Glass Lewis Proxy Talk
Subject: Delaware Appraisal Rights in Advance of Providian's Merger Vote
Speakers: Greg Taxin, CEO & Kevin Cameron, President, Glass, Lewis & Co.
Date/Time: Thursday, Aug. 25 at 4 p.m. ET

OPERATOR: Good day, ladies and gentlemen, and welcome to the Glass Lewis Proxy Talk conference call. All lines have been placed on a listen-only mode for this call. Institutional investors that would like to ask questions of the participants may do so my emailing them to Proxytalk@glasslewis.com.

Before we get started I'd like to remind everyone of our conference call series and this call in particular should not be considered a solicitation of proxies by Glass Lewis & Company. Glass Lewis has not sought permission to do so from Securities and Exchange Commission, nor will it. This call is for information purposes only and should not be construed as providing legal or investment advice.

Given the subject of today's call, Glass Lewis wants to emphasize that investors should seek independent legal advice. Our speakers cannot offer legal help. As a reminder, this conference call is being recorded. At this time, it is my pleasure to turn the call over to your host, Greg Taxin, Chief Executive Officer of Glass Lewis & Company.

GREG TAXIN, CHIEF EXECUTIVE OFFICER, GLASS LEWIS: Thank you very much and welcome everybody, good afternoon. Today we will be discussing the legal and operational aspects of appraisal rights, they're sometimes called dissenter's rights – under Delaware law.

As I think everybody on the call knows, we recently released our analysis and recommendation for shareholders of Providian Financial. And we recommended that shareholders oppose the merger transaction with Washington Mutual and consider exercising their rights to appraisal rather than taking the merger consideration.

During the call, I want to very briefly outline why we have so recommended and then talk about how one goes about exercising appraisal rights, what they are, what are the logistical and operational complications of doing so.

Joining me on the call is Kevin Cameron, Glass Lewis' President and co-founder of the firm. Kevin and I are both trained as lawyers but are not serving today as lawyers. We, of course, want everyone on the call to seek their own legal counsel about their own situation. This is a very complex topic and we plead of you to not to take our final word on these topics. We're here for educational and background purposes and trust you will all work with your compliance groups and legal groups to get more precise advice on your particular situation.

That being said, let me just give a little background as to how we found ourselves here. As those of you who have read our proxy paper on the Providian deal know, we found there a similar unusual combination of circumstances that we think should lead shareholders to vote against the transaction.

Those unusual circumstances, if you will, are really three things. First, executives that are receiving substantial funds in the form of change-of-control payments, though they actually aren't being inconvenienced or thrown out of a job, they are actually going to stay on and work for Washington Mutual, will get a whole new bucket of shares and new employment agreements.

And that in and of itself isn't all that unusual, although it does give the management team incentives that are different from those of shareholders. It makes doing a transaction much more attractive to the executives than doing a transaction might be to shareholders. And so that, of course, raises our interest level, and the process that was engaged in at finding the outcome.

The company was not apparently shopped to other potential buyers. There's no mention in the proxy of contacting other companies or engaging in any sort of competitive situation.

We customarily find such disclosure when it has happened and, indeed, under SEC rules the entire background of how the deal came about needs to be disclosed in a proxy. And so our only conclusion is that the company did not reach out to other potential buyers.

In this case the company achieved a result that we don't think is terribly remarkable of four-percent premium to its trading price. We think the company was doing quite well, with improving prospects and could easily stand alone and remain a successful company. But instead, here the board has chosen to sell out at a very modest premium.

We note as well that after the deal, now looking with 20/20 hindsight, there were two other transactions that took place in this space, both MBNA and Metris. They were both sold at substantially higher multiples than Providian in the weeks and months following the announcement of this transaction. So there clearly were other buyers interested in this type of business and in this space.

By our math, as we say in our report, we believe Providian is worth between $21 and $24 in the merger market. In the current transaction shareholders get about $18.75. Much of the consideration is based in WaMu stock and so it varies day to day, but it's about 18.70 to 18.75 a share. We think the right price is $21 to $24.

So our overall sense is that this management team may have incentives different from shareholders, they did not follow a process here that was likely to yield the best transaction and, indeed, the transaction that was agreed upon is one that on its face does not appear to fully value the company. And so we've recommended people vote against the transaction.

We have also said in our document – in our proxy paper – that people ought to consider whether they would like to exercise appraisal rights and that, of course, is the purpose of getting everyone together on this call today.

Kevin Cameron is going to cover the basic outlines of what is an appraisal right, a so-called dissenter's right, how do you go about exercising it, what's the process and cost and timeframe and so forth. So let me turn over the call to Kevin to cover those important topics.

KEVIN CAMERON, PRESIDENT AND CO-FOUNDER, GLASS LEWIS: Thanks, Greg. For those of you who are less familiar with this process, appraisal rights, which are often known as dissenter's rights, are intended to protect the interests of minority shareholders. And the goal is to allow those shareholders to essentially opt out of the proposed deal and instead ask the Delaware Chancellery Court to determine the fair value of the share being tendered. Ultimately, what that results in are the shareholders that elect to seek appraisal end up getting what the Delaware Chancellery Court deems fair value for the shares.

Now importantly, in making that showing to the Delaware Chancellery Court, one doesn't have to show illegal or fraudulent conduct by the board or the management team. Instead, the Delaware Chancellery Court focuses at the end of the day on the simple question of what is fair value for the shares.

There has been a long line of these cases in Delaware and Grant and Eisenhofer was kind enough to provide us with some background statistics. It turns out that when shareholders actually seek to exercise their appraisal rights and, in fact, are successful in doing so, the medium premium above the deal price exceeds 20 percent. And, in fact, there have been instances where the premium above the, quote, "deal price" exceeds 400 percent. So there can be a significant advantage to shareholders to electing to follow this process.

Now the process itself, is somewhat convoluted and is to be approached with some caution. And we again urge you to consult with your in-house counsel and Delaware counsel. There are certain issues that may turn on your particular situation and thus the information I'm about to give you is really a general overview.

So the important and crucial elements under Section 262 of the Delaware General Corporate Law are first and foremost you have to be a holder as of the record date. You will then get a notice from the company. And you then have to make a demand for appraisal prior to the meeting date. The form you fill out to obtain the appraisal is relatively straightforward. You simply need to list your name and elect appraisal.

Another crucial point is, having made that election to seek appraisal you have to hold the stock from the date of demand through the effective date of the merger. Perhaps even more importantly, you cannot vote in favor of the merger or consent to the vote in writing.

After you've made the election, you have 60 days to change your mind. So there is an element of an auction here which everybody can avail themselves of. And once you have made an election and held the stock through the effective date of the merger then you have a period of 120 days in which you have to file a petition for appraisal. If you don't file the petition for appraisal your election of appraisal is essentially wiped out and you get the merger consideration.

However, once you do make your petition for appraisal the company has 20 days to respond and they have to include in their response a list of all the shareholders who have requested appraisal.

Once that process has begun the Delaware Chancellery Court steps into the picture and the legal proceedings begin. There are really two ways that one can fight the fair value determination. One is to simply argue that there are valuation flaws in the way the company has determined their merger consideration. And this has the benefit of being a relatively straight-forward process. There's no discovery or little discovery and one's really arguing over what the appropriate valuation metric is.

That, while faster, may be a less thorough outcome than delving into the more time-consuming question of– did the merger consideration truly reflect the prospects of the company. That raises a whole series of questions which may or may not be applicable here: bad management, excessive compensation, poor allocation of capital, et cetera, et cetera.

The problem with this approach, as you might imagine, is it requires delving and doing a thorough scouring of the company's records, which can be a very time-consuming process, requires the hiring of experts, et cetera, et cetera. It usually, but not always, also entails a decent number of depositions, document requests, all of which come with attendant time delay and expense.

Now regardless of which path one elects to follow, the company can also undertake what's called an entitlement determination in which the company will go through very carefully and review to make sure that those who have elected to seek appraisal actually qualify under the statue. And the company is required to list a notice of defects with respect to each and every party seeking appraisal.

With those two paths underway, the Delaware Chancellery Court will then hold a trial. As a general rule, the trial is one week to two weeks at most, and judgments generally are delivered within a month or so thereafter.

In looking at the question of "What is fair value?" which at the end of the day is the key question the Delaware Chancellery Court is going to address, there are a couple of important points to remember. One is that the court is going to look at fair value as of the date of the transaction, not as of the date of announcement of the merger, not as of two weeks prior to the merger, not as of two weeks after, but as of the date of the merger. That's a very important point for obvious reasons.

Two, is in looking and in making this determination the court is going to exclude any synergies or other attendant benefits that come from the announcement of the merger. The goal at the end of the day, remember, is that the court is looking to determine what is fair value for the company if it were sitting there on a standalone basis without the prospect of the proposed merger. As a consequence the court is going to ignore issues such as synergies or any other benefit that might come as a consequence of the merger.

GREG TAXIN: That being said, Kevin, the court has in the past applied a takeover premium to that standalone value though not admittedly a synergy or cost-savings calculation.

KEVIN CAMERON: And in looking at the actual calculations themselves, perhaps unsurprisingly, the court as a general rule looks to a discounted cash flow analysis. There have been instances, certainly, and there is no statutory requirement that other methods are precluded, but that seems to be the default metric used by the court.

There are instances where the court has used a comparable transaction and/or a comparable company's analysis. One gets the sense though in reviewing the case law that the court's inclination, if not default, is to look at the discounted cash flows. Now as a general rule as well, I think it's fair to say that the court is most skeptical of deals that involve significant related party transactions. It is certainly not a requirement.

In Cede & Co., a case brought a few years ago, the court looked at a process that involved at least two bidders, yet considered the fact that the controlling shareholder was seeking to retire and sold what many sitting there in the abstract would have said was not the most opportune time. One, in fact, triggered a significant tax liability for all of the shareholders. And that was a case where those who elected to seek appraisal rights received a significant premium over the merger consideration.

So while the court is definitely skeptical of deals that involve related parties, significant executive compensation payments, et cetera, it is certainly not a requirement under the statute. Now with that said, I think I will turn it back over to Greg to discuss a few of the intricate details that would have to occur between now and the time of the shareholder meeting if one did want to seek appraisal.

GREG TAXIN: OK, thanks, Kevin. I think the important thing to be mindful of here is that this is a highly technical area of the law and as the company says in its prospectus, shareholders who don't follow the exact prescriptions of the law may be left with just the merger consideration and no ability to participate in the appraisal proceeding. So we encourage you to follow the procedures carefully and let me see if I can outline them as I understand them and again, seek your own counsel on this.

Investors seeking appraisal rights must file a notice with the company, must mail it to the company's San Francisco address and it must be received before the meeting date, which is next Wednesday, with a statement of intent to exercise appraisal rights. That notice must be signed by the registered owner of the shares as of the date of the demand letter or of the notice of intent.

So for most institutions, that registered owner is going to be a custodian or the custodian's master custodian. It is not likely to be the institution. So this is a notice you'll need to go to your custodian and get– to the extent that they're the registered holder – get them to send such a notice indicating the name of the holder, the address of the holder, and your intent to exercise appraisal rights. And again, that has to happen before the meeting date.

Once that happens, the company is required upon consummation of the deal – closing of the deal – to send a notice to everyone who has provided them an appraisal demand and they must do so within 20 days. So you should look out for that notice. You will not receive any merger consideration. You will be in this somewhat of a nether region where what you have is really the right to the results of the appraisal proceeding. You no longer have common stock. That means you will not be entitled to vote, to get dividends, to have any of the rights of a shareowner but instead you've got a right to this sort of contingent payment that depends on the outcome.

Now you may, as Kevin said, within 60 days change your mind and decide instead to take the merger consideration. And that is, in a sense, a free option because you can at any point send a letter to the company and say, "You know what, I've changed my mind. Send me the merger consideration." And you will get exactly what you would have gotten in the deal.

What happens during those 60 days that might help you or inform you is any person seeking appraisal can file a petition in the Delaware court to begin an appraisal proceeding. Indeed, anyone seeking appraisal must file a petition within 120 days but certainly someone could file before then.

You can also make a demand upon the company for a list of the number of shares or statement as to the number of shares seeking appraisal, and they must respond to you in that request, promptly. And so by the end of the 60 day period, you could have a sense of how many other shares are seeking appraisal which will give you a sense of how the costs of the proceeding are likely to be shared. I think, as Kevin mentioned, in general the Delaware Courts permit the cost of attorneys and evaluation experts, and other pocket costs incurred by an investor who is seeking appraisal generally allow those costs to be spread across all of the people seeking appraisal.

And so one of the important things you might learn in those 60 days is am I going to have to pay for this all myself? Or are there other people in the boat with me, with whom I can share these expenses and costs, so that it makes sense for me to proceed in the appraisal proceeding.

The next step after getting a notice back from the company is to file within 120 days of the close of the transaction a petition for appraisal in Delaware Court. That petition is a very simple form. It's essentially a short form. It does not require weeks upon weeks of lowering. It's actually quite a simple statement that you're seeking appraisal. And that kicks off, as Kevin said, the proceedings. So the requirements on an institution are get a demand letter before next Wednesday. Make sure it's signed by the registered owner. And then, within 120 days of consummation file this short form petition in the Chancellery Court in Delaware that expresses your continuing interest or intent on appraisal.

We've droned on long enough. Let me – we've got a bunch of questions which came in over e-mail. I guess I should repeat how we're doing this. We're not going to take live questions on the call. Instead, we would prefer if you would e-mail them to proxytalk@glasslewis.com. And some of you all ready have – after we invited you on this call. So we'll start with those questions that were all ready sent. And then you should feel free to continue to ask questions and send things along.

Let me first ask Kevin, what are the risks to this proceeding? What are the downsides that investors ought to be very mindful of as they think about exercising appraisal rights?

KEVIN CAMERON: Well, I think certainly an obvious one is that you are putting yourself in the hands of the Delaware Chancellery Court to decide what is fair value. And while historically, certainly many shareholders who have petitioned for appraisal have received very favorable verdicts out of the Delaware Chancellery Court, there's no guarantee, and you can – as Providian points out in their proxy – certainly receive the same consideration that you would otherwise receive, or in fact, you could receive less.

GREG TAXIN: But there are, I think, important examples of people who sought appraisal rights, only to be told by the Delaware Chancellery Court that the company was actually worth less than the merger consideration and they end up with less. So that is a very certain economic risk.

We should also say that the Delaware Court may award interest from the time of the closing of the merger, to the time that a final determination is made as to value. It's not required. I think it is typical that they do. They generally award it based on the cost of capital – cost of debt capital of the buyer, which in this case given the buyers of bank, is going to be low. But historically, it has ranged in the nine percent range, but my guess is here, it would be less than that. And again, it's not required though it is often awarded.

Kevin speaking of that, what is the timeframe people should expect this to take -- from the date that the merger closes to the time a final determination has reached appeals if there are some, and so forth?

KEVIN CAMERON: I think as a general rule, depending on the vagaries of the T&3 (ph) Court's docket, and which guys (ph) one ends up in front of, it's a fair assumption to say that one would end up with a verdict out of the Delaware Chancellery Court within a year. And appeal tacks on another year. So certainty as to the amount within a year, and either party can obviously appeal which could add a year.

GREG TAXIN: OK. We have a question from one of our pension fund clients. "How will the legal costs be allocated or shared among participants?"

KEVIN CAMERON: As a general rule the costs are shared pro rata, among all of those that elect to seek appraisal. There have been instances, where the court has required the company to pick up the costs of those who elect appraisal. That, however, is certainly the exception rather than the norm.

As Greg pointed out earlier, however, there is an important point to be made here which is given the 60 day period during which one with can withdraw one's election of appraisal, and given the fact that one has the right to request a list of all others who have sought appraisal, one can certainly elect and at some point during that 60 day period, submit to understand who else has elected to seek appraisal to have a sense of whether one is, in fact, the only one who is elected to seek appraisal, and thus would be the sole bearer of all of the costs.

GREG TAXIN: And while it would be improper for us to guess at what our lawyer friends in Delaware, and evaluation experts and others might charge to help in a proceeding like this, it's important to be mindful that there are hundreds of millions of shares here. I guess the number is about 300 million shares, 295 million shares call it, out standing, if 10 percent of those, hypothetically were to seek appraisal that's 30 million shares. Again – I – without wanting to pump up our Delaware friends or deflate them, if the cost of a proceeding were even $3 million of legal bills and other expenses over a 12 month period, and it was shared among 30 million shares, that's about 10 cents a share.

And so today, the merger consideration is $18.71. We think there's up side into the low 20s. And so you're talking about potential costs worth maybe 10 cents a share. And obviously that's some rough math, and you'd have to look harder at that, and talk to people about it, but I wouldn't think your costs would be so prohibitive as to make this unfavorable assuming that a fair number of other people get into the boat with you. And that's something, obviously, you get a chance to look at.

Kevin we have another question which is, "As of what date is the company valued?" And I guess we covered how the company is valued, but on what date is the company valued? And in this case, of course, there have been some transactions subsequent to the board's agreement. Do those end up coming into play?

KEVIN CAMERON: They certainly do. They are important because the court is going to be looking at the value of Providian as of the date of the vote. And …

GREG TAXIN: The close of the deal.

KEVIN CAMERON: The close – I'm sorry. And the important point there is that if there have been any positive changes in the business between the time the merger was entered into and the date of the close, when the court sits down to look at the fair value of the business, as of the date of the close, they are certainly going to be mindful of those positive changes in the company's economic position.

GREG TAXIN: It's also the case that the court has in the past used comparable transactions to help it get its arms around valuation. And here you've got two transactions that took place, after this agreement was signed, both of which, I think, are quite helpful on the topic of valuation. And it's also the case, that the company had a very strong second quarter, which was announced after the deal was signed. And certainly, what we've heard from Street analysts, and I think, what probably many people on the call, internal analysts believe was that the company was on a good trajectory and performing stronger and stronger every day.

We've got a question here about how does someone hold this on their books after the merger closes? And how do you calculate NAV, with respect to this security or entity that you own? And I'm embarrassed to tell you it's a complicated answer and I'm not sure I know all of the complications. It obviously depends on the type of fund we're talking about and that even can have an implication for whether you're even able to hold a security like this or a right that's like this.

It's really a right of contingent payments in some sense, not really an equity. And there are important implications for whether you can hold that in certain types of funds. And whether it goes into a basket, or not in to a basket and other things, kind of depending on how your fund is set up. So it's a question that I encourage you to pursue with compliance and legal people at your shops and not one, frankly, I really know the answer to. So I'm sorry to the person who asked that but it's the best I can do. Kevin, we have another question here about what happens if your shares were out on loan on the record date. What implications are there from that?

KEVIN CAMERON: Well that's a very tricky question, and one that is near and dear to my heart as some of you know. As I mentioned earlier, the trick is to have held the securities as of the record date. However, it's not clear under Delaware that that is absolutely required. What's required is that you make a notice of demand prior to the effective date, prior to the medium date, I should say. And also, importantly that your shares not be voted against the merger.

The problem, obviously, therefore, is if you had linked your shares out as of the record date, you may have no knowledge as to whether they were voted for or against the transaction. So that makes it very unclear as to whether you've actually met the statutory requirements.

So that is the safe answer, and in fact, many of you who were on the call have already worked with us in this arena, to actually make sure that all of your shares had been recalled prior to the record date. Thereby ensuring if you want to seek appraisal rights, you can be double sure your shares were not loaded in favor of the proposed transaction.

GREG TAXIN: I have another question, we actually got from two people the same question, which is what do I do if I own WaMu also? And probably most of our clients own both – many of your clients will own both Providian and Washington Mutual. And so how do you think about that problem?

Our advice to people is that this is a good deal for WaMu. We believe it's buying Providian on the cheap. That may be too colloquial, but anyway, we think WaMu is getting very good deal. And so as a shareholder of WaMu, you should be happy that they've negotiated such a terrific deal, apparently without competition. And you should want the deal to go through. On the other hand, as a Providian shareholder, you'd just as soon soaked up more value. So what do you do?

Our advice is to abstain from voting in the Providian vote, so that you don't harm the chances of the deal being approved, and insuring to your benefit as a WaMu owner, we think it's perfectly fine for you to abstain as a Providian shareholder, and seek appraisal rights, or consider seeking appraisal rights, and try to get, if you will, kind of an unfair share of the consideration that's being paid across all Providian shareholders.

So other Providian shareholders may be satisfied with $18.71, you as a WaMu shareholder think that's great. I suppose the more of those people, the merrier in terms of your perspective as a WaMu shareholder. But that doesn't mean you have to accept $18.71 as a Providian shareholder. You can be with the smarter, unusual shareholder that seeks appraisal rights, for example. So there are lots of ways of skinning this cat and thinking about it.

We would encourage you to think about abstaining from the Providian vote, and seeking appraisal. And we believe that probably maximizes value to your fund overall with your WaMu holdings, and your Providian holdings. Though, again, that's something that may depend a little bit on how much of each you own in your portfolio. So for example, if you own very little Providian and a ton of WaMu, you might actually want to affirmatively vote in favor at Providian to help push that deal along since it's not the economic value that you'd be giving up – or potential value – as part of the appraisal proceedings.

So lots of things to think about. But I would think in general, you'd want to abstain from the vote, and seek appraisal rights, at least that's one possible outcome. Let's see, we received another interesting comment from someone on the call and I will summarize it. He is aware that there may be some entities and funds that are being put together to help with liquidity issues around this. And that it's possible that a market could emerge for these rights.

I don't know really any of the legality around this or the process or procedure, but I suppose it's possible to imagine that just as some funds have cropped up around litigation receipts, and securitized litigation receipts, that someone might come along, if you were seeking appraisal and offer essentially to buy your interest in the appraisal proceeding and securitize it.

Needless to say, I don't know how one does that, but it appears, at least from the comment we're getting from one of our clients, that there are some people talking about it and potentially, you know, will be out there offering to provide liquidity to people who have got appraisal rights and no assurances that actually comes to fruition of course, but it's interesting. It's an interesting idea. I certainly hadn't thought of it before and maybe we'll hear more about whether that's really going to happen or whether it's possible.

With the 60-day option here to take a look at the appraisal and always be able to opt back into the merger consideration, one might think this might be a reason to hang around and see whether or not during that 60-day period a market like this or a securitized offering were to emerge.

GREG TAXIN: You know, one of the questions here is, is there a risk that that the deal doesn't even get approved and then where am I? And I guess the answer to that is you're back loading (ph), Providian as a going concern and all of this conversation about appraisal rights sort of goes out the window.

We don't think that's cause for much alarm. We think Providian was performing quite well and if you look at the street consensus EPS estimates for 2005 and 2006, they've run an upward trajectory over the last 18 months or certainly a year as the street got more and more confidence in the ability of Providian to generate an economic return as a standalone entity.

So it’s certainly possible that if enough people abstain or vote against that, that the deal doesn’t get approved. If you vote against, so the deal doesn’t get approved, but we don’t think you should – you should be shaking in your boots about that because I think this is a company that, as I say, is performing quite well and can stand alone.

KEVIN CAMERON: Yes, I think one final question that has come up a few times, which people may have missed earlier, is simply the expense involved and as Greg said, well, we can’t put a tally on what Delaware counsel and all the associate experts would charge. Certainly, history shows that a million dollar expense would certainly not be unlikely or unreasonable and then it really becomes a question of how many shares is that being spread over.

GREG TAXIN: I think – let’s see, I think that pretty much covers it. Kevin and I are in the office today and tomorrow and we welcome any of you to follow up with us directly and we’ll try to be as much help as we can and can point you in the direction of some materials and some counsel that may have expertise on this topic. But as I say, we’re happy to help.

Please remember, if you’re interested in pursuing this remedy, you really need to get cracking so that you get a notice sent to Providian before the meeting date next Wednesday and it has to be signed, most likely by your custodian. So it may take some effort.

With that, we will leave you. We thank you for joining us. We encourage you to seek your own legal counsel. I’ll say again, so it’s a broken record, but we think it’s important for you to do that and quickly note that we host these sorts of proxy type calls monthly.

For more information about the conference call series, you can always e-mail us at proxytalk@glasslewis.com, and if there’s ever a particular meeting you’d like to discuss or have us discuss, we’re happy to take your suggestions and do so. We’re working on a couple of control contest proxy talk sessions for the next month or so, and of course, your feedback is always welcome. And I think everybody knows how to reach us. You can reach our San Francisco office and through that, Kevin and me here at 415-678-4110. Thank you all for joining us.

OPERATOR: Ladies and gentlemen, this does conclude today’s teleconference. We thank you for your participation. You may disconnect your lines at this time and have a great day.

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