, as a general matter, (i) a person must beneficially own stock in the Public Company in order to be a member of a group, (ii) the agreement required to create a group need not be a formal written agreement and may, in certain cases, be inferred from the conduct of the parties and (iii) business or personal relationships which fall short of an actual agreement will not create a group. (Note that even if a group does not exist for purposes of Section 13(d), certain relationships must still be disclosed in the Schedule 13D as described on p. 6.)

III. HART-SCOTT-RODINO⁷

Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the “HSR Act” or “HSR”), certain purchases of voting securities or assets may not be consummated unless certain information has been furnished to the Antitrust Division of the Department of Justice and the Federal Trade Commission (the “FTC”), a fee varying from \$45,000 to \$280,000 depending on the size of the transaction has been paid and the required waiting period has expired or been terminated. For purchases of voting securities (other than by an all-cash tender offer), the waiting period is 30 days; however, the antitrust authorities can request additional information and extend this period until 30 days after the additional information is furnished.⁸ Thereafter, the only means of blocking the acquisition on antitrust grounds is through court order.

Absent an applicable exemption, a transaction is subject to the HSR Act if (i) the parties involved in the transaction satisfy certain “size of person” tests (which will be satisfied in the case of a typical Public Company) and (ii) the “size of the transaction”, meaning the ownership level of the Purchaser after such transaction, would exceed \$50 million (as adjusted) (the “Minimum Transaction Threshold”) worth, in the aggregate, of voting securities and/or assets of the Public Company. The “size of person” test applies only to transactions valued at \$200 million (as adjusted) or less, i.e., absent an applicable exemption, if the “size of the transaction” equals or exceeds \$200 million (as adjusted), the size of the parties is irrelevant and filing is mandatory. The “size of transaction” thresholds, as well as the “size of person” thresholds, are adjusted annually for changes in GNP and, accordingly, effective March 2, 2005, the dollar thresholds described above were increased to \$53.1 million and \$212.3 million, respectively (until further adjusted).

The two principal exemptions -- use of a non-control partnership and passive investments not exceeding 10% -- are discussed below. Though the HSR filing is not a public document, at the time of filing a notice must be delivered to the Public Company (which is required to make its own HSR filing in connection with the transaction).⁹ The Public Company will usually disclose its receipt of the notice and, accordingly, the Purchaser would no longer have the benefit of being able to accumulate shares at prices unaffected by speculation as to its intentions.

The HSR filing must be made by, or on behalf of, the “ultimate parent entity” of the acquiring person -- i.e., the uppermost entity in the chain of entities that control the acquiring person (with control measured by ownership of 50% of a corporation’s voting securities or the

7. Substantive antitrust considerations are not addressed in this publication but should be analyzed in connection with any investment in a Public Company.

8. Early termination of the waiting period may be requested.

9. If early termination of the waiting period is requested and granted, the early termination will be publicly reported.

right to name a majority of the directors -- see below for partnerships). The ultimate parent entity also must disclose the identity of all stockholders owning 5% or more of its shares.

The HSR filing must describe the proposed transaction and disclose certain information (e.g., revenues broken down into industry and product categories; prior acquisitions), which would assist the antitrust authorities in determining whether the proposed transaction is anticompetitive. A potentially sensitive aspect of the filing is the requirement that there be furnished to the antitrust authorities all studies, surveys, analyses and reports prepared by or for any officer(s) or director(s) (or, in the case of unincorporated entities, individuals exercising similar functions) for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets, including, in some circumstances, drafts, informal analyses and investment banker reports.

The HSR Act does not apply the same “group” concept as Section 13(d), although spouses and minor children are aggregated. See pp. 7 - 8. Thus, it is possible for a Section 13(d) group to acquire more than the Minimum Transaction Threshold of voting securities without triggering the HSR filing requirement.

Determining whether purchases of stock have reached the Minimum Transaction Threshold requires a two-part calculation. Prior to making each new purchase, the Purchaser must calculate (i) the value of the Public Company stock already held and (ii) the value of the Public Company stock to be acquired, determined as follows:

(1) The value of Public Company stock already held, on any given day, is the lowest closing quotation (or lowest closing bid price, if the shares are traded on an interdealer quotation system but not an exchange), during the prior 45 calendar days, multiplied by the total number of shares already held. This value is recalculated each day and will change over time as lowest prices are lost from or added to the 45-day period. If the value, computed pursuant to the formula, increases to more than the Minimum Transaction Threshold on account of changing stock prices, the increase would not by itself trigger an HSR filing, but no additional shares could be acquired unless a filing were first made (and waiting period observed) or the value again decreased below the Minimum Transaction Threshold.

(2) The value of Public Company stock to be acquired is the greater of (i) the acquisition price actually to be paid net of any commissions or (ii) the lowest closing price within the prior 45 calendar days as described above, in either case multiplied by the number of shares to be acquired.

Additional shares may be purchased without an HSR filing if the value of the Public Company stock already held (as calculated under paragraph (1) above) plus the value of the shares to be purchased (as calculated under paragraph (2) above) would not exceed the Minimum Transaction Threshold. This calculation must be made prior to each purchase -- i.e., if there has been a prior purchase on the same day, the prior purchase must be taken into account.

For purposes of determining whether an HSR filing is required, only actual acquisitions of voting securities count. Purchases of convertible securities or options to acquire voting securities and executory agreements to acquire voting securities (e.g., an agreement to acquire a block of shares -- see pp. 15 - 16) may be used to increase the Purchaser's position without triggering an HSR filing (but a filing would be required prior to acquiring the underlying voting securities if a reporting threshold would be crossed).¹⁰ In contrast, the underlying voting securities may be deemed to be beneficially owned for purposes of the 5% filing requirement under Section 13(d). See p. 7.

Once a filing has been made at the level of the Minimum Transaction Threshold, additional acquisitions of stock or assets of the same Public Company do not require further HSR filings and waiting periods unless, as a result of any such acquisition, (i) the aggregate value of voting securities and/or assets of the Public Company held by the Purchaser would equal or exceed \$100 million (as adjusted) or \$500 million (as adjusted) or (ii) the percentage of voting securities of the Public Company held by the Purchaser would equal or exceed 25% (if valued at more than \$1 billion (as adjusted)) or 50% (if valued at more than the Minimum Transaction Threshold). The dollar thresholds described in clauses (i) and (ii) above are adjusted each year to reflect changes in the GNP in the same manner as the HSR "size of transaction" and "size of person" thresholds (see above) and, accordingly, effective March 2, 2005, they were increased to \$106.2 million, \$530.7 million and \$1.0613 billion, respectively (until further adjusted).

"Non-Control" Partnerships

If a newly-formed non-control partnership has assets -- apart from those used in the acquisition transaction -- of less than \$10 million (as adjusted),¹¹ the partnership would fail to satisfy the "size of person" test and, as a result, could purchase up to \$200 million (adjusted as described on p. 8) of voting securities of a Public Company without making an HSR filing.¹² The size of a newly formed entity that has no regularly prepared balance sheet is determined based on the assets it holds at the time of the acquisition other than cash that will be used as consideration or for expenses incidental to the acquisition. Further, so long as the partnership is not "controlled" by any person, none of the assets and sales of any of the partners will be used in determining whether the size-of-person test has been met.

"Control" is determined by whether any person has directly or indirectly a 50% or greater interest in the profits of the partnership or in its assets upon dissolution. Because "control" is

10. However, if the Purchaser obtains any indicia of ownership (such as the right to vote the securities and/or the right to receive dividends) prior to acquiring the voting securities, it is necessary to consider whether the securities could be attributed to the Purchaser for HSR purposes before the acquisition.

11. As noted above, the "size of person" thresholds are adjusted each year to reflect changes in the GNP and accordingly, effective March 2, 2005, this dollar threshold was increased to \$10.7 million (until further adjusted).

12. The same analysis applies to limited liability companies and other non-corporate entities.

determined solely by the financial interests of the partners, it is possible to structure a partnership so that a single partner has voting or managerial control of the partnership without such partner being deemed to be in “control” for HSR purposes (provided that such partner does not have either of the aforesaid 50% financial interests).

In contrast, formation of a corporation or a controlled partnership must be reported if the “size of transaction” test is met and a special “size of person” test is met. In applying this special “size of person” test, assets to be used in subsequent acquisitions are included. Thus, if two or more parties form a corporation or a controlled partnership to serve as an acquisition vehicle, two HSR filings may be required: one to set up the corporation or controlled partnership and a second one to acquire shares in the Public Company.

The use of a non-control partnership as an acquisition vehicle to avoid an HSR filing may give rise to an FTC challenge. The rules prohibit the use of a device employed to avoid the HSR requirements. Factors that would be important in establishing a bona fide partnership include:

- (1) A (non-HSR) business purpose for the partnership.
- (2) Partners that are separate economic entities, although some cross-ownership is permissible.
- (3) Each partner having funds at risk, with independent sources of financing, and bearing risk of loss and gain.

Factors that should be permissible include:

- (1) That the partners have formed a Section 13(d) group for the purpose of acquiring shares of the Public Company.
- (2) Prior or current business relationships among the partners.

10% Passive Investment

The acquisition of up to 10% of the stock of a Public Company is exempt from HSR filing requirements if made solely as a passive investment. This exemption is strictly construed, with the FTC staff taking the position that an intent that includes the possibility of taking control, gaining a seat on the Board of Directors or even affecting the management of the Public Company is inconsistent with passive investment. The penalty for improperly relying on the exemption (or for any other failure to comply with HSR’s filing and waiting period requirements) is substantial – over \$11,000 per day (adjusted periodically for inflation) as well as the undoing of the transaction. The FTC staff has been active in policing this exemption and it is clear that claimed investment purchases followed shortly by a takeover bid would be scrutinized closely. The exemption should only be relied upon for a truly passive investment (i.e., where

there is no record of any intent to acquire control) and where no change in plans is contemplated for a substantial period.¹³

IV. SECTION 16

If the Purchaser acquires beneficial ownership of more than 10% of any class of equity security of a Public Company, it must file a Form 3 within 10 days thereafter and report subsequent changes in beneficial ownership on either a Form 4 or a Form 5 (depending on the circumstances), in accordance with Section 16(a) of the Exchange Act. With narrow exceptions, (i) filings on Form 4 are due on the 2nd business day after the execution (trade date) of a transaction resulting in a change in beneficial ownership and (ii) filings on Form 5 are due 45 days after the end of the Public Company's fiscal year. These Forms must be filed electronically with the SEC and a copy must be sent to the Public Company. The Public Company must post the filing on its website by the end of the business day after the filing with the SEC, and the filing must remain accessible on the Public Company's website for at least 12 months. Late filings must be disclosed by the Public Company in its proxy statement and Form 10-K and may be subject to monetary penalties imposed by the SEC.

Purchases and sales of Public Company shares by a 10% owner are subject to Section 16(b) of the Exchange Act, which provides for the return to the Public Company of "short-swing" profits. Subject to certain limited exceptions, any sale may be matched with any purchase that occurs within the 6 months before or after such sale and (assuming that the Purchaser is a 10% owner at the time of both transactions) if the sale price exceeds the purchase price, the "profit" is forfeitable to the Public Company. The matching is of individual purchases and sales and it is therefore possible to be required to disgorge profits even though the overall position reflects a loss. The provision is applied literally and the inadvertence of the violation or the Purchaser's good faith is no defense.

Sections 16(a) and (b) also apply, with some differences, to officers and directors of a Public Company. A Purchaser that designates one or more members of the Public Company's Board of Directors to represent its interests may itself be deemed to be a director "by deputization" and thus to be subject to Sections 16(a) and (b) even if its ownership is less than 10%.

The purchase by which a person becomes a 10% owner does not count and cannot be matched against subsequent sales -- i.e., if the Purchaser moved from 9.9% to 15% by purchasing one block there would be no Section 16(b) exposure from that transaction. Similarly, transactions effected after the Purchaser has sold off its holdings to below 10% will not be matched with transactions effected while a 10% owner.

13. Attempts to rely on the "passive investment" exemption must take into account the requirement in Schedule 13D to disclose the purpose of the purchases. See p. 6.

For purposes of determining whether a person is a 10% owner, beneficial ownership is defined generally in the same manner as under Section 13(d) – i.e., whether the person has or shares voting or investment power – but only securities in which the person has a direct or indirect pecuniary interest are reportable and subject to short-swing profit disgorgement.

If a Section 13(d) group in the aggregate owns more than 10% of a Public Company, each member of the group will be deemed a “10% owner” for purposes of the filing requirements of Section 16(a). However, each group member’s Section 16(a) filings and Section 16(b) exposure would be limited to shares in which that group member had a pecuniary interest.

Section 16(b) poses a serious limitation on the Purchaser’s ability to realize profits by selling shares into a competing bidder’s tender offer if the Purchaser has purchased any shares after crossing the 10% level (since all purchases above the 10% level would be matched against tender offer sales within 6 months thereafter, and the resulting profits would be disgorged to the issuer). However, the Purchaser generally would be able to dispose of its shares in a merger between the Public Company and a competing bidder without risking exposure under Section 16(b) if the merger is deemed a “forced sale” and not a voluntary act by the Purchaser. In order for the merger to be treated as a “forced sale,” the Purchaser cannot play an active role in the transaction (such as participating in the negotiations), or have access to inside information regarding the transaction, and should not even vote its shares in favor of the merger. Nevertheless, it should be recognized that this is not a complete solution due, among other things, to timing differences, the possibility that the merger consideration will be less attractive (in form and/or amount) than the cash price paid in the tender offer and the possibility that a merger will not be consummated.

V. RULE 10B-5

Rule 10b-5 under the Exchange Act is perhaps the broadest of the SEC’s “anti-fraud” rules. It prohibits manipulative and deceptive devices “in connection with the purchase or sale of any security.” Prospective Purchasers should be aware that one of the deceptive devices prohibited by Rule 10b-5 is so-called “insider trading.”

Rule 10b-5 prohibits certain persons who possess material nonpublic information about a Public Company from buying or selling the company’s securities (or “tipping” other persons) unless they first publicly disclose the information. The persons subject to this duty to “disclose or abstain” from trading are the Public Company, its insiders and (under certain circumstances) their tippees. The duty to disclose or abstain also may be extended to an underwriter, accountant, lawyer or consultant working for the Public Company who is given access to information solely for corporate purposes (“temporary insiders”). With respect to a tippee, liability will result only if (i) the tipper has breached a duty not to disclose the information and (ii) the tippee knows or should have known of the breach.

Because the Rule 10b-5 duty to disclose or abstain is owed to the stockholders of the Public Company, such stockholders may bring a private action for damages (typically a class action) for any breach of that duty. The SEC may also seek civil penalties (including treble damages in addition to disgorgement of profits) against not only the person who committed the

violation but also, under certain circumstances, against the “controlling person” of an insider found liable for violating Rule 10b-5. Criminal prosecution is also possible.

In general, so long as the Purchaser is not an actual “insider” of the Public Company (see p. 17), it would have no duties to a prospective seller and its purchases of Public Company stock should not be constrained by Rule 10b-5.¹⁴ However, this general statement is subject to the following limitations:

(1) If the Purchaser receives any material nonpublic information from the Public Company pursuant to a Confidentiality Agreement, the Purchaser should consider itself to have a duty to disclose or abstain by virtue of the agreement. Purchases of Public Company stock without disclosure of the information would violate Rule 10b-5. But, unless the Confidentiality Agreement contains an appropriate exception, disclosure of the information would breach the Confidentiality Agreement. Confidentiality Agreements can contain traps for the unwary and should be reviewed carefully by any Purchaser, even if the Purchaser is contemplating a friendly transaction with the Public Company.

(2) If the Purchaser receives any material nonpublic information from an insider or other third party and has reason to know that such person has breached a duty in disclosing the information, the Purchaser might have tippee liability under Rule 10b-5.

The tippee concern is especially acute if the Purchaser obtains information from an employee or former employee of the Public Company in connection with an unfriendly transaction. Particularly since it is highly unlikely that information obtained in this manner would be critical to the Purchaser’s assessment of the Public Company, the best course for a Purchaser contemplating an unfriendly transaction would be to avoid any contacts with employees or former employees of the Public Company that could give rise to claims of tipping.

VI. “TENDER OFFER”

Some courts have held that certain rapid accumulations of stock constitute a “tender offer” for purposes of Section 14(d) of the Exchange Act.¹⁵ While no particular factor or factors

14. An employee of the Purchaser or one of its advisers may commit an insider trading violation by “misappropriating” inside information and using it to trade for personal profit.

15. Disclosures required by the tender offer rules are generally comparable to Section 13(d) disclosures, with certain exceptions. An important difference is that material financial information concerning the bidder may have to be disclosed in a tender offer, but does not have to be disclosed in a Schedule 13D. (Financial information of a bidder in a tender offer is not considered material if, among other things, the consideration offered consists solely of cash and the offer is not subject to a financing condition.) If financial statements for a foreign company are disclosed, they must be accompanied by disclosure of the material differences between the applicable foreign accounting principles and U.S. generally accepted accounting principles. It should also be noted that contacts with the Public Company (e.g., meetings, letters, telephone calls) must be disclosed and may

(Footnote continued on next page)

are dispositive, characteristics which contribute to this conclusion are (i) the widespread and active solicitation of stockholders; (ii) solicitation made for a substantial percentage of stock; (iii) offering a premium over the prevailing market price; (iv) offer terms that are not negotiable; (v) making the offer contingent on a minimum number of shares being tendered (and possibly specifying a maximum number to be purchased); (vi) limiting the time during which an offer is open; (vii) publicly announcing a purchase program preceding or accompanying a rapid accumulation of shares; and (viii) pressuring stockholders to sell.

Open market purchase programs generally do not exhibit these types of characteristics and, accordingly, have consistently been deemed not to constitute a tender offer. In the case of negotiated block purchases, in order to avoid any possible issue with respect to tender offer treatment, only a limited number of stockholders should be solicited, preferably institutional investors and sophisticated individuals. State laws may also define certain transactions as a “tender offer” and should be reviewed. In addition, it would be desirable to furnish written guidelines dealing with these matters to the persons who effect purchases of Public Company stock for the Purchaser’s account.

VII. NEGOTIATED BLOCK PURCHASES

Purchasing the shares of a significant stockholder may represent a quick way of accumulating a major stake in a Public Company. It is unlikely, however, that this approach will enable the Purchaser to reduce its acquisition cost substantially. Negotiated purchases may involve the payment of a premium to the selling stockholder, particularly if the number of shares involved is not otherwise readily obtainable in the open market and the selling stockholder, who is almost always a sophisticated investor, suspects or knows that the Purchaser intends to acquire, or is considering acquiring, the entire company. Under these circumstances, the stockholder would be expected to negotiate for “price protection”, i.e., the benefit of any subsequent increase in the price paid to acquire additional shares.

Negotiated purchases of a control block raise certain additional issues:

- (1) In general, the fact that the Purchaser pays a premium to acquire the shares of a controlling stockholder should not as a matter of corporate law obligate the Purchaser to acquire the remaining public shares or, if it determines

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be important in any subsequent litigation. Adequate preparation prior to any such contacts can avoid significant problems.

The tender offer rules also set forth certain timing requirements, including a minimum offer period of 20 business days. As a practical matter, if the Public Company has adopted a “poison pill” (see pp. 19 - 21) or is subject to a state takeover law (see pp. 17 - 19), the tender offer process will likely exceed the minimum period (since the Purchaser would not purchase shares in the offer unless these impediments were invalidated or rendered inapplicable by action of the Public Company’s Board of Directors).

to acquire those shares, to pay the same price paid to the controlling stockholder. Similarly, controlling stockholders in a Public Company generally are entitled to sell their shares without affording other stockholders an “equal opportunity” to participate in the transaction. Nevertheless, from a planning standpoint, the Purchaser should assume that there is a high likelihood that a transaction structured along these lines would be litigated. For this reason, the controlling stockholder may prefer an equal opportunity transaction such as a tender offer (which is made to all stockholders at the same price).

(2) If the Purchaser does not acquire, or commit to acquire, the remaining public shares at the same price in connection with the purchase of control, a later “freezeout” of the public stockholders would be treated as a “going private” transaction under Section 13e-3 of the Exchange Act, resulting in increased disclosures when the latter transaction is submitted for approval to the Public Company’s stockholders. A “going private” transaction must also satisfy state law “fairness” standards, both substantively (e.g., price) and procedurally. At a minimum, procedural fairness requires full disclosure (including the controlling stockholder’s conflict of interest) to the public stockholders. Also important is the integrity of the negotiation process and, for this reason, many companies contemplating a freezeout adopt procedural safeguards such as appointing a committee of independent outside directors (represented by independent legal counsel and investment bankers) to make the determination whether to approve or reject the controlling stockholder’s merger proposal.

(3) Of course, the Purchaser could determine not to acquire the remaining equity interest in the Public Company and, instead, could operate the Public Company as a controlled subsidiary. By virtue of its control relationship, the Purchaser would have fiduciary duties to the other Public Company stockholders, meaning, among other things, that transactions between the Purchaser and the Public Company would have to meet a fairness test and the Public Company could not be deprived of business opportunities in which it has an expectant interest. For these reasons, the presence of a minority public interest in a subsidiary is often considered undesirable.

As discussed in Parts IX and X below, certain defensive measures -- e.g., state takeover statutes and poison pills -- can effectively cap the Purchaser’s ability to purchase (or agree to purchase) shares through negotiated transactions (or in the open market) without Board approval. See pp. 17 - 21.

VIII. AFFILIATE STATUS

A large minority holding, if coupled with Board representation and active participation in the Public Company’s affairs, could result in the Purchaser being deemed an “affiliate” of the Public Company under the Exchange Act and the Securities Act of 1933 (the “Securities Act”). If so:

(1) Sales by the Purchaser of the Public Company shares would have to be registered under the Securities Act (which would require the Public Company's cooperation) or made pursuant to an applicable exemption (such as Rule 144, where the number of shares which may be sold is limited -- up to 1% of the outstanding shares every 3 months -- or in a private offering).

(2) As an "insider", the Purchaser would have to exercise care to avoid selling or purchasing Public Company shares when it possesses (or could reasonably be said to possess) inside information. See pp. 13 - 14.

(3) A subsequent merger or other business combination between the Purchaser and the Public Company probably would be deemed a "going private" transaction for purposes of Rule 13e-3 under the Exchange Act. See pp. 15 - 16.

(4) The terms of the business combination between the Purchaser and the Public Company might be subject to attack on state law "unfairness" grounds (although this risk should be reducible to an acceptable level if proper procedures are followed). See pp. 15 - 16.

(5) If the Public Company is listed on a U.S. stock exchange or Nasdaq, then there are additional ramifications to being an "affiliate" of the Public Company under the Sarbanes-Oxley Act. See pp. 21 - 22.

IX. STATUTES REGULATING TAKEOVERS

State Takeover Laws

Prior to 1982, many states adopted takeover statutes (so-called "first generation" statutes) which purported to regulate the acquisition of control of Public Companies which were incorporated or had substantial assets, stockholders, principal executive offices or principal places of business in such states. Some of these statutes purported to apply to open market and negotiated purchases of stock exceeding a specified threshold (generally, 5% or 10% of the target's voting securities) as well as to traditional tender offers. They typically required that the Purchaser make certain disclosures (which were sometimes comparable to Section 13(d) disclosures) and, in some cases, granted state officials the power to block the transaction. A few statutes also prohibited the Purchaser from making a tender offer for a specified period of time (e.g., one year) after purchasing a specified amount (e.g., 5%) of the Public Company's shares if, prior to its acquisition of the first share, the Purchaser failed to disclose its intention to acquire control of the Public Company.

In 1982, the United States Supreme Court invalidated one state's takeover law on constitutional grounds. In response, most states have since adopted "second generation" takeover laws (described below) and/or revised their "first generation" statutes in an effort to eliminate constitutional infirmities. Whatever the nature or vintage of a state's takeover law, a Purchaser contemplating purchases in excess of a statutory threshold should evaluate the statute in the context of an initial purchase program as well as subsequent transactions such as a tender offer or merger, and should consider its options in dealing with the statute (comply; litigate; and/or, if possible, seek to replace the Public Company's Board with a new Board which will

render the statute inapplicable to the proposed transaction). If a specific statute has not previously been challenged, litigation may afford certain tactical benefits to a hostile bidder even if the law does not present some of the glaring problems reflected in the “first generation” statutes.

Drafters of the “second generation” takeover statutes sought to avoid a constitutional challenge by including these provisions in state corporation laws (since states have the power to regulate the internal affairs of corporations incorporated within their borders). Two typical types of statutes are (i) the “control share” statute, which generally prohibits a 20% stockholder from exercising voting rights with respect to any additional shares unless the other stockholders approve such action (the statute contains procedures for calling a special stockholders meeting for this purpose, even if the Public Company’s by-laws normally do not permit stockholders to call special meetings)¹⁶ and (ii) the “fair price” statute, which generally requires that a business combination with a substantial (e.g., 10%) stockholder be approved by a supermajority (e.g., 80%) vote of the stockholders, unless the Purchaser pays stockholders a “fair price” which is calculated in accordance with the statute (and which may, under certain conditions, exceed the price paid by the Purchaser in a tender offer preceding the business combination). The latter statute is modeled after “fair price” charter provisions. See pp. 19 - 21.

Another common “second generation” takeover statute is the “moratorium” statute, which has been adopted by more than half the states, including Delaware and New York. This statute generally prohibits a substantial (e.g., 10%) stockholder who did not receive the approval of the Public Company’s Board of Directors prior to acquiring the shares from merging with the Public Company or engaging in certain self-dealing transactions for a specified period of time. Depending on the statute, the moratorium period ranges from 2 to 5 years. New York’s law, with certain exceptions, applies to 20% stockholders and provides for a 5 year moratorium, while Delaware’s law, with certain exceptions, applies to 15% stockholders and provides for a 3 year moratorium.

Although the “fair price” and “moratorium” statutes operate only at the “back-end” of a takeover and do not directly regulate open market or negotiated purchases, if a Public Company is subject to such a statute, a Purchaser contemplating the acquisition of the Public Company must take the statute into account when developing its overall strategy. For example, the potential time delay and/or uncertainty engendered by moratorium statutes can be critical if an acquisition is being financed through outside sources and the Purchaser needs quick access to the Public Company’s assets in order to pay down the debt or otherwise satisfy its lenders. Since the commencement (as opposed to the consummation) of a tender offer by a Purchaser owning less than the statutory threshold would not trigger the moratorium period, a Purchaser in this situation

16. If the Purchaser makes a tender offer conditioned on “control share” approval and solicits proxies for the special meeting during the pendency of the offer, presumably the Public Company’s stockholders will give their approval if the tender offer is made at a desirable price. For this reason, “control share” statutes may be less of an impediment to a hostile takeover than the other statutes described below (which do not afford the Purchaser the right to call a special meeting).

typically makes a tender offer which is conditioned on judicial invalidation of the statute or (in an effort to put pressure on the Board of Directors of the Public Company) approval of the offer by the Board. The Purchaser may also be able to conduct a simultaneous tender offer and proxy contest, in which the Purchaser seeks to replace the Board with its nominees, and have the new Board approve the offer, prior to purchasing shares under the tender offer. (The viability of this strategy may be undermined or eliminated by certain “shark-repellent” charter and by-law provisions discussed on pp. 19 - 21 below.) As a practical matter, then, these statutes operate much like a “control share” statute and effectively cap open market and negotiated purchases at the percentage threshold.

In 1986, the United States Supreme Court upheld the constitutionality of Indiana’s control share statute. Although the decision contains language which may be used to support the other kinds of “second generation” takeover statutes, the constitutionality of these statutes was not addressed by the Court. There have not been any subsequent Supreme Court decisions addressing the constitutionality of state takeover laws.

Regulated Industries

Companies in certain industries are subject to extensive federal and/or state regulation that include provisions relating to changes in control. At the federal level, regulated industries include aviation, banking, communications, investment advisers and shipping. At the state level, regulated industries include banking, insurance, consumer finance and gaming.

Under some regulatory schemes, a change in control (sometimes defined as the acquisition of as little as 10% of the stock of the Public Company) may require the prior approval of a regulatory authority. As part of the approval process, the regulatory authority may be required or authorized to hold hearings which could have the effect of delaying the transaction. If acceptable to the applicable regulatory authority, a way of avoiding such delay would be to purchase the shares and place them in a voting trust pending receipt of approval of the change of control. During that period, the terms of the trust would prevent the Purchaser from controlling the Public Company but would permit the Purchaser to vote the shares in favor of its merger proposal and, if necessary, to vote them against a competing bid.

In addition, certain statutes limit foreign ownership in a Public Company. See pp. 23 - 25.

X. SHARK-REPELLENTS AND POISON PILLS

Many Public Companies have adopted so-called “shark-repellent” charter and by-law provisions that can make it more difficult (and possibly more expensive) to acquire the company on an unfriendly basis. The most common provisions (i) divide the Board of Directors into classes (in a typical “staggered Board” provision, one-third of the directors are elected at each annual meeting) and limit the ability of stockholders to remove directors, fill vacancies or otherwise change the composition of the Board between elections, (ii) prevent stockholders from acting by written consent or calling special meetings and (iii) establish certain requirements (such as a supermajority vote and/or payment of a “fair price”) for a business combination with a substantial (e.g., 10%) stockholder. All of these provisions complicate matters for a Purchaser

seeking to acquire the Public Company, since it is conceivable that voting control will not be accompanied (at least immediately) by Board control and the ability to effect a merger in which the remaining stockholders relinquish their interest in the Public Company. The provisions described in clauses (i) and (ii) above may also have an adverse effect on a stockholder or stockholders who desire to wage a proxy contest but do not seek to acquire additional shares of the Public Company.

The shark-repellent strategies described above are joined by another, more potent, defensive strategy. Many Public Companies have adopted “Rights Plans”. Unlike most shark-repellent provisions, Rights Plans generally do not require stockholder approval, meaning that a Board can implement one even after it receives a takeover proposal. Indeed, any Purchaser that contemplates making an unsolicited offer should assume that if the Public Company has no Rights Plan when the Purchaser first announces its intentions, it will put one in place shortly thereafter.

Under a typical Rights Plan, the Public Company dividends to its common stockholders one “Right” for each outstanding common share. If a Purchaser accumulates a specified percentage of the Public Company’s shares (usually 10 - 20%), the Rights “flip in” and entitle holders -- other than the Purchaser -- to buy the Public Company’s common stock at a 50% discount. If the Public Company is acquired in a merger or other business combination, the Rights “flip over” and become Rights to buy the Purchaser’s stock at a 50% discount. The potentially enormous dilutive effect of these provisions (from both a voting and economic perspective) is the reason why Rights Plans are often called “poison pills”.

The dilutive aspects of a Rights Plan seek to deter a hostile Purchaser from crossing the flip-in threshold while the Rights Plan is in place -- and, indeed, this situation has yet to occur. Instead, a Purchaser typically makes a tender offer for shares of the Public Company and conditions its offer on the removal or invalidation of the Rights Plan, so that the Purchaser is not obligated to purchase shares while the Rights Plan is in effect. Although some bidders are able to conduct a proxy contest at the same time as the tender offer, with a view to installing new directors who would eliminate the Rights Plan before the bidder buys shares in the tender offer, this normally is not a workable strategy when the Public Company has a staggered Board (with limitations on removing directors) and, particularly, when the staggered Board is coupled with provisions that prohibit stockholders from calling special meetings or acting by written consent.

Rights Plans are also designed to encourage bidders to negotiate with the Board of Directors of the Public Company. They contain a provision that enables the Board to redeem the Rights for a nominal amount (e.g., \$.01 per Right) up to or shortly after the time when a Purchaser’s stock ownership reaches the flip-in threshold. Thus, the Board has the flexibility to approve a transaction that it believes is in the stockholders’ best interests.

This flexibility is critical, since the legal decisions upholding the adoption of Rights Plans have made clear that the technique may not be used to make a company “takeover-proof”. The adoption of a Rights Plan does not change the fiduciary standards to be followed by the Board of Directors in responding to a takeover bid. Depending on the facts and circumstances, the Board may be justified in blocking a hostile takeover bid by refusing to redeem the Rights. One of the reasons for adopting a Rights Plan is to protect stockholders from inadequate takeover bids. In

other cases, the Board may conclude that its duty to act in the best interests of the Public Company's stockholders requires it to redeem the Rights in order to permit the Purchaser to complete its tender offer. As a practical matter, the more attractive the offer, the more difficult it may be for the Public Company to resist the Purchaser (or avoid initiating an alternative transaction).

In recent years, institutional stockholders have generally been critical of Rights Plans and, in some cases, Public Companies have removed or modified their takeover defenses in response to opposition from institutional holders. Nevertheless, Rights Plans remain a key part of the defensive arsenal. Though they do not prevent a Public Company from being taken over, they can complicate an investment or takeover, add a significant element of delay and uncertainty to the transaction, and significantly increase the cost to the Purchaser if the Public Company's Board does not support the transaction.

XI. CORPORATE GOVERNANCE

Starting with the dramatic collapse of Enron Corp. in 2001, a series of corporate and accounting scandals at Public Companies focused Congressional, SEC and public attention on corporate governance reform. In response, Congress enacted comprehensive legislation, known as the Sarbanes-Oxley Act ("Sarbanes-Oxley"), which became law on July 30, 2002. Pursuant to Sarbanes-Oxley, the SEC has adopted significant new rules and the U.S. national securities exchanges (such as the New York Stock Exchange) and Nasdaq have enhanced the corporate governance practices required of listed companies.

Although most of Sarbanes-Oxley imposes obligations on a Public Company's management and directors (and its accounting and legal advisors), rather than its stockholders, some provisions in the statute can affect a Purchaser, depending on factors such as the amount of stock acquired and whether the Purchaser is a passive investor or desires representation on the Board of Directors. Regardless of its intentions, a prudent Purchaser will also want to consider, as part of its "due diligence" analysis, whether any Public Company in which it is considering investing has in place the processes, policies and procedures called for by Sarbanes-Oxley and, if applicable, the consequences of failing to comply. The following list covers -- in very general terms -- some of the requirements that may directly or indirectly affect Purchasers. *For additional information, we invite you to visit the Corporate Governance section of Hughes Hubbard's website, www.hugheshubbard.com, or contact Ellen Friedenberg at frieden@hugheshubbard.com.*

(1) *More Rapid Section 16 Ownership Filings.* If a Purchaser acquires more than 10% of a class of equity securities of a Public Company, it will be required to make ownership filings under Section 16 of the Exchange Act. See pp. 12 - 13. In most cases, the initial report on Form 3 must be made within 10 days after the acquisition of such ownership, and any subsequent changes in ownership must be reported on Form 4. As a result of Sarbanes-Oxley, the deadline for Form 4 filings has been accelerated and is now 2 business days after the execution (trade date) of the transaction. Filings must be made electronically, via the SEC's EDGAR system.

(2) *Director Independence Requirements.* If a Purchaser becomes an “affiliate” of a Public Company, that status can have various ramifications under the federal securities laws and state corporate law. See p. 17. If the Public Company’s shares are listed on a U.S stock exchange or Nasdaq, Sarbanes-Oxley has additional ramifications, including the requirement that all directors who serve on the company’s audit committee be “independent”, as defined by the SEC. Subject to certain exceptions for controlled companies (i.e., those in which more than 50% of the voting power is held by an individual, group or another company), the stock exchanges and Nasdaq have also gone beyond Sarbanes-Oxley to require that a majority of the Board of Directors be independent; to impose independence requirements on the determination of Board nominations and executive compensation; and to add their own definitions of independence above and beyond the SEC’s audit committee independence test. These definitions include a list of present and past relationships that are deemed to render a director non-independent for these purposes.

(3) *Director Nominations.* A Purchaser may acquire stock in a Public Company with a view to pressuring the directors to name the Purchaser or its representative to the company’s Board of Directors, or otherwise obtaining a “leg up” in a potential proxy context. Although proxy contests are outside the scope of this publication, recent SEC rule changes will be of interest to such a Purchaser. In its annual proxy statement, a Public Company must now disclose to its stockholders whether or not the company has a policy in place for the evaluation of director nominations, including candidates recommended by stockholders, and whether or not the policy treats candidates recommended by stockholders any differently from candidates whose consideration is initiated by the nominating committee or Board.¹⁷

(4) *Enhanced Disclosures.* The SEC filings and other public disclosures of a Public Company are an important source of due diligence information for a Purchaser, particularly when the Purchaser is not buying shares directly from the Public Company. Sarbanes-Oxley and related SEC rules add or strengthen a number of specific disclosure requirements for Public Companies. For example, since 2002, Public Companies have been required to include with their annual and quarterly reports various certifications of the CEO and CFO, who are subject to both civil and criminal liability in the event of false certifications. All Public Companies will be required (in some cases, starting with their 2004 fiscal year) to include with their annual report a management report on internal controls for financial reporting, attested to by the outside auditor. In a significant step towards the “real time” disclosure contemplated by Sarbanes-Oxley, the SEC recently amended Form 8-K to add new disclosure items, expand some existing items, and shorten the filing deadlines under the Form (the filing deadline for most Form 8-K’s is now 4 business days after the triggering event).

17. In addition, the SEC is currently considering proposed rules that would, under certain circumstances, require Public Companies to include stockholder nominees for election as directors in their proxy materials.

XII. FEDERAL STATUTES APPLICABLE TO FOREIGN INVESTORS¹⁸

Exon-Florio Review of Acquisitions of U.S. Businesses

Section 721 of the Defense Protection Act of 1950, commonly called the Exon-Florio provisions, authorizes the President to review acquisitions which could result in control¹⁹ of U.S. businesses by foreign persons to determine whether such acquisitions threaten to impair U.S. national security. Upon finding the existence of such a threat, the President is authorized to take any necessary corrective action, which may include suspending or prohibiting the transaction, requiring that corrective measures be adopted before the acquisition can proceed, or requiring disinvestment if the acquisition already has occurred.

The President has delegated his initial authority to review transactions subject to the Exon-Florio provisions to the Committee on Foreign Investment in the United States (“CFIUS”), an interagency committee originally set up in the 1970’s to monitor foreign investments.²⁰ The Exon-Florio regime as implemented by CFIUS establishes a system of voluntary written notification to CFIUS of covered transactions. In brief, the notification must identify the nature of and parties to the transaction, the foreign ownership involved, the U.S. business activities that are being acquired and whether those activities involve certain kinds of products, technologies or government business, the nature of the foreign acquiror’s business, and certain information regarding the foreign acquiror’s plans with respect to the U.S. business. All information provided to CFIUS in an Exon-Florio review is required by law to be kept confidential. While, as indicated, notification is voluntary, if a transaction is not notified it theoretically remains subject to possible review and divestiture indefinitely.

Under the law and implementing regulations, CFIUS has 30 calendar days following receipt of a written notification to determine whether to initiate a full scale investigation of the transaction. If CFIUS does not determine to commence such a full scale investigation within 30 days, the Exon-Florio review process ends and the transaction may proceed without further concern regarding Presidential action under Exon-Florio. If an investigation is commenced, CFIUS must complete such an investigation within 45 days, and a decision by the President whether or not to take action must be made no later than 15 days after completion of the investigation. Thus, at most 90 days may pass from the filing of a formal notification to the

18. In connection with a particular transaction, any potentially applicable state statutes should also be reviewed.

19. “Control” is defined extremely broadly and functionally as the power, direct or indirect, whether or not exercised, to “determine, direct or decide matters affecting” the entity through ownership of a majority or “dominant minority” of the entity’s voting securities, proxy voting, contractual arrangements or other means.

20. CFIUS is comprised of representatives of the Departments of State, Treasury, Commerce, Defense and Justice, the U.S. Trade Representative, the Chairman of the Council of Economic Advisors, the Director of the Office of Management & Budget, the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs and the Assistant to the President for Economic Policy. The Treasury Department chairs CFIUS. In 2003, the Department of Homeland Security was added to CFIUS.

completion of the Exon-Florio review process. A finding by the President that a transaction raises a threat to the national security is not subject to judicial review.

While the Exon-Florio process carries the potential for significant U.S. government impediment to foreign acquisitions of U.S. businesses, in practice CFIUS and the President have used that authority with great restraint. The vast majority of the transactions which have been voluntarily notified to CFIUS have been screened and approved within the initial 30 day review period and required divestitures have been extremely rare (in one such case, a divestiture of an acquisition of a company possessing sensitive aircraft manufacturing technology by China National Aero-Technology Import-Export Corp., a Chinese government-owned entity with a record of violating U.S. export controls, was ordered).

International Investment and Trade in Services Survey Act (“IITSSA”) (formerly known as the International Investment Survey Act of 1976)

In general, IITSSA applies to the acquisition or establishment by a foreign person, directly or indirectly, of a 10% or greater voting interest in a U.S. “business enterprise”, defined to include (i) the ownership of any organization, association or venture which exists for profit-making purposes or to otherwise secure economic advantage and (ii) the ownership of any real estate (other than for personal use). Unless the transaction is exempt (as described below), the U.S. enterprise must file certain information with the Department of Commerce within 45 days thereafter. Required disclosures include the name and country of origin of the “ultimate beneficial owner” of the foreign person.

The U.S. enterprise may also be subject to ongoing reporting requirements under the statute. Exempt investments under IITSSA include, among other things, (i) an acquisition by an existing U.S. affiliate of a foreign enterprise, for a total cost of \$3 million or less which does not involve the purchase of 200 acres or more of U.S. land and (ii) the establishment or acquisition of a U.S. enterprise which has total assets of \$3 million or less and does not own 200 acres or more of U.S. land. In such a case, though, the U.S. enterprise must still file an Exemption Claim report to validate the claimed exemption.

Agricultural Foreign Investor Disclosure Act of 1978 (“AFIDA”)

In general, AFIDA applies to the acquisition or transfer by a foreign person of any interest (with certain exceptions) in “agricultural land”, which includes forest land. A change to or from agricultural use of land is also covered. For purposes of the statute, the term “foreign person” includes any U.S. corporation in which a foreign person (or group of foreign persons) has a 10% or greater direct or (with certain exceptions) indirect interest. Under AFIDA, the landowner must file certain information with the Department of Agriculture within 90 days after the transaction or change in use, and any change in information previously reported must be reported within 90 days after the change. Required disclosures include the name, address and citizenship of 10% stockholders and, upon request, a foreign entity named in the report must furnish such information regarding its stockholders.

Statutes Limiting Foreign Ownership

Certain federal statutes impose restrictions on foreign ownership of the stock of a Public Company which is engaged in certain regulated activities. Examples of such companies include broadcast licensees, domestic air carriers and vessels used in the domestic coastwise trade. Among other things, these statutes may limit total foreign ownership to a noncontrolling amount (e.g., 20%). In considering the applicability of such a statute to a particular transaction, it is important to determine whether the statutory restriction would apply regardless of the form of ownership, i.e., directly or through a U.S. subsidiary. State statutes may also be applicable.

Other Considerations Applicable to Foreign Investors

Under U.S. industrial security procedures, as reflected in the National Industrial Security Plan Operations Manual, Public Companies that perform contracts requiring access to classified information must have security clearances to the level required for the performance of the contracts in question. When a cleared Public Company enters into any kind of arrangement with a foreign entity that may lead to foreign ownership, control or influence over such Public Company, it is required to inform the applicable U.S. Government security office, and possibly take corrective action or risk losing its clearance. Ownership of as little as 5% of a Public Company may trigger these requirements, depending on the facts and circumstances. A U.S. Public Company in which a controlling block of its voting stock is acquired by a non-U.S. Purchaser becomes ineligible for security clearances, unless a mechanism acceptable under U.S. industrial security regulations is entered into. A number of such mechanisms are available. Each of these mechanisms, though, would impose certain restrictions on the ability of the Purchaser to manage the Public Company, and/or would limit the kinds of classified contracts the Public Company could perform.

In evaluating an investment in, or acquisition of, a Public Company, a foreign Purchaser should also be aware, among other things, that the Public Company may be subject to limitations on where it conducts business that would not apply to the Purchaser itself. For example, U.S. companies are prohibited from engaging in almost all business transactions with Iran, Sudan and Cuba, and may be further limited in doing business with particular persons or entities that have been identified as being associated with terrorism or narcotics trafficking. In addition, U.S. persons must be sensitive to U.S. antiboycott rules.

XIII. OTHER LEGAL CONSIDERATIONS

Depending on the particular facts and circumstances, open market and/or negotiated purchases, as well as any acquisition of a Public Company, can give rise to additional legal considerations including the following:

Financing Considerations

The extent to which the Purchaser can finance the acquisition of Public Company stock through the use of borrowed funds will vary depending upon the applicability of the margin rules promulgated by the Federal Reserve Board. If a transaction is subject to the margin rules, a maximum of 50% of the current market value of the acquired shares may be financed with borrowed funds. In structuring a potential transaction, it should be noted that the issuance of

preferred stock may, under certain conditions, be treated as the incurrence of debt for purposes of the margin rules, thereby counting towards the 50% test.

Foreign Laws

If the Public Company has substantial operations in foreign countries, consideration should be given to whether any filing or approval requirements, under competition laws, foreign investment laws, or otherwise, would be triggered by an investment in the Public Company's shares and/or an eventual takeover. In the European Union, for example, it may be necessary to obtain antitrust clearance from the European Commission or antitrust authorities in applicable countries.

Tax Considerations

For both U.S. and foreign Purchasers, the proposed investment in, or takeover of, a Public Company should be evaluated from a tax perspective, including the form of the acquisition vehicle and the structure of any second-step transaction. In the case of a foreign Purchaser, another important tax issue to address is whether to purchase shares through a U.S. or foreign entity. Generally speaking, the choice of acquisition vehicle and its relationship to the other members of the Purchaser's corporate family may have domestic as well as foreign tax implications.

Change of Control Provisions

The Public Company may be a party to contracts with "change of control" provisions, such as loan agreements or other debt instruments, or joint venture agreements with third parties. Depending on how "change of control" is defined in the applicable contract, it is possible that a substantial investment by the Purchaser would trigger the provision even if the Purchaser does not obtain majority control of the Public Company or its Board of Directors. Consequences might include, in the case of indebtedness, acceleration of the debt or, in the case of a joint venture, a buyout right in favor of the other party to the joint venture. The Public Company's benefit plans and employment/severance agreements with executives may also contain "change of control" provisions (so-called "golden parachutes").

Investment Company Act

The Purchaser could become an "investment company" for purposes of the Investment Company Act of 1940 if it acquires shares of the Public Company which have a value that exceeds 40% of the Purchaser's total assets on an unconsolidated basis (exclusive of cash and U.S. government securities). Notwithstanding this test, the Purchaser will not be deemed to be an "investment company" if it is primarily engaged, directly or through a wholly-owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities.

For a Purchaser of size, the Investment Company Act will only be a consideration for very large acquisitions. And even if there is an "investment company" issue, there are various means of dealing with the problem, including a one-year temporary exemption that is available without making any application to the SEC.

Tender Offer

There are additional legal considerations for a Purchaser to take into account in connection with a stock purchase program if it is also planning or considering a tender offer. They include (i) Rule 14d-10 under the Exchange Act (the so-called “all holders/best price” rule), which obligates a Purchaser making a tender offer to extend the offer to all stockholders of the affected class of equity security and to pay the same price per share for all of the shares purchased in the offer and (ii) Rule 14e-5 under the Exchange Act, which generally prohibits the Purchaser and its affiliates from purchasing shares in the Public Company outside the tender offer while the offer is pending.