A WASTELAND

Clint Murcheson was supposed to have said that a man is worth two times what he owes, which made him a visionary in some quarters.

"You should leave, and give us a chance to talk." Joe Lanier, chairman of West Point–Pepperell, was speaking to Tom Foley, chairman of Bib, a small sheet manufacturer. Anger made his words a command. Rarely did Joe Lanier lose his temper, but now his eyes hardened and his mouth twisted, holding back an eruption. It was 2 a.m., and Lanier and Foley had been sitting opposite each other in the conference room for at least fourteen hours, trying to reach an agreement. This was their second day at it, and they were close. If they could contain their bitter feelings, they could adjourn until the morning and begin again after some sleep. Tom Foley, much younger than Lanier, but no less weary, stood up stiffly, followed by his chief financial officer and his two lawyers, leaving without a word to wait in the adjoining conference room.

"We've come so far," Joe said after they had closed the door. "We shouldn't have to quit now."

"There's no way we'll ever make a deal with him on these points," Clay Sauers said. Clay was West Point–Pepperell's chief financial

officer. He spoke slowly and deliberately, reflecting his habitual caution. Joe always listened to him.

"We don't have to agree on everything," Joe said. "We have most of a deal. Tom Foley's agreed to buy J. P. Stevens's institutional sheet and towel business for $122 million. That's what we've asked him to do. That's all that we have to settle tonight."

"We found out a lot about him tonight, Joe," Clay said, reminding Joe that they had just spent over two hours arguing to the point of impasse.

"That we have," Joe acknowledged.

"He's a very tough man, Joe," Clay said.

"That's no surprise," Joe responded. "He's a good businessman. Remember, we haven't been able to find anybody else."

That was true. West Point–Pepperell and its investment banker, Merrill Lynch, had called everyone in the industry to find someone to buy a portion of the sheet and towel business of J. P. Stevens. Tom Foley, who ran Bib, was the only one interested enough to talk, but he wanted every advantage.

The situation at that late hour came to this. West Point–Pepperell was about to make a tender offer to acquire J. P. Stevens, a direct competitor in the sheet and towel business. Ordinarily West Point's bid would be barred as anticompetitive unless it could show that it had a reputable purchaser of a sizable portion of Stevens's sheet and towel business, approximately 20 percent of the sheets and about 50 percent of the towels. Only a sale to that degree would reduce West Point's market share to a level acceptable to the antitrust authorities. Wrestling with selling a large share of a business West Point didn't yet own, and hadn't been permitted to examine, was novel and not easy. Tom Foley would wait until Joe figured out how to proceed, secure in the knowledge that despite his anger Joe would offer up a reasonable compromise. None of us realized that we were embarked on a course of action that would signal the end of the merger wave of the 1980s and of indiscriminate leveraging of companies.

While Tom Foley waited outside, everyone turned to Joe Lanier. There was nothing on the surface about Joe Lanier that expressed his determination or uncommon ability. If you asked him, he'd tell you that there was nothing particularly special about him. He was

down-home. He was a Southerner who lived simply, spending his time with his family. Of little more than average size and full-bodied, he looked soft at every turn, his face full and round, and his figure that of a man who lingered at the dinner table with hearty pleasure. He was now in his mid-fifties, and middle-age spread had been part of his life for at least twenty years. He was comfortable with himself: there was never a suggestion that, like many men of his station, he'd commit himself to some diet or fad that would change the way he looked. That sense of ease and acceptance carried over to his personal and business dealings. He always listened, giving everyone time to make their case, whatever it was. By asking questions, he'd get to understand the matter, however intricate and however convoluted the speaker's motives. Layer on layer of complexity would be slowly peeled apart like towels in a stack, each examined and then pulled back to reveal the next, in an attempt to uncover the crux. If the meaning was worth understanding Joe would try to find it and express it himself. His words were simple and direct and always stated with a slight hint of a question: have I gotten it right? If he hadn't, he'd listen again.

Four generations of Laniers had run West Point–Pepperell, from about 1880, and Joe had worked in the company for about thirty years. The company was headquartered in West Point, Georgia, about an hour's drive from Atlanta, next to the Alabama border. The family owned very little stock, less than 1 percent, and management responsibility came from being involved in the business. In this acquisition, he was pursuing his vision of making the company the leading bed and bath company in America. During his tenure, the company had changed significantly, with emphasis shifting from manufacturing to marketing. What differentiated the products was marketing efforts to replace the clean, white hospital look. By making bedrooms cozy and baths intimate, sheets and towels ceased to be commodities and became an expression of the personality of the house. Highly styled products, cast as unique, offer better profit margins than their utilitarian counterparts and benefit from elasticity in personal budgets. West Point's sophisticated designs had made significant marketing inroads, increasing the firm's market share. Those gains hadn't come about by following a well-tracked path that had been laid down by Joe's forebears.

Business had extended Joe, forcing him to meet and best the competition.

West Point had never done a hostile deal and the thought of doing one made Joe uncomfortable. The closest he'd come to the hostile arena was the acquisition of Cluett Peabody, an apparel manufacturer, in which West Point had been a White Knight. He was aware of the stresses involved in hostile transactions and had acted decisively to buy the company against all bidders. That arena held no lure for him, and he had no particular desire to expand West Point by acquisition. But in mid-February 1988, Whitney Stevens, chairman of J. P. Stevens, announced the management buyout of J. P. Stevens for $38 in cash plus a $5.00 debenture, an aggregate price of $43 per share. The announcement of a proposed sale of J. P. Stevens prodded Joe to reevaluate his thinking about acquisitions. He began to consider buying the company.

Five generations of Stevenses had run J. P. Stevens since its founding prior to the Civil War. The company's headquarters were in New York, but its textile factories were located in the South, like West Point's. Whit Stevens, the chairman, was a soft-spoken, quiet man, more bookish than outgoing, conscious that the history of his family was entwined with the development of the United States. His father had been Secretary of the Army under Eisenhower, and like him, Whit Stevens was used to command. But there was nothing harsh in his manner, and he was accessible. Although the family name was on the door, the family owned very little stock in the company, like the Laniers, less than 1 percent. Although chairman, Whit Stevens had little to do with the operations of the company, but he wanted to keep the company independent or at least to control it. Twice in the last few years the company had paid greenmail to buy out raiders who had accumulated sizable stock positions in the company. The company paid premium prices for this stock, eroding its equity, subjecting itself to further coercion. Being at the mercy of bullies and extortionists is no way to run a business. Whit Stevens's experiences weren't unique, nor was his distaste for paying greenmail. Like others, he thought about doing a leveraged buyout. An idea like that grows over time, but most often is dismissed for a number of reasons: the stock price is too high, making a buyout too expensive; there are too many likely

bidders once a company is put into play; business prospects are cloudy; and the risks of leverage are too great. All these reasons are substantial and truly discouraging.

On October 19, 1987, the stock market crashed and along with it so did J. P. Stevens stock. For almost everyone the crash was a sobering experience. In the ensuing weeks everyone watched the stock market's trading activity as a recognizable early warning of drastic changes in the economy. Few were willing to take any risks, and even if they wanted to make a corporate acquisition while the prices were low, the banks were wary. But many executives found that while the market had crashed, their businesses hadn't. Companies were induced to buy their own stock because the prices were low, and in that environment, leveraged buyouts became thinkable again. With the J. P. Stevens stock trading in the 20s, it was possible to offer a huge premium for the company and still pay substantially less than it would have cost six months before.

Whit Stevens again took up the idea of buying out his company and contacted Bankers Trust to act as his investment banker. The planning took time, and by the beginning of the year, in January 1988, the merger and acquisition market showed signs that it would be as frenetic as ever. Stock prices, however, hadn't rebounded, making a buyout still look desirable. But there were a thousand judgments that had to be made before announcing a bid, and all the risks had to be measured and understood. With so much at stake, it was important to be careful. And the most important decision was the offering price. Not until February was the decision finally made, and then $43 was chosen—a significant premium over the trading price, which was still in the 20s.

On the announcement of the buyout of J. P. Stevens, the New York Stock Exchange halted trading in its stock during dissemination of the information, and when the stock again opened for trading, the market price was at $48 a share, $5.00 above the bid by Whit Stevens for the company. The market had found Whit Stevens's offer to be a low-ball bid and was betting against his buying the company at any price under $50. The expectation was that if Whit Stevens didn't raise his bid, then others would offer to buy J. P. Stevens at a much higher price. The players were arbitrageurs who were speculating, but they were a highly informed

lot, and their pricing was a sharp criticism of Whit Stevens and his advisers. The reaction of the market professionals was almost immediate. Every day that the stock traded the arbitrageurs held more of it at prices higher than Whit Stevens had thought to offer, which meant that he'd probably have to raise his price.

Not only was Whit Stevens's bid undistinguished; nothing in his situation differentiated him from Bill Stokely when Stokely attempted an unsuccessful buyout of Stokely–Van Camp. Indeed, Whit Stevens had much less stock than Bill Stokely controlled and lacked Stokely's claim to hands-on leadership. Stevens looked like he was seizing an opportunity, taking advantage of the depressed market. If the seismic reverberations of the crash didn't frighten everyone, his bid was an invitation to an auction. And the J. P. Stevens board would have little choice but to orchestrate one.

Whit Stevens's buyout announcement was a total surprise to Joe, and was received the way one views self-immolation. "Does he understand what he's doing?" Joe asked. He paused after he said that, letting the question hang in the air. Whit Stevens had guaranteed that his company would be put up for auction by making an unreasonably low bid. Joe concluded that Whit Stevens had lost his bearings, and Joe remarked, "He's not close to the smokestacks," referring to Whit's permanent residence in New York, far from the company's operations in the South. To Joe, that said everything.

Joe understood the pressures of the marketplace and the imperatives of family control. Whatever Whit had gone over in his mind, Joe Lanier had gone over in his. Joe's interest was in running West Point and keeping it independent, knowing that it was a target company, bound to be attractive to a raider. Like Whit Stevens, he'd seen the appeal of a leveraged buyout: it took the company out of the takeover cycle. But as a practical businessman, Joe didn't like the debt burden that a buyout would bring. Its weight required more than discipline; it made you cut corners and make do with old equipment rather than replace it, which ultimately affected safety, production, and even innovation. But there was some level of debt that he could live with, a reasonable trade-off for the benefit of controlling his company. He more than toyed with the idea: he went through financial plans to see what it would take to buy the

company and concluded that nothing justified a leveraged buyout unless you were directly threatened by a hostile takeover.

"We should buy J. P. Stevens," Joe said. "Someone's going to buy it, and it ought to be us."

"It'll be perceived as hostile, Joe," I said.

"It's for sale," he said. "The shareholders are supposed to get the best price. The arbitrageurs are already bidding against him. There's no reason why we shouldn't put in a cash bid."

"Whit Stevens will see it as hostile," I said.

"No doubt," Joe said. "But the company isn't his private preserve, and he's put it into play."

Joe was committed. He knew Whit and his wife socially and knew that one of the consequences of the bid would be that they wouldn't talk to him again. There was nothing he could do about that outcome. More was at stake than merely the possible breakup of someone's leveraged buyout. A vision had made itself clear to Joe, which he would follow.

Putting the two companies together would create the premier company in the bed and bath markets. J. P. Stevens had licenses for the Ralph Lauren and Laura Ashley brands among others, which presented extraordinary marketing opportunities. What was more exciting, Stevens had profit margins of about 10 percent of sales, compared with West Point's of upwards of 15 percent. Operating efficiencies would help to improve the Stevens margins if Stevens was combined with West Point. That kind of built-in profit growth would permit West Point to pay more than almost anyone else for the business. And acquiring Stevens would significantly increase West Point's debt, at least until it was able to dispose of many of the unwanted businesses. About two years would be required to rationalize the businesses and sell off those that were unrelated, which would make West Point largely takeover-proof during the period. Moreover, after it emerged from redoing itself, it would have at least a third of the market for bed and bath products in the United States, which would entitle it to a higher multiple of earnings in the marketplace, substantially increasing its stock price. Conservatively viewed, the acquisition would help Joe maintain the more than 20 percent compound growth rate the West Point stock had experienced in the last three years, which

again would make West Point more difficult for a raider to acquire. This opportunity of buying J. P. Stevens wasn't to be missed. Accordingly, West Point sent a letter to the directors of J. P. Stevens indicating that it was interested in submitting a bid.

Before the bidding started, Joe Lanier tried to talk to Whit Stevens. The approach was not only to confront the human elements of the contest on a man-to-man basis but also to offer a rational economic deal that could satisfy both of them. Whit Stevens wouldn't talk to Joe, and the economic message was delivered for him through intermediaries representing Whit Stevens's acquisition vehicle, called Palmetto. The representatives were told that West Point was prepared to buy the bed and bath businesses and sell everything else to Whit Stevens. In effect, Whit would be able to retain the carpet and apparel businesses, among others (representing almost two-thirds of the assets of J. P. Stevens), on an assured basis. It was better than half a loaf and should be seriously considered. The rejection by Whit Stevens was almost immediate. After the bidding started, the same proposal was again made and rejected again. After each rejection we tried to determine what would convince Whit Stevens that it was in his interest to join forces with us rather than compete. At first he probably thought he could outbid us, and then he must have looked upon the antitrust barriers as insuperable. The personal acrimony couldn't be bridged.

The committee of independent directors of J. P. Stevens sent out a notice of the auction procedure to be followed, which included blind bids, and invited offers from all interested parties. As always, there was lively interest shown by financially oriented buyers in getting the bidding package, but we thought that few parties would participate. West Point's first bid was $56, against the market price of about $48, which was meant to preempt the field. Whit Stevens, however, made a bid, consisting of cash and paper, that nominally looked like $55. Finding the offers close, the committee called for another round.

In this further round West Point bid $61, again to make a preemptive bid and clear the field of competitors. The bids were taken in on a Friday, and a day after the auction I was called by John Golden, the partner at Goldman Sachs representing J. P.

Stevens, and told that our bid had been leaked to the next-highest bidder of $60 cash, which wasn't Whit Stevens, but an unnamed financially oriented buyer seeking to do a leveraged buyout. We chose not to challenge the failure in the procedure because West Point was given a chance to bid again. The interested party, we found out later, was Odyssey Partners, a group formed to do leveraged transactions. In that round Whit Stevens had thrown his lot in with Odyssey. He could no longer compete and felt that if Odyssey bought the company, the firm would retain the current management.

There was going to be another round, and Joe decided to raise again, from the $61 bid to $62.50, seeking once more to distance West Point from its competitors. At this point, he felt that he'd stretched farther than he thought he'd have to go. Although West Point had the high bid, the committee chose Odyssey at $61.50 because the firm didn't have an antitrust problem. Only after the auction was over, when it could no longer be taken into account for bidding, did we find out that a discount of $2.50 was being applied to West Point's bid to reflect uncertainty of completion based on antitrust considerations. The discounting action was consistent with other barriers imposed, for the committee wouldn't delay the bidding until after West Point cleared its antitrust obstacles, which would have taken about thirty days. Once Odyssey emerged as the victor in the auction by announcing a merger contract with J. P. Stevens, including a breakup fee of $1.00 a share (worth $18 million) if its offering price was topped by West Point, the only way West Point could compete was to commence a counter-tender at $62.50, the price it had bid in the auction. Since it was a dollar better than Odyssey's bid, the marketplace would choose West Point's tender unless the antitrust authorities indicated that they would block the deal.

Although the Reagan administration had considerably relaxed antitrust enforcement, which permitted many domestic competitors to merge, antitrust authorities still carefully watched acquisitions where there were only a few industry leaders. In those cases, the best way to overcome antitrust obstacles was to buy the company sought and then divest those parts that, according to federal guidelines, would lessen competition. Once the acquirer began operating

the business, the necessary divestitures could be precisely calibrated and effected. The government, however, wouldn't go along with buying and then divesting, and favored a procedure known as "fix it first," which involved selling the offending assets (or making arrangements to sell them) before buying any of them. The reason for the government's harsh position was that it had found that companies rarely fixed it after they bought it, or if they did, they were dilatory in doing so. The government didn't have the manpower or necessary funds to monitor activity after the acquisition.

The problem that West Point–Pepperell faced was that it was buying a business which it had never physically examined. J. P. Stevens wouldn't let West Point personnel on the premises. To allow an inspection of assets, the company was requiring that West Point agree to stand still and not make a bid except on terms approved by J. P. Stevens. I counseled against signing the agreement. Accordingly, West Point was in the position of contracting to sell assets that it had never seen. Considering the federal guidelines, we estimated that divestitures of 20 percent of the sheet and 50 percent of the towel business would have to be made. West Point wanted to retain the designer products and sell the institutional product business. The revenue stream of the institutional business was known and the task was to find a purchaser at a reasonable price, approximately $122 million, game enough to buy the institutional sheet and towel business sight unseen. Among the pitfalls faced in such a purchase was not knowing the condition of plant and equipment, which affected future capital costs and the cost of production. Neither West Point nor Merrill Lynch could find such a buyer until Tom Foley called Joe, having read of Joe's interest in Stevens in the newspapers.

Tom Foley had acquired Bib in 1984 when he was little more than thirty years old. After Harvard College and Business School, Foley worked for McKinsey & Co., a management consulting firm, and then moved to Citibank's venture capital organization. It was there that he found Bib and bought it by putting up $5 million of equity (part his own money and the largest part from friends) and $95 million borrowed from Citibank. He left the bank to run the company and within one year he'd paid down a substantial portion

of the debt, partially through selling assets and partially from cost reductions and improved earnings. By the time he'd come to see Joe, after controlling Bib for about four years, Bib's debt had been substantially worked down and it was in a position to make the acquisition. To make this deal, Tom Foley would be betting much that he'd made. Citibank would want Bib to co-sign the loans now that Foley had a successful company.

We all met to sell something that we couldn't describe in concrete terms. The differentiation of the products by end users was conceptual, and didn't necessarily accord with the way they were manufactured. Facilities that made institutional products also made brand-name products, and there was no way to begin to separate, without physical inspection and discussions with Whit Stevens's managers, the different businesses. The only way to make headway was to create an abstract model of a business, the way mathematicians would proceed, which was intimidating for business lawyers and businessmen used to dealing with tangible reality. After J. P. Stevens was acquired, we'd then put together a physical business in a manner most reasonably approximating the model.

Foley was a difficult negotiator. He told Joe right out he was doing West Point a favor, that he was necessary for the transaction, and that without him Joe couldn't proceed. While Joe Lanier was heavyset, Foley was all angles, lean and stringy, sharp edges at the knees and elbows and chin. As the discussions wore on, it became clear that West Point was taking all the risks. The last argument was over the liabilities of the institutional business. Attached to these J. P. Stevens plants would be liabilities, mortgages and other liens, as much a part of the physical aspects of the facilities as the operating fixtures. Foley wanted to be assured that in buying the institutional sheet and towel businesses he wouldn't be taking on any of the liabilities, that West Point would assume all of those. Foley's position was that he had to have a deal that was bankable: in other words, he was borrowing all the money to buy the business, and the bank had to know that there would be at least $122 million of assets (at book value) and matching revenue, without any offsetting liabilities. If West Point couldn't give those assurances, then Foley wouldn't play. Joe Lanier clenched his teeth and asked Foley to leave the room.

"That's one hell of a deal," Clay Sauers said. His words reflected the weariness of making concession after concession.

"He's the right man at the right time," Joe said.

"He never meets you halfway," Clay said, shaking his head.

"He doesn't have to," Joe said, "and he knows it."

"We've given him a near-perfect business," Clay said, "when no business is perfect."

"There'll be warts," Joe said. "The warts are in the leverage. He's going to have to run it to pay down the debt."

"He's young, Joe," Clay said. "He's used to living with all that debt."

Joe paused as if asking himself what would happen if negotiations failed that evening. He couldn't accept or countenance failure. This was a mission, he told me, to save his company and make it grow. He was a regular churchgoer and he'd prayed and promised to devote all his energy to this task and withstand all the pain of dealing with greed, petty peevishness, anger, and exhaustion.

"Being used to it doesn't make it any easier. He'll have to run it," Joe said, appreciating all the operating difficulties never reflected in the financial statements.

"The mortgages and liens that are on the plants go with the plants," Clay said. "He's got to take some bad with all the good he's getting."

"The reason that he's so difficult," Joe said, "is that he's become like us. He may have started out willing to bet everything, but he's built something in Bib and doesn't want to lose it. Let's call him back in to see if we can make a deal." Joe sighed. "Everything always costs a little more than you first thought. But you're right, let's protect ourselves."

Once a deal was struck with Tom Foley, antitrust clearance was in the hands of Jack Izard of King & Spalding, West Point's Atlanta law firm. Jack was a tall, courtly Southerner with impeccable manners which belied his commitment and political acumen. He had to guide the transaction through the Federal Trade Commission in fifteen calendar days, the initial period for antitrust review, and not a day longer. If the commission made a request for additional information, quite usual for a transaction between competitors, the period of time for review would be extended by at least ten calendar

days, which would totally kill the credibility of West Point's offer and push the time for acceptance of shares well past Odyssey's closing date. On that basis, the market would choose the Odyssey bid, although a dollar less. It was the likely possibility of delay that had been the committee's basis for discounting the West Point bid and for favoring Odyssey. West Point was now put to the test of showing that it could clear the antitrust hurdle.

Knowing Jack to be tough and clever, it was still hard to imagine this soft-spoken gentleman ramming the transaction through the commission and its staff in record time. His major tactical weapon was the agreement with Foley that showed that the offending assets would be sold to someone who would be able to manage them and be an effective competitor. But it wasn't a perfect answer, and there would have to be some horse trading with the staff. All the offered concessions wouldn't be seen as enough, and they would try to extract some additional divestitures. Any changes would mean further negotiations with Tom Foley, which would be my responsibility.

Joe gave Jack a free hand to make the decisions as he saw fit. There really weren't enough hours in a day to accommodate all that had to be done, and a lot of the work Jack had to do ran around the clock. Each day I'd get a report, after encounters with all the commissioners and the staff members, filled with storm warnings and the effects of local squalls, averaging individual temperatures and pressure readings. Most days it seemed hopeless, but Jack persisted. Even on the fifteenth day it wasn't clear whether we'd get approved. In fact, at 5 p.m., the ordinary close of business, the commission put out a news release that they had requested additional information, which would mean the crippling of our bid by the additional ten days of review. With that announcement, Odyssey thought it had won. Twenty minutes later, however, the commission cleared West Point. The request for information had been made for the record, without requiring that additional information be produced, to accord with the policy that in acquisitions involving competitors such requests were always made. Immediately Odyssey raised its bid to $64. Since both bidders were now able to acquire J. P. Stevens, price would determine the winner.

In the same way that we'd approached Whit Stevens, Joe called

Odyssey to see if we could make a deal, rather than bid up the price for the company. After the call, Joe concluded that Odyssey's price thinking was way out of line. It wanted to sell the bed and bath businesses at a price practically equal to the price West Point thought it would have to pay for the whole of J. P. Stevens. Not only was it senseless, it was also offensive. Joe was dealing with a competitor that had an inflated estimate of the value of the businesses. The only way for him to get what he wanted was to compete directly by bidding again, but it began to seem hopeless. Odyssey's price thinking permitted it to continue to keep raising. On the final round, Odyssey bid $68.50 against West Point's $67. Odyssey was now at a price beyond which Joe wasn't prepared to raise.

Joe felt that Odyssey had bid itself into a corner, for it would be next to impossible for it to get the kinds of prices it thought it should get from breaking up the company. To confirm his thinking, Joe made an analysis of Odyssey's position. If the new owner of J. P. Stevens sold the bed and bath business, the oldest of the J. P. Stevens businesses with a low tax basis, there would be a profit realized significantly above its tax basis, which would attract a very substantial tax. The tax was punitive in amount and soured the whole deal. The only sensible tax strategy would be to sell the other, more recently acquired carpet and apparel businesses with tax bases close to their current fair value, and retain the bed and bath business. But Odyssey, at the prices bid, was expecting to sell the bed and bath business. Joe concluded that, in the heat of the auction, Odyssey had lost sight of the values (and tax strategy) and would be left with an insurmountable problem if West Point didn't raise its bid. Joe informed the Odyssey partners of his tax analysis, letting them know that he thought they were out on a limb. They realized then that Joe would walk away, and it didn't take long for them to acknowledge their problem. They proposed that West Point swap places with them, which meant that West Point would also bid $68.50 and be allowed to buy all stock tendered. Once West Point acquired Stevens, Odyssey would buy the other J. P. Stevens businesses from West Point. It was a strange situation, one that had never occurred before. Finally someone was acknowledging that it was possible to bid too much.

We were then able to sit down with Odyssey to negotiate the

prices for all the other J. P. Stevens businesses. West Point, however, was in a powerful bargaining position and wouldn't bid $68.50 until it was satisfied with the prices to be paid for the businesses Odyssey wanted. What was clear from the outset was that Whit Stevens was no longer a party to the discussions and that J. P. Stevens would be broken up without any of the Stevens senior management participating. It was more complicated than a mere swap of positions. There had to be a three-way split of J. P. Stevens. Foley and West Point would take the bed and bath businesses, and Odyssey Partners the other textile businesses. (Little more than a year later Odyssey Partners was to feel the effect of the heavy acquisition debt incurred to buy those textile businesses and ultimately put the businesses into bankruptcy to rationalize the debt structure, taking the losses from bidding up the price of the businesses.)

None of us had contemplated an immediate carve-up of J. P. Stevens at the closing. The thinking had been that it would take a year or two to make the dispositions of all the unwanted businesses. The auction, however, had flushed out all the interested buyers. The disposition of the J. P. Stevens businesses to Odyssey and Foley at the closing was an efficient vehicle for keeping West Point from being burdened with cumbersome and unwanted debt. Most of the money that would have been borrowed to buy the whole company (and then repaid from the sale of the parts) didn't have to be borrowed, and West Point's purchase obligations were limited to only those businesses that it would be running directly. Management was able to get on with the job of integrating the acquired sheet and towel brands without operating what would have been the corporate equivalent of a used-car lot, selling textile assets, such as apparel and carpet businesses. Dashed was the hope, however, that putting the two companies together would dissuade others from being interested in acquiring West Point. In many respects West Point looked more attractive now than it had before the acquisition. It possessed a unique market position in bed and bath products, with the largest market share of any company and most attractive margins

No more than six months passed before there were intimations that a takeover bid would be made to acquire West Point. In

October 1988, William Farley, through his company, Farley Industries, offered to acquire West Point at $48 a share, for an aggregate price of about $1.5 billion. Who was William Farley and what was the source of his interest? When I found out, it was as if all the avoidance actions we'd taken had led West Point inevitably into Farley's orbit.

The information available on William Farley was a hodgepodge. Most obvious was the public figure, the man who had thrown his hat in the ring in early 1988 as a Democratic candidate for the United States presidency. In preparation, he'd hired Jack Albertine, one of Senator Lloyd Bentsen's speechwriters, and made him vice chairman of his company. Albertine scripted a series of national television spots, costing about $2.5 million, in which Farley talked earnestly in locker rooms and other sports settings about the benefits of teamwork and good management. One of them had him standing alongside a swimming pool saying, "Just imagine being a diver for a coach who pushes you to do a lot of dives as fast as you can, instead of one perfect dive. Is putting quantity before quality any way to win?" In personal appearances in Iowa, he pledged that he'd reduce the federal deficit, neglecting to mention that his whole business structure was supported by massive borrowings. His candidacy fizzled early in the Iowa caucuses, but the public persona was still on display. He dated a recent Miss America and promoted Fruit of the Loom products on television while shown pumping iron in the ads. Handsome, physically fit, with high-status women on his arm, he cultivated the image of the all-American male from a humble background. He'd grown up in Pawtucket, Rhode Island, where his father had been a postman.

His business success, unlike his image, was spotty. He was an early believer in leverage, embracing the concept of financing with debt as only the undercapitalized can. Though trained as a lawyer, Farley never practiced law. He worked as a financial analyst in mergers and acquisitions at NL Industries (the old National Lead) and then as an investment banker at Lehman Brothers in Chicago. He did his first negotiated deal in 1976 when he was twenty-nine years old, putting up $25,000 of his own money to buy a metals company from his old employer NL for $1.7 million. Until 1984 all his deals were negotiated acquisitions in which he risked everything

he'd earned to keep growing larger. In 1984 he paid $135 million for Condec, using $10 million in equity, outbidding the company's management for control of the company. The acquisition was a financial disaster. The company experienced significant cumulative losses, upwards of $100 million, until settlements were made with the creditors in 1988. But in the merger marketplace, Farley was seen as a success because he'd won an auction. In 1985, before the effects of the operating difficulties at Condec were felt, Drexel Burnham backed Farley against Don Kelly of Esmark in his bid for Northwest Industries, which became Farley Industries. The acquisition price for Northwest was $1.4 billion, a tenfold increase in acquisition size for Farley in little more than a year, engineered largely through Drexel Burnham's junk bonds. In that acquisition Farley sold off all the businesses except Fruit of the Loom, the crown jewel, which continued to grow with the help of professional managers already in place at the company. That billion-dollar acquisition, with the operating success of Fruit of the Loom, gave Farley national business prominence and allowed him to raise money for further deals and settle up the mistakes made in the Condec acquisition.

In February 1988, Farley Industries raised $500 million from junk-bond sales sponsored by Drexel Burnham, $300 million of which would be a war chest to make acquisitions. The bondholders left the target to Farley and Mike Milken, who had placed the bonds with them. Farley's successful management team was at Fruit of the Loom, so he was looking closely at textile and apparel companies. The timing of the raising of the money coincided with Whit Stevens's announcement of the buyout of J. P. Stevens. Once West Point bid, Whit Stevens contacted Farley and had him look at the company and its prospects, in the hope that Farley would serve as a White Knight. Farley did a study of J. P. Stevens and became familiar with its business, but declined to bid. Stevens alone wasn't an inviting target for him. But half a year later Farley hadn't found a target, and West Point and Stevens together became a very interesting acquisition opportunity.

The $500 million of junk bonds issued by Farley Industries bore annual interest of from 14.6 to 15.6 percent, costing about $80 million a year. There weren't sufficient earnings in Farley Indus-

tries (including the earnings from Fruit of the Loom) to come anywhere near to covering those carrying costs. The proceeds of the bonds, which were meant to be the acquisition war chest, were being used to cover the interest, and Farley Industries showed negative net worth on its financial statements. Everyone knew that Farley had to make an acquisition; otherwise the bonds would bankrupt him. The theory was that if a good acquisition was made, the excess assets of the acquired business could be sold to pay down a fair portion of the debt and the earning assets could be polished and squeezed to service the remaining debt. In practice, that theory had always worked, for each year companies were worth more than they had cost, especially good companies, and there was little or no risk in the process of getting into a business and then getting out of it. Everyone always sold businesses for more than they paid for them, sometimes substantially more.

There was a corollary theory at work, which also encouraged acquisitions: it wasn't possible to pay too much, at least in the long term. If the business was a market leader and you paid too much because anticipated earnings didn't match required payments, the debt could be stretched out over a longer term to accommodate a difference in the business cycle. In the period when delays in debt payment might be required, then Mike Milken would be there to help with the holders of the junk bonds, always able to swap the debt securities of one kind for other securities that more easily accommodated current needs. Ultimately, under this theory, the value of the unique assets of the business would pay off. The one thing that had been clear for as long as people could remember was that equity compounded every year at a greater rate than even interest on high-yield junk debt, and the longer you held on to the entrepreneurial equity, the greater your reward, which meant that the more you borrowed, the greater the winnings. Clint Murcheson, the wildcat oilman, was supposed to have said that a man is worth two times what he owes, which made him a visionary in some quarters.

Bill Farley, backed by Drexel Burnham, was formidable. Indeed, the adversary was Mike Milken, the power behind Drexel. Farley might pick the target, but Drexel would supply the cash. The more Farley paid, the greater Drexel's power, for the debt would control

the equity until it was substantially repaid. Given that relationship, there would be few restraints on Farley's bidding for West Point: Drexel was his safety net, always there to refinance the debt. There was another powerful incentive for Farley to ignore all customary bidding limits. The credit of his crown jewel, Fruit of the Loom, wasn't involved in the financing, nor was his personal equity interest in Fruit of the Loom. If he defaulted on the loans, his personal wealth was safe, unless he chose to commit it at some later time. For the first time, he'd taken a significant portion of his winnings out of the game.

Farley had a theme: superior managerial and marketing skill. He'd turned Fruit of the Loom around and substantially increased its profit margins. From his perspective, West Point's vision was faulty. Its game plan was to bring the Stevens assets up to West Point's margins, and those margins were their ceiling. Bill Farley felt that Joe Lanier had aimed too low. Also, he'd keep West Point largely in the bed and bath business, where he saw the most profit, and sell off all the apparel businesses, including Cluett Peabody, a recent West Point acquisition effected before West Point acquired J. P. Stevens. Bill Farley would be competing to buy West Point not only on the basis of cost cutting but also on the basis of more aggressive marketing, which meant he could pay more than anyone who didn't share his vision.

How could you stop someone so formidable? There was only one blocking move, and that was to challenge leverage itself. We brought a case in the Federal District Court in Atlanta, the court nearest West Point's headquarters, alleging that Farley's financing for the offer violated the federal margin rules. Those rules, part of the New Deal legislation correcting deficiencies in the financial system, were adopted after the stock market crash of 1929 to curb speculative buying of stocks largely with borrowed money. The margin rules require that at least half the purchase price of stock come from equity, the acquirer's own funds, and not from borrowed money. Paul Volcker, when he was chairman of the Federal Reserve, had expressed significant concern with highly leveraged merger transactions, especially hostile takeovers by shell companies financing acquisitions largely through the target's own assets. The Federal Reserve issued an interpretation of the margin regulations

meant to limit these highly leveraged transactions because they could easily fail in an economic downturn and weaken the financial system. Although unintended, the interpretation encouraged negotiated leveraged buyouts, since it set guidelines that could easily be followed, in friendly transactions, without needing significant equity. Most hostile transactions did not remain so to the bitter end. At some stage the parties commenced negotiations. To the extent that a hostile transaction resulted in the target's finally agreeing to be taken over at an acceptable price, the interpretation also facilitated the transaction at that time. But during the period of hostility the interpretation could be used to defend against the leveraged takeover bid. Relying on Volcker's regulations, we believed that we had a clear-cut case to stop the takeover bid. Farley showed only $300 million of equity out of transaction costs of $1.5 billion, and the $300 million called equity came directly from the Drexel-placed junk bonds. Thus, the bid was based solely on borrowed money.

Judge G. Ernest Tidwell in Atlanta concluded, however, that there was no right of action by private parties to enforce the Federal Reserve's rules, which meant that the court couldn't act on West Point's complaint. If enforcement action was necessary, the court found, it should be done by the federal regulatory agencies. The court, however, stated that the "financing is substantially suspect and may be a violation of the margin requirements," and asked the Federal Reserve to look into the matter. Following the court's lead, we wrote to the Federal Reserve, which asked for position papers from both parties, much like briefs. Once the Federal Reserve decided the issue, it would have to be turned over to the SEC, which enforced the margin rules. It was a curious split of authority between the agencies, existing only because of historical circumstances. We felt we were on fairly solid ground with the SEC, as well as the Federal Reserve, since the former chairman of the SEC, John Shad, had, like Volcker, given a number of speeches expressing concern with the increased use of borrowed money to make acquisitions.

Farley's claim was that Farley Industries was not a shell company and therefore the rules didn't apply to his takeover bid. When examined carefully, however, it was clear that he was proposing to make an acquisition for about $1.5 billion using Farley Industries

as his equity. But Farley Industries had a negative net worth, its surplus earnings having been drained by bond interest. On that basis, we argued that there was a clear violation. Joe Lanier called all the congressmen and senators that West Point had dealt with over the years concerning all phases of its businesses, including tax policy and import duties. West Point was able to contact a broad group and got many of them to urge the commission and the Federal Reserve to enforce the rules. We told everyone that this was the perfect case to use to speak out against high leverage. Farley Industries was a failing company without the acquisition. All the acquisition did was impose the debt of a failing company on West Point, weakening it as a competitive company. A downturn in the economy would make a wasteland out of a fine company, costing numerous jobs, benefiting foreign competitors.

No one wanted to take up the debate in this case. The Federal Reserve took the position that where there was a holding company such as Farley Industries involved with a principal operating subsidiary such as Fruit of the Loom, a determination of whether excessive leverage was being used was a question of fact. The Federal Reserve stated that it wasn't a fact finder, merely an agency that expressed rules, and it would be up to the SEC to look into the facts of the matter. With that position, the Federal Reserve could ignore the fact that Fruit of the Loom's credit and earnings weren't standing behind Farley Industries and leave findings like that to the SEC. The SEC took the position that it hadn't been given any clear direction by the Federal Reserve and that it wasn't going to get into the midst of an ongoing takeover battle. At one level it was an internecine dispute between the two agencies, and at another it was a complete withdrawal by them from the responsibility of dealing with the issues. Nothing can be more frustrating to a lawyer than silly finger pointing. Joe expressed his anger: "Getting them to act is like trying to nail Jell-O to the wall." What we had learned was that no one wanted to intervene in a particular case and stop the merger music. The effect of such an intervention on the financial system and the economy was unpredictable, and contemplating calling a halt to leveraging paralyzed both agencies. They felt that it was up to Congress to add new rules, after debating the political and economic consequences, rather than themselves

enforcing the old rules. But even Congress was wary of taking any action. In October 1987, congressional talk of limiting interest deductions in corporate acquisitions, which would deter leveraged deals, had been implicated as an important factor in the market crash of October 19. Thereafter, there had been few regulatory initiatives directly attacking leveraging.

Our failure with the agencies to stop his offer emboldened Farley, just as we'd run out of effective defenses. All other challenges to Farley's tender offer were simply delaying tactics. Early on in the fight Joe Lanier had said, "We'll fight him until hell freezes over, and then we'll fight him on the ice." It was a rallying cry that showed the spirit of the man, but he knew that if we couldn't stop the Farley bid on the basis of its leverage, West Point would be put up for auction. Once that happened, Joe would have to bid for the company, and West Point would end up being highly leveraged, devoted to servicing its debt, not anything like the company that Joe had helped build.

There was one hope in delay and that was that Drexel would fail and Farley's offer would then fall flat. By November 1988 everyone knew that Drexel was subject to criminal indictment for certain of its junk-bond and takeover activities. The indictments were the outgrowth of the SEC's insider-trading investigations based on the confessions of Dennis Levine in May 1986. What had started out as a small upsetting vibration with convictions of players such as Levine, Robert Wilkis, and Ilan Reich had become a sizable quake threatening the foundations of merger activity. The effects of imminent criminal action against Drexel and of investigations of Milken were already noticeable in the marketplace. When Henry Kravis had proposed to do the buyout of Macmillan, he'd appeared with Drexel, but had Merrill Lynch as a backup. If Drexel couldn't put the deal together, he told me, then Merrill would, indicating that even at that time there was some question by knowledgeable bidders about Drexel's financial muscle and long-term viability.

We could delay Farley until about February 1989—six months from his October 1988 starting date. For defense, we interposed the "poison pill" between Farley and West Point. The pill was so named because once adopted (in effect swallowed) it allowed the

shareholders of the target company to buy shares of either the target company or the raider at half price. All shareholders had this right, proportionate to the shares they owned, except the raider. The pill became lethal when the raider crossed a predetermined threshold of share purchases in the target company, usually between 10 and 20 percent. The raider could request the board of the target company to "redeem" the pill (in effect rescinding it) to permit the raider's offer to be considered by shareholders. As fiduciaries, the board of the target company had to carefully consider the fairness of the offer. If the board rejected the raider's request for redemption (cancellation of the rights to acquire stock for half price), then the raider could take his case to the courts to consider whether the directors had acted properly or to the shareholders, requesting them to change the incumbent directors in favor of a slate proposed by the raider. The raider's slate would seek shareholder votes on the platform that they would "redeem" the pill, making way for the raider's offer. Imposing the pill in the face of an offer, at the least, usually bought time for the target, which otherwise would only have twenty business days in which to defend. The end point for West Point was its annual meeting, in February, when Farley could take his case to the shareholders. Farley's lawyers also understood that by the time of the annual meeting they would be able to present to the shareholders their proposal in the form of a proxy solicitation seeking removal of the West Point board of directors. West Point couldn't withstand that solicitation, which would pave the way for Farley's bid, and had to provide a financial alternative to Farley's tender. The question was whether Drexel would fail by then. If so, either Farley's bid would expire for lack of financing or he would be outbid.

Farley never faltered. He made the rounds of the Georgia and South Carolina state legislatures, introducing himself, acting like the new owner of West Point, promising people that if he controlled the assets, he'd expand the business. He might have to sell Cluett Peabody, he openly admitted, but he had no intention of selling other assets or changing the headquarters or the venue of operations. Wherever he went, he gave syrupy assurance, which played well, for West Point hadn't shown any ability to derail him and

his audience was appreciative of his attention to them. Not until much later did he announce that he would sell all assets other than the bed and bath business.

Farley well understood the risks he ran from delay, but there was nothing that his lawyers or investment bankers could do to accelerate the process. He felt that if he could talk to Joe he'd be able to convince him to step aside. But Joe wouldn't talk to him, for there was nothing to say. Joe knew that Farley would just try to sell himself and wouldn't listen to what Joe had to say. Farley, however, persisted. Finally, in a move that I'd never seen before, he demanded to be allowed to attend Joe's deposition in the ongoing court case between the companies. It wasn't a sensible way for the two men to get together, but Farley was entitled as a matter of law to be present at the deposition of his adversary. Farley hoped that if he was in the same room with Joe, Joe would talk to him at some time.

Joe's deposition was taken in Atlanta at the offices of King & Spalding, and Farley sat quietly in the room waiting for an opportunity to talk to Joe. But Joe ignored him. Finally, during a break, Joe left the room to go to the bathroom, and Farley followed him. No one else went along, and Farley and Joe stood next to each other at adjacent urinals. When he came out Joe was asked what had transpired. "He introduced himself," Joe said, and then smiled in a cherubic Southern way and added, "and we politely acknowledged each other." Later Joe observed, "Ego's driving him. He won't stop."

In January, Drexel was indicted and settled with the government, agreeing to pay $650 million in fines and assorted damages. In that connection, Milken withdrew from the firm. But the payment of the huge sum and the loss of Milken didn't then seem to have weakened Drexel's vigor, and the admissions of wrongdoing didn't seem to have affected its ability to do business in the marketplace. It had been able during the past three months to place enormous quantities of junk bonds for the leveraged buyout of RJR Nabisco, first as a bridge loan and then in the form of permanent financing. There seemed to be some contraction of the market for junk bonds, but that was accounted for by the herculean effort of Drexel to place the RJR debt, which sopped up most funds available for junk

debt. When it came to Farley's tender offer, Drexel continued to state that it was highly confident that it could finance the offer. What we didn't know was that Leon Black, acting as adviser to Farley at Drexel, was having trouble convincing the Drexel organization to "buy" West Point. It later came out in the press that Drexel traders in a "screaming match" with Black warned him against the deal, saying they would have trouble selling the junk bonds. Black was reputed to have castigated them by saying, "Since Mike left you're all lousy salesmen." Finally, through force of personality, Black was able to get the Drexel organization to work for the deal.

In February 1989, Joe announced that the company would be put up for auction and that a bidding package would be made available to all interested buyers. As expected, those interested were all financial buyers looking to compete against Drexel. Joe decided that he'd help anyone bid for the company against Farley, which was the most sensible strategy. Whoever outbid Farley could then make a deal with Joe Lanier and his management team.

A committee of independent directors was formed and they would structure the auction procedures and negotiate with all the bidders. We continued to represent the company and the directors. Joe withdrew from any participation in consideration of the bids and was treated like an outsider. Merrill Lynch, which had been the investment banker for the company, asked to withdraw from its representation in order to participate in putting together a group that would also make a bid. They thought that they had an excellent chance of winning and were committed to retaining the management. Goldman Sachs, which had been co-banker with them, would conduct the auction with the committee.

Everyone was told it would be a blind bidding procedure. Such a procedure was usually used in corporate auctions to maximize the bids. All bidders were told to bid cash. When the final sealed bids were opened, Farley had bid $58, making him the clear winner.

He was notified immediately. I then spoke to Joe and told him that Farley had won the auction.

"No one was going to beat him," Joe said. He paused, wanting to speak his mind. "But how is he going to make it work for him and pay down the debt? I don't see it."

Farley was eager to get his tender offer closed, and acted as a gracious winner in all respects. By the end of his offer, 95 percent of West Point's shares were tendered, and he bought them all.

Thereafter, Farley visited West Point, Georgia, and was received with a parade in his honor. The turnout was grand, and for the day the town was renamed "Farleyville," proclaimed in streaming, bright banners.

And then everything collapsed around Farley. This tender offer was the last deal that Drexel was able to finance as the stresses of the indictment and the loss of capital in fines began to show. Drexel wasn't able to support a weakening junk-bond market which began to fail as recessionary pressures in the economy slackened corporate revenues. And Farley was affected by the failures in the junk-bond market almost immediately. He'd anticipated selling Cluett Peabody, the apparel company, for about $600 million but finally was able to get only about $350 million, part in cash and part in notes. The buyer had also been relying on Drexel for financing, and when Drexel couldn't raise the money, the offering price was drastically cut. Farley took what he could get, but that sale practically wiped out the $300 million that Farley had put into the West Point acquisition. Other assets that he planned on selling couldn't be sold, leaving the debt piled higher and on more costly terms than had been thought possible. If the assets he couldn't sell were realistically priced, then the whole structure was insolvent.

The banks, weakened by failing acquisition loans, wouldn't lend Farley any more money and Drexel couldn't raise any more. As a result, the unthinkable happened. Farley wasn't able to buy the remaining 5 percent of West Point and replace all the temporary acquisition financing. There was no other case like this one. This was the high-water point in the merger tide, and as the financing sources withdrew, Farley was left high and dry, able only to pledge his Fruit of the Loom stock, putting everything at risk, to buy time in the hope that the market would come back soon enough for him.

And Joe Lanier, dismissed by Farley, joined an investment group to acquire Dan River, which he now runs and which competes against a debt-weakened West Point, the company he and his family helped build.

I remember Chief Justice Roger Traynor, for whom I'd been a

law clerk after law school, saying to me, over twenty years before these events, that "change hurts." It was an eye-opening statement to me then because I'd always benefited from change. And looking back, I know that I am a creature of change, for lawyers administer it and it's the source of our activity. I continue to welcome it and encourage it, but it isn't always for the best. And there are considerable costs.