

“Greenmail” Makes a Comeback

By Spencer Klein and Enrico Granata

The much-maligned 1980s tactic of “greenmail”¹ appears to have made a comeback in 2013. “Greenmail” has generally been defined as the practice of purchasing enough shares in a company to threaten a takeover, and then using that leverage to pressure the target company to buy those shares back at a premium in order to abandon the takeover. Today’s variety of greenmail does not always involve the threat of a takeover, but instead typically involves the actual or implied threat of a proxy contest that would effect major corporate change.

In just the last few months, several noted activist investors have profited handsomely by selling shares back to their target companies, including, among others, Icahn Associates with respect to its stake in WebMD and Corvex Management with respect to its stake in ADT.

In some cases, these stock repurchases may be the culmination of a legitimate effort by activist investors to drive corporate change. In other cases, they may result from the activists’ attempt to turn a quick profit without any legitimate governance objective at all. Either way, outsized returns for one investor at the expense of others (in certain cases share prices fell in excess of several percent the day after the announcement of the repurchase) may undermine the legitimacy of “constructive” activists and diminish the recently observed enthusiasm of large institutional investors in supporting activist efforts.

Market participants should be aware that, in response to the wave of greenmail in the 1980s, several states—including New York—adopted statutes specifically prohibiting corporations organized in those states from paying greenmail.² The New York statute, for example, prohibits a New York corporation from buying back more than 10% of its stock from a shareholder for more than market value, unless approved by an affirmative vote of both the board of directors and a majority vote of the shareholders excluding the shareholder being redeemed (unless the certificate of incorporation requires a greater percentage of the votes of the outstanding shares to approve). Other states—Ohio and Pennsylvania in particular—have statutes that require investors who engage in greenmail to disgorge the profits they earn.

Moreover, under Section 5881 of the Internal Revenue Code, a 50% excise tax is payable on the profit derived from greenmail. However, due to the narrow definition of greenmail, the excise tax is easy to avoid. Greenmail is defined for these purposes as any amount a corporation (or any person acting in concert with a corporation) pays to a shareholder to directly or indirectly acquire its stock if:

1. The shareholder held the stock for less than two years before entering into the agreement to make the transfer;
2. At some time during the two-year period ending on the date of acquisition, the shareholder, any person acting in concert with the shareholder, or any related person, made or threatened to make a public tender offer for stock of the corporation; and
3. The acquisition was made under an offer that was not made on the same terms to all shareholders.

¹ Prominent examples of greenmail include Sir James Goldsmith’s greenmail of Goodyear Tire and Rubber Company in 1986 and St. Regis Paper Company in 1984, Carl Icahn’s greenmail of Viacom International Inc. in 1986, Saul Steinberg’s greenmail of Walt Disney Co. in 1984 and the Bass Brothers’ greenmail of Texaco Inc. in 1984.

² The other states include Arizona, Minnesota, Tennessee and Wisconsin.

In this context, the term “public tender offer” means “any offer to purchase or otherwise acquire stock or assets in a corporation if the offer was required to be filed or registered with any federal or state agency regulating securities.”

Because of the second prong of Section 5881, the excise tax is not likely to be implicated by most activist strategies associated with the current version of the “greenmail” tactic, short of a tender or exchange offer.³ Similarly, given that the shares of the activist investor are not repurchased at a premium (as in the more traditional greenmail scenarios) but have generally been bought back at the market price (*i.e.*, the previous day’s closing price), the state anti-greenmail statutes will usually not come into play. Of course, the absence of a premium does not on its own prevent the possibility of disparate treatment of shareholders. In fact, because stock prices tend to fall following such repurchases (as noted above), an exit at the repurchase/market price will often be available only to the activist investor. A related concern is that because it is improbable that an activist investor would have been able to divest its entire stake at the repurchase price on the open market, a company engaging in this type of repurchase may be perceived as having overpaid for the shares of the activist investor.

Whether these “greenmail” practices will endure will largely be a function of whether those activist investors engaging in such practices will be increasingly perceived as less than genuine in their claim to represent the interests of all shareholders as opposed to seeking an opportunistic short-term gain. In addition, considering the increasingly widespread criticism associated with this new type of “greenmail,” companies may wish to evaluate whether such repurchase transactions should be open to other shareholders through a Dutch tender offer or similar buyback arrangement.

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³ There is no guidance on whether a threat of some other major corporate transaction might be deemed to be equivalent to a threat of a “public tender offer.”