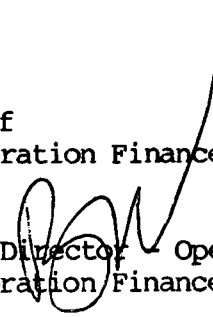


MEMORANDUM

May 13, 1985

TO : Professional Staff
Division of Corporation Finance

FROM : William C. Wood 
Senior Associate Director - Operations
Division of Corporation Finance

RE : Dual Capitalization Proposals

As you may be aware, there has been a sharp increase in the number of companies proposing recapitalization plans which provide for the authorization and issuance of a second class of common stock. Shares of the new class of common stock, frequently denominated Class B Common Stock, have enhanced voting rights and reduced rights to receive dividends. The Class B shares typically are not transferable but may be converted into Class A Common Stock.

Dual capitalization proposals raise several concerns and disclosure issues which the staff should consider when reviewing such proposals.

Anti-takeover Purpose and Effect

The essential element of most dual capitalization proposals is the establishment of disparate voting rights, e.g., Class B Common Stock has ten votes per share, votes as a class to elect one-third of the directors and votes together with the common stock on the election of the remainder of the directors and on all other general corporate matters. The stated purpose of most dual capitalization proposals is to assure the perpetuation of voting control of a principal shareholder or group. Accordingly, the anti-takeover purposes and effects of such proposals should be carefully examined. In this regard, the disclosures required by Exchange Act Release No. 34-15230 (October 13, 1978) should be provided. Special attention should be given to disclosure of the practical effect of the proposal including: specification of the percentage of voting power concentrated in principal shareholders both before and after completion of the recapitalization; the implications of such a concentration of voting power on (a) the ability of other shareholders to change or influence control, (b) the ability of the principal shareholders to satisfy supermajority voting requirements and/or (c) the elimination of a blocking position or veto power previously held by unaffiliated shareholders; and, the chilling effect on potential mergers, tender offers and proxy contests resulting from the concentration of voting power and the lack of transferability of the Class B Stock.

Differential Dividend Rights

In addition to the disparate distribution of voting power, dual capitalization proposals frequently purport to effect a redistribution of economic rights. In the usual case, this is accomplished through the fixing of a differential in the dividends payable on each class of stock, e.g., Class A Common Stock entitled to a dividend 10% higher than Class B. With respect to such provisions, the attention of the staff should focus on the extent to which the purported economic benefits may prove to be illusory or may be substantially reduced by later action of the Board or shareholders. In this regard, the staff should elicit disclosure relating to: whether dividends on the higher paying class are cumulative or are a legal obligation of the company or whether such payment is entirely within the discretion of the Board; whether the dividend differential provision applies to all cash dividends or is limited to regular quarterly dividends; whether the Board is authorized to declare "special" cash dividends which are not subject to the dividend differential provision; whether the provision relating to the dividend differential may be revised by the Board or by shareholders and the requirements for such revisions; whether the benefit of the dividend differential may be effectively reduced or eliminated at the discretion of the Board through failure to declare dividends or through the declaration of "special" dividends; and the source or account from which dividends legally may be paid by the corporation and whether such funds are available in an amount sufficient to make the proposed dividend payments.

Marketability and Transferability

An additional concern that the staff should consider is the impact of the dual capitalization upon the marketability and transferability of the company's securities. Historically, the New York Stock Exchange ("NYSE") has had a policy against listing the common stock of a company with more than one class of common stock. The NYSE, however, is currently reconsidering this policy and has placed a freeze on delistings

of companies that have adopted plans for dual capitalization. */ Disclosure of the NYSE's position in this regard should be provided along with a discussion of whether the proposal complies with the recommendations of the NYSE Subcommittee. In addition, the disclosure document should include a discussion of the company's plans regarding a trading market if delisted by the NYSE and the effect of such action on the liquidity of the market for the company's securities.

Class B shares typically are not transferable but may be convertible into Class A common stock. Full disclosure as to all restrictions on transfer and the terms and conditions of conversion should be provided.

*/ For additional information on the NYSE review see: Dual Class Capitalization: Initial Report of the Subcommittee on Shareholder Participation and Qualitative Listing Standards, January 3, 1985. The Subcommittee's recommendations are as follows:

An issuer with securities listed on the New York Stock Exchange should not have those securities delisted because of the adoption of charter provisions creating two classes of common stock having disparate voting rights if:

- a. The transaction in which the shares with different voting rights are to be issued has been approved by two-thirds of all shares entitled to vote on the proposition;
- b. If the issuer had a majority of independent directors at the time the matter was voted upon, a majority of such directors approved the proposal; if the issuer had less than a majority of such directors, then all independent directors approved;
- c. The ratio of voting differential per share is no more than one to ten; and
- d. The rights of the holders of the two classes of common stock are substantially the same except for voting power per share. With respect to this last condition, some members of the Subcommittee believe the disparity permissible should be limited to voting for directors and some believe payment of a larger dividend to holders of the lesser voting shares should be permissible. We suggest the Public Policy Committee study the limits of permissible disparity with particular care.

Issuance of Class B Stock

The filing should also provide a clear description of the manner in which the new Class B stock will be issued to shareholders. Generally speaking, there are two principal methods for the issuance of such securities. The first, a "straight recapitalization," typically is effected through a reclassification of each outstanding share of common stock into a portion of a share of Class A stock and a portion of a share of Class B stock. The new shares are issued following the mandatory surrender by each stockholder of all shares of the existing class of common stock. Under the second and more common method, the "exchange offer," each stockholder is provided an opportunity to exchange all or a portion of his or her shares of the existing class of common stock for the new Class B stock or for a predetermined mix of Class A and Class B stock.

This Division and the Division of Market Regulation have taken the position that an exchange offer, as described above, is a "tender offer" within the meaning of Rule 13e-4 (the issuer tender offer rule), requiring compliance with the provisions of that Rule. This is true even if the instrument defining the rights of the new class of common stock afford shareholders the opportunity to exchange. Accordingly, in the case of any dual capitalization proposal which contemplates the issuance of securities by way of an exchange offer */, the issuer should be asked what consideration has been given to the application of Rule 13e-4 to the proposed transaction. Questions with respect to the application of Rule 13e-4 should be directed to the Office of Tender Offers.

Financial Statements

Item 13 of Schedule 14A requires certain disclosures with respect to any proposal for the modification of a class of securities or issuance or authorization for issuance of securities in exchange for outstanding securities of the issuer. As noted above, most dual capitalization proposals are effected by way of an exchange of outstanding securities for newly authorized Class B stock. Accordingly, the disclosure required by Item 13 is required. Since Item 15 of Schedule 14A requires financial statements where action is to be taken with respect to any matter specified in Items 12, 13, or 14 of Schedule 14A, financial statements will

*/ As a general rule, if shareholders have the opportunity to vary the mix of their Class A and B securities in relation to other shareholders the transaction involves an exchange offer.

be required with respect to dual capitalization proposals. Some issuers have argued that financial statements are not material to a shareholder's voting decision on a dual capitalization proposal. This Division, however, has taken the position that financial statements are material to such decisions. This position is based on the view that the transaction is creating a preference security and therefore information with respect to the financial ability of the issuer to make the increased dividend payments contemplated by the proposal is essential to a shareholder's decision.

Staff Action

All proxy statements which include a dual capitalization proposal should be assigned for "full review". A copy of the definitive along with the anti-takeover checklist should be forwarded to Edythe Macchiavello. Dual capitalization proposals containing any unusual provisions should be brought to the attention of the appropriate Branch Chief, Assistant Director and Associate Director prior to clearing the subject filing.