

Tender Offers Make a Comeback

New interpretation of old rule makes M&A tool private equity-friendly

Private equity buyers, faced with increasing opposition by target company shareholders demanding a higher price, are reviving the use of an old M&A staple that can help secure deals: tender offers.

Tender offers all but disappeared for more than a decade but are now becoming increasingly used in deals, including the recent takeover of **Biomet**. They became virtually extinct after a 1995 legal decision opened the process up to legal challenges under the best-price rule that could make them prohibitively expensive for buyers. But in December 2006, the Securities and Exchange Commission clarified the best-price rule in a way that reversed the previous, unfavorable interpretation and restored tender offers' usefulness as a tool.

In a tender offer, buyers, whether strategic or financial, do not have to go through a shareholder vote but instead make an offer to the shareholders to buy their shares at a certain price for a certain period of time. The offer is usually made as part of an agreement with the management and has two steps: The first is the tender offer; the second is the post-tender period when the buyer can acquire additional shares. In a typical merger, a buyer must first win support from the majority of shareholders. In a tender, a buyer can go straight to the shareholders and not involve shareholder proxy services like Institutional

Shareholder Services.

"Tender offers are a major antidote to shareholder activism," says **Charles Nathan**, global co-chair of the M&A practice at **Latham & Watkins**.

In the past two weeks, two deals, for **Laureate Education** and **Biomet**, were restructured as tender offers after shareholders opposed the earlier bids. Both buyers raised their bids but changed the deal structure to that of a tender offer. Nathan says he expects other buyers to use the tool.

The agreement has to be written in a way that will preclude a situation in



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which the buyer does not gain a majority. "No one wants a partial deal," says Nathan. To get around it, the agreement has a second part in which the buyer can buy shares in a second post-tender stage. The technique has a disadvantage, however. Private equity buyers typically finance the acquisition with the cash flow of the target. But in a tender offer, the buyer has to come up with the cash to pay for the tendered shares before it has control of the company's cash flow. To get around this, buyers can use various approaches, including bridge financing or financing that uses the tendered shares as collateral.

The best-price rule was adopted in 1986 and was intended to assure that

all tendering shareholders receive equal treatment. In particular, it was meant to guard against some shareholders receiving a higher offer after the tender period is over.

The well-intentioned rule boomeranged, however, after a federal court in 1995 made the rule dependent on a detailed and factual analysis of all other consideration paid to shareholders in a merger, including compensation to the target's management both before and after the tender offer. Such an interpretation of the rule meant that acquisitions via tender offers could become very expensive because buyers could be legally challenged to offer all shareholders the highest price per share, and match any sweeteners that management may have received. As a result, tender offers all but disappeared from the M&A scene.

At the end of 2006, the SEC amended the interpretation and clarified that the rule applies only to consideration paid in the tender offer, not to payments to shareholders who do not tender during the tender-offer period. This helped private equity buyers, because buyouts often involve management rolling over some of the compensation they receive in a deal into shares of the acquiring company.

The new interpretation makes a lot more sense, says **James Abbott**, an M&A attorney at **Seward & Kissel**. "It allows for a quicker opportunity for the shareholders to decide if they want to sell their shares and fewer ways for anyone to delay the process."

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