To Our Clients

Takeovers

The General American and El Paso tender offers demonstrate again the dangers of front-end loaded and partial tender offers.

Mesa offered $40 per share for 50% of General American Oil and stated its intention to acquire the other 50% for Mesa securities worth less than $40 per share. General American, being debt free, arranged a $600,000,000 loan to finance a self-tender at $50 per share and after making the self-tender dropped all but the white knight condition so that if Mesa obtained 50% of General American at $40 per share, General American would purchase a major portion of the balance at $50 per share and thereby provide a cash second step giving General American shareholders an average price of $45. Phillips came in as a white knight at an average price of $45 per share and the General American self-tender provided convenient financing for Phillips as well as the assurance of success it sought as a condition to making its bid. Thus the self-tender proved to be both a means of protecting the shareholders of the target against a lower-price-paper second-step after a front-end-loaded tender offer and a means of facilitating a white knight transaction. However, it should be noted that a self-tender of this magnitude is possible only in the rare case where the target has sufficient unrestricted assets to support borrowing to repurchase almost 50% of its stock.

Burlington Northern offered $24 per share for 50% of El Paso and stated its intention not to acquire the balance of the shares in the foreseeable future but to take control of El Paso and thereafter decide what if anything it might propose for a second step. El Paso is highly leveraged and while it determined to seek a white knight, it was recognized that it could be difficult to find one. El Paso had authorized blank check preferred stock. In order to provide some protection to the El Paso shareholders El Paso created a series of convertible preferred stock and declared a dividend of one share for each 20 shares of common. The preferred stock was convertible share for share into common, was noncallable for five years and contained special protection for the El Paso shareholders upon Burlington Northern obtaining control of El Paso. The preferred provided for a class vote for one-third of the directors if Burlington Northern did not propose a "fair" second step within 10 days.

The preferred also provided for a 90% super majority class vote if Burlington Northern attempted a second step other than for cash at the first step price. Burlington Northern attacked the legality of the preferred stock dividend. Before the case was decided the parties reached an agreement that terminated the Burlington Northern tender offer two days before the withdrawal date and required Burlington Northern to start a new partial tender offer with a full pro-ration period that El Paso could urge its shareholders to accept if they wanted to get their pro rata share of the first step. The agreement also provides for minority board representation and fair treatment with respect to a second step.

While the resolution of the General American and El Paso takeovers was reasonably satisfactory, they serve to emphasize the desirability of a staggered board and second-step fair-price charter provisions. They also prove the utility of careful advance planning for structural defenses to takeovers. If General American had restrictive loan agreements the self-tender might not have been possible. If El Paso did not have authorized blank check preferred, the fair-price preferred dividend would not have been possible.

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