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To Our Clients:

Tender Offer Strategy:
Lessons From The Pullman Contest

The Pullman takeover contest produced several important lessons in takeover strategy. It also resulted in an SEC amicus brief arguing, and a Seventh Circuit decision, that an amendment increasing the number of shares sought in a tender offer is not a new offer and does not trigger any of the minimum periods provided for in the Williams Act or the SEC Rules; all that is necessary is that the offer be open for a few days after announcement of the amendment to assure adequate dissemination of the amendment.

The Pullman battle opened with a cash tender offer by J. Ray McDermott at $28 per share for only 2,000,000 of the approximate 11,150,000 outstanding shares of Pullman. No second-step acquisition was proposed. Prior to making the tender offer McDermott had purchased 510,000 Pullman shares in the open market. The McDermott strategy was designed to enable it to defend against an antitrust action by Pullman on the ground that it was not then seeking control and to present Pullman with the alternative of (1) McDermott as a 22% shareholder who would eventually seek to force Pullman to agree to an acquisition by McDermott in a transaction that solved any antitrust problem or (2) Pullman forthwith seeking a White Knight to outbid McDermott. In other words, the McDermott strategy was to get 22% now or to smoke out the price at which Pullman would sell and then top that price and acquire Pullman or, if the price was too high, sell its 510,000 shares at a profit. In large measure this strategy was modelled on the 1975 Crane exchange offer for Anaconda.

Pullman countered with the usual response -- an antitrust suit and a White Knight search to find a better deal if the antitrust suit was not successful. Pullman's attempts to preliminarily enjoin McDermott's bid on antitrust grounds subsequently proved unsuccessful, and Pullman, a financially troubled company, found the quest for a White Knight difficult. Eventually Pullman found Wheelabrator-Frye. To induce Wheelabrator to enter into a firm agreement for a tax-free merger with Pullman at $43 per share in market value of Wheelabrator common stock, Pullman granted Wheelabrator

options to acquire Pullman's engineering and construction division for $200,000,000 and to purchase from Pullman 1,800,000 unissued Pullman shares at $36.875 per share (the NYSE closing price on the day the option was granted), which options were exercisable if the Wheelabrator $43 bid was topped or Pullman did not complete the merger. The merger agreement provided for an immediate cash tender offer by Wheelabrator for 2,000,000 Pullman shares at $43 per share with Wheelabrator reserving the right to take up to but not more than 4,000,000 shares. The Wheelabrator tender offer was to expire on September 19.

McDermott responded with a $43.50 per share cash bid for 6,300,000 Pullman shares conditioned on a minimum tender of 5,400,000 shares and the nonexercise of the two options granted to Wheelabrator in the merger agreement. McDermott attempted to treat its new bid as an amendment to its original $28 bid for only 2,000,000 shares and thereby avoid recommencing any of the minimum periods other than the 10 calendar day proration period specified by the Williams Act when a tender offer is amended to increase the price. Thus the McDermott $43.50 offer would have expired before the Wheelabrator $43 offer and since arbitrageurs and professional investors, more concerned with immediate realization of their profits than a possible tax-free merger three months in the future, would tender to McDermott, it could be expected that McDermott would have obtained control of Pullman even though its second-step could not have been tax-free.

Pullman attacked the McDermott bid on the ground that it was a new offer, not an amendment, and therefore the full 20 business day offer period and 15 business day withdrawal period should apply. The U.S. District Court in Chicago held that McDermott's $43.50 bid for 6,300,000 shares was so materially different from its original $28 bid for 2,000,000 shares that it should be treated as a new offer with the 20 and 15 business day periods being applicable.

McDermott then amended its offer to comply with the court's decision that it remain open for 20 business days and that there be a 15 business day withdrawal period. However, the McDermott offer specified the statutory 10 calendar day proration period and that all shares tendered after the 10 day period would be accepted on a first-come, first-served basis.

Concurrently, Wheelabrator negotiated revised merger terms with Pullman. The new bid was $52.50 and, again, the cash portion was limited. This time 3,000,000 instead of 2,000,000 shares were sought but the 4,000,000

share maximum was retained. When the new bid was announced the second-step, tax-free common stock merger had a market value slightly greater than $52.50 per share. This new bid by Wheelabrator was treated as an amendment of its original bid and the September 19 expiration and proration dates were retained. In addition, Wheelabrator and Pullman entered into a definitive agreement for the purchase, on three days' notice by Wheelabrator, of the Pullman division previously subject to option and Pullman paid Wheelabrator $5 million. McDermott went into Delaware state court to challenge the validity of the purchase agreement and the $5 million payment, but the court denied McDermott's request for expedited relief.

September 8 and 19 became the key dates. On September 8 the 10 day proration period of the McDermott offer would expire and only shares tendered before that date would be entitled to be purchased pro rata. On September 19 the Wheelabrator offer would expire and Wheelabrator would purchase and pay for the shares tendered to it. However, the withdrawal period under the McDermott offer continued through September 19 so that shares could be tendered to McDermott before September 8 to take advantage of the proration period ending on that date, but still be withdrawn and tendered to Wheelabrator on September 19 if on September 19 the Wheelabrator offer was better than the McDermott offer.

On September 18 McDermott had tenders of about 3,800,000 shares. Absent changes in the competing offers, as September 19 approached the issue was whether the professionals who had tendered to McDermott would prefer $43.50 without proration or $52.50 with substantial proration but with a second-step, tax-free merger still with a market value of approximately $52.50.

Wheelabrator and McDermott made their moves on September 19. Before the opening of the market Wheelabrator announced that it would purchase 5,500,000 shares instead of the 4,000,000 share maximum theretofore applicable. Shortly after 3 P.M. McDermott increased its bid to $54 cash for a new maximum of 5,400,000 shares, retaining the conditions that it receive tenders for 5,400,000 shares, that the Wheelabrator option to purchase 1,800,000 Pullman shares not be exercised and that Wheelabrator not close under the contract to purchase the Pullman engineering and construction division. McDermott also announced that it intended a second-step, taxable merger at about $39 per Pullman share. McDermott apparently believed

that the arbitrageurs and professionals who had tendered the 3,800,000 shares would not withdraw from the McDermott offer and would take the $54 without proration. McDermott also was hoping that the first-come, first-served treatment available for additional tenders would enable it to obtain the 5,400,000 shares it sought.

McDermott was wrong. The arbitrageurs did not want to be party to a takeover in which they got $54 per share and the public got $39 per share. The arbitrageurs were fearful that a public outcry, resulting from a situation where quirks in tender offer regulation that by their nature are availed of by arbitrageurs and other professionals to a much greater extent than the public, would result in adverse legislation. In addition, the arbitrageurs were concerned about the conditions to the McDermott offer. If they did not withdraw from the McDermott offer, McDermott would have obtained tenders for at least 5,400,000 shares and Wheelabrator would have terminated its offer. However, the McDermott offer was still conditioned on the 1,800,000 share stock option not being exercised and the sale of Pullman's engineering and construction division not being consummated. If either of the conditions were triggered, McDermott might well have exercised its right to terminate its offer without purchasing any shares. Thus it was possible that instead of two offers there would be none and the arbitrageurs would have a loss instead of a profit. The arbitrageurs were similarly concerned that the 5,400,000 share minimum condition to McDermott's offer may not have been met. By the end of September 19 Wheelabrator had received tenders for 7,300,000 shares and had achieved a clear-cut victory in the marketplace.

McDermott responded with a desperate attempt to upset the Wheelabrator victory through litigation. At 8 P.M. on September 19, shortly after a Delaware state court rejected an attempt by McDermott to have Wheelabrator's amended terms construed as a new offer under the Delaware takeover law, and thus extended, the same U.S. District Court which had earlier held that the August 29 changes by McDermott from $28 to $43.50 and from 2,000,000 to 6,300,000 shares constituted a new offer, held that the September 19 changes by both Wheelabrator and McDermott should be treated as new offers, snatching victory from Wheelabrator's grasp at the last moment. Wheelabrator appealed to the Seventh Circuit and this resulted in the decision that an amendment increasing the number of

shares sought is not a new tender offer. The Seventh Circuit said:

> The district court's order can only rest upon the proposition that the announcement of the increase in the number of shares Wheelabrator obligated itself to buy created a new tender offer, thereby triggering the time requirements of the statute and regulations attendant upon the commencement of a tender offer. We conclude that this proposition is untenable, based upon our reading of the statute and regulations thereunder. Even an increase in consideration is not treated as a new tender offer. See 17 C.F.R. § 240.17e-1(b). It is illogical to assume that when the SEC, acting under rule-making authority granted by Congress, expressly required a ten day waiting period after a change in the consideration offered, id., it intended that an increase in the number of shares sought be the commencement of a new tender offer, triggering more extensive requirements than the SEC thought necessary for a change in the price.
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> It is argued that the regulations treat a change in the number of shares sought as a change in information, requiring the lapse of some reasonable time thereafter during which the tender offer must remain outstanding. 17 C.F.R. § 240.14d-4(c). Under the order appealed from, the offer has remained open while this appeal has been pending. Assuming without deciding that the regulations require the offer to remain outstanding for a reasonable period after the announcement made the morning of September 19, we think that the period of time which has already lapsed since the order of the district court on September 19 has clearly been an adequate period. We therefore see no need to remand to the district court to fix the reasonable time under this theory.

It should be noted that the Seventh Circuit did not directly address the question whether the proration and withdrawal periods, as well as the tender period, should be extended

after an increase in the number of shares sought. These questions are easily avoided if the original offer reserves the right to purchase more than the number of shares originally specified and thereby obviates the need for an amendment.

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