WACHTELL, LIPTON, ROSEN & KATZ

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To Our Clients

Tender Offers; State Takeover Laws

In Matter of Pabst Brewing Co. and APL Corp., (Wisc. Commr. of Sec., June 6, 1978) it was held that the proposed exchange offer of APL subordinated debentures for up to 52% of Pabst stock violated the "fairness" requirements of both the Wisconsin Blue Sky Law and the Wisconsin Takeover Law on the basis that the earnings of APL did not meet the debt service on the debentures and that APL would be dangerously leveraged. With respect to the Wisconsin Takeover Law the opinion contains a number of significant holdings:

1. Coercive tender offer doctrine; effect on remaining shareholders of the target. This is the first decision to recognize explicitly that fairness to the nontendering or prorated shareholders is at issue in a tender offer. The Wisconsin Takeover Law requires "fairness" to all offerees -- interpreted here to mean remaining as well as tendering shareholders. The Commissioner found unfairness to the remaining shareholders because the raider would have to divert the target's assets and earnings to the raider in order for the raider to service the debt incurred for the partial takeover. The opinion states:

> "As we have mentioned, our responsibility under the Wisconsin Corporate Take-Over Law goes not only to persons who accept the Offer and whose tendered shares are purchased, but also to those who will remain Pabst shareholders after the transaction, since both are offerees. Unfairness or inequitableness as to either variety of offeree results in a finding that the Offer fails the statutory test.
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> "The only feasible method by which APL could service the debt it would incur through the issuance of these Debentures would be to gain working control of Pabst's resources. The diversion of Pabst's assets and earnings for such debt service purposes, however, would work a severe hardship on Pabst and its remaining shareholders. For although APL, having acquired a control position in Pabst (possibly a majority

position), might initially channel Pabst earnings to itself in the form of increased dividends, which of course would go also to the minority shareholders, such an application of Pabst's internal capital would be seriously detrimental to the brewing company's long-range interests. Furthermore, it is unlikely, in such a circumstance, that Pabst could borrow the funds it will take to permit the firm to maintain its competitive position in the brewing industry. Minority shareholders in an APL-controlled Pabst, therefore, could expect little growth (or more probably a decline) in the earnings of their firm. And when the earnings begin to fall, dividends will have to decline, the market price of the stock will drop, and Pabst's days as a major competitor in the brewing industry will be numbered.

"If APL is successful in obtaining a large enough percentage of Pabst shares, the scenario changes slightly, but not to the advantage of the minority shareholders. After some period of time, APL may move to eliminate all remaining Pabst shareholders in order to gain unfettered access to the company's assets and earnings. Indeed, in his testimony in these proceedings, APL's president confirmed his company's intention to attempt, ultimately, 100 percent control of Pabst. The effect of such a "squeeze out" would be similarly detrimental to public shareholders of Pabst. Although the law provides the affected shareholders with certain rights to be fairly compensated, one might reasonably expect that Pabst's financial and operational status by that time would not justify as high a price to those shareholders as if Pabst had not been used to support APL's debt.

"Whatever APL's actions once it gains control of Pabst, it is more than likely the impact on remaining shareholders will be negative. They will have no effective voice in management; their continued investment in the firm may be subject to involuntary termination at an inopportune time; and they will be forced to wait for the other shoe to drop. That shoe, we have suggested, will not likely fit those shareholders' financial needs and investment objectives. Therefore, we find the Offer unfair and inequitable to those offerees who remain Pabst shareholders after the Offer is completed."

2. Fairness of offer price. The Commissioner held that while Wisconsin would continue to defer to the market in cash offers and allow the shareholders of the target to decide for themselves whether or not to accept the price offered, in exchange offers there would be a substantive determination with respect to securities offered in exchange. The opinion states:

> "It is one thing to say, as we did in EZ Paintr, that we place great reliance in the market mechanism to assure fairness of the price in a cash tender offer, and it is quite another to expect efficiency from the market mechanism where the primary consideration being offered is a $26 principal amount 10 percent 20-year subordinated sinking fund debenture of a highly leveraged company with inadequate earnings coverage. The question is not whether Pabst shares are today worth $28 (for this is a decision we would leave to the market), but rather whether Pabst shareholders, in the circumstances, are being offered anything of discernible value for their shares (other than the $2 cash) and the extent of the risk they are being asked to bear."

3. Disclosure. The opinion accepts the TSC Industries v. Northway, Inc. disclosure test as being applicable to tender offers and finds no disclosure violation. On this aspect there was reliance on compliance with the SEC comments after extensive SEC review.

4. Illusory offer. The opinion rejected the argument that where a condition to a raider's offer was triggered when the offer was made, the offer is fraudulent because it is illusory. The opinion states:

> "One aspect of the transaction challenged by Pabst is the effect of the so-called "litigation-out" clause of the Offer. Pabst argues the Offer is fraudulent (or, at least, unfair and inequitable) due to the undisputed fact that APL presently has the right, under that clause, to abandon its Offer at any time. This is because the Offer is made on the condition, among others, that no action or proceeding before any court or governmental agency, challenging APL's acquisition of Pabst shares or otherwise relating to the Offer, be 'threatened, instituted or pending.' Since there are presently at least two such proceedings pending in this state alone, and several more in other states, it is argued APL's Offer is disingenuous and illusory.

"As a matter of contract law, an offeror has full discretion over the terms of his offer. He can create in the offer limitations and reservations as he pleases, provided the offeree is so informed before the offer is accepted. The only restriction is that the offer must contain sufficiently definite terms to permit a reasonable inference that the offeror intends an agreement to result. Any offer may be revoked or withdrawn at any time prior to acceptance. Furthermore, an offeror's promise to perform is not rendered insufficient by the fact it is conditional even upon a voluntary act of the offeror himself.

"Nearly every tender offer that has come to our attention includes a variety of "out" clauses dealing with every imaginable subject (e.g., wars, bank failures, pestilence, law suits, and business climate) giving the offeror the right to abandon the offer if one or another of the conditions occurs. In every case, the offeror claims the right to make the sole determination as to the existence and effect of the contingency. Thus, if APL's Offer is illusory, so too was nearly every offer we have seen in the last five years.

"We do not believe a broad "litigation-out" clause, even one that presently may be invoked, makes APL's Offer illusory; nor do we think the Offer is unfair or inequitable on this ground."

5. Avoidance of state takeover laws. The opinion notes that where a state takeover law does not require that the offer be made to all shareholders of the target in the state, it may be avoided by not offering in that state. "Without [a provision requiring the offer to be made to all shareholders in Wisconsin], an offeror could easily avoid the regulatory requirements of Wisconsin law and make the offer elsewhere, leaving non-participating Wisconsin shareholders to fend for themselves. If the offer proves successful, the Wisconsin shareholders could find themselves involuntarily holding a minority interest in a company controlled by the offeror. They would now own shares of a radically different entity, probably with totally new management and objectives, without having had the benefit of the protections afforded by Wisconsin law (including a "fairness" review by the Commissioner). But see Great Western United Corp. v. Kidwell [439 F. Supp. 420, 437-39 fn.8 (N.D. Tex. 1977).]"

6. Market manipulation. Although rejecting the argument on the facts, the opinion notes that buying a position in a target and then attempting a tender offer with the real objective not of takeover but of attracting a white knight so as to sell the position at a profit, would be a blatant violation of the Wisconsin and federal securities laws.

7. Tender offer as an "offer". "An interesting question arises as to whether a tender offeror is actually 'offering' anything. (The term 'tender offer' itself is confusing, since it is not the offeror who is tendering.) 'Take-over offer,' under Wisconsin law, is defined as 'the offer to acquire or the acquisition of any equity security of a target company, pursuant to a tender offer or request or invitation for tenders . . .' (Emphasis added). Wis. Stat. 552.01(5). One might well conclude that a so-called tender offer, particularly one in which the offeror retains an unqualified right to refuse tendered shares and abandon the transaction, is really not an offer at all (in a common law contract sense), but rather a request or invitation for tenders. Lowenschuss v. Kane, 520 F.2d 255, 265 n.9 (2d Cir. 1975) is often cited for the contrary proposition; however, in Lowenschuss, Gulf & Western's offer contained no requirement that a tender be accepted for payment by the offeror or that any other condition be satisfied before a valid purchase contract would be consummated. 520 F.2d 255, 264."

M. Lipton