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HOSTILE EXCHANGE OFFERS

A rash of hostile exchange offers may be an unintended consequence of the new purchase accounting rules proposed by the FASB. For the first time in the United States, since the pre-Williams Act "Chinese Paper" exchange offers by conglomerates in the 1960s, it will be practical — indeed quite attractive — for acquirers to make hostile exchange offers.

Under the new accounting rules, expected to be effective in June of this year, goodwill will not be amortized but instead will be subject to periodic tests for impairment. Only if the fair value of goodwill has fallen below its book value, will it be written off (in whole or in part). This method of accounting will in many cases be more favorable than pooling in that it will not saddle the combined companies with the restrictions against share repurchases and asset dispositions that encrust the pooling rules.

Because it is so easy to kill a pooling, it is not practical to attempt a hostile exchange offer that requires pooling treatment in order to work from an earnings dilution standpoint. Therefore, favorable accounting treatment through pooling could only be achieved in a friendly negotiated merger. Now in many cases it will be possible to achieve accounting treatment at least as favorable as pooling through a hostile exchange offer.

In 1999, Vodafone (a UK company) took over Mannesmann (a German company) in a $200 billion hostile exchange offer. Indeed, if in a hostile exchange offer the bidder's shares have a higher price earnings ratio and are more acceptable to investors than the target's shares, there is no limit to the size of the hostile exchange offer.

Current market conditions, particularly in the technology, media and telecommunications sectors, with some companies continuing to enjoy lofty share prices and others being oversold, out of favor and selling at prices significantly below real value, are specially hospitable to hostile exchange offers. In some ways the current situation in the TMT sector is reminiscent of the mid 70s to mid 80s in the oil and gas sector. Then we had junk bond financed hostile cash bids, now it may well be exchange offers.

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