SEC Proposes Amendments to the Tender Offer "Best-Price" Rule

The SEC recently has proposed amendments to the tender offer "best-price" rule in order to eliminate uncertainties that have led practitioners to structure transactions as mergers rather than tender offers. The amendments are designed to level the regulatory playing field between statutory mergers and tender offers and to reflect more appropriately the intended underlying premise of the rule – that offerors pay consideration of equal value to all security holders <u>for the securities that they tender in a tender offer</u>. The SEC has requested that comments on the proposed amendments be submitted by February 21, 2006.

Currently, the best-price rule[1] requires that the consideration paid to any security holder pursuant to the tender offer is the highest consideration paid <u>to any other security holder during such tender offer</u>. The best-price rule is applicable both to third party tender offers and issuer self-tender offers. Since its adoption, the best-price rule has spawned litigation based on claims that consideration paid under agreements and arrangements with management and other security holders of the target entered into or amended at the time of the tender offer violate the best-price rule. Examples of the types of arrangements that have been called into question include employment compensation arrangements, severance arrangements, benefit plans and commercial agreements.

The proposed amendments to the best-price rule are intended to:

- clarify that compensatory arrangements between directors or employees of the target and the offeror are not subject to the best-price rule;
- correct unintended consequences of the current rule which, as interpreted by some courts, has been read to capture bona fide compensation and other arrangements merely due to the time at which such arrangements were entered into or paid; and
- afford parties to a transaction greater flexibility in determining which structure (*i.e.*, merger or tender offer) to employ.

Background

The best-price rule was adopted as one of a number of measures to ensure that all holders that participate in a tender offer are treated equally. Specifically, the best-price rule requires that the consideration paid to any security holder pursuant to the tender is the highest consideration paid to any other security holder during such tender offer and the rule applies to both third party tender offers and issuer self-tender offers.

In its current form, the best-price rule has been interpreted by some courts to capture compensatory and other arrangements either because such arrangements were deemed to be "integral" to the offeror's willingness to effect the tender offer (the "integral part test") or because such arrangements

[1] 17 CFR 240.132-4(f)(8)(ii)[issuer self-tenders] and 17 CFR 240.14d-10(a)(2)[third party tenders]

were entered into or amended between the time the tender offer formally commenced and expired (the "bright line test"). The agreements or arrangements that most frequently have been the subject of best-price rule litigation have involved employment compensation, severance or other employee benefit arrangements with executive officers and directors of the target, as well as other commercial arrangements. In several of these litigations it was successfully argued that these types of arrangements were additional consideration for the stock tendered by directors and employees in a tender offer enabling the directors or employees to sell their shares at prices greater than those paid to non-employee security holders. The economic consequences to the offeror of an adverse determination can be dire -- an obligation to pay the additional consideration to each security holder of the target. Because of these potential dire consequences and because the retention of key employees and directors and the structuring of severance arrangements often are critical components of structuring a transaction, parties have tended to structure acquisitions as statutory mergers even if a tender offer otherwise would have been preferable.

Proposed Amendments to the Best Price Rule

Proposed Amendments to the Issuer and Third Party Best-Price Rules

Under the proposed amendments, the best-price rule would be modified to clarify that it applies only to securities tendered in a tender offer. Specifically, the SEC proposes to revise the best-price rule to state that an offeror shall not make a tender offer unless"[t]he consideration paid to any other security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer." The clause "for securities tendered in the tender offer" would replace the current clauses "pursuant to the tender offer" and "during such tender offer" to clarify the intent of the best-price rule.

Specific Exemptions and Safe Harbor Provisions Related to the Third Party Best-Price Rule

The proposed amendments would add a specific exemption from the best-price rule in connection with third-party tender offers for:

- the negotiation, execution or amendment of any employment, compensation, severance or other agreement with directors or employees of the target *provided*
- the amount payable to the directors or employees pursuant to these arrangements
  - relates to past services performed or future services to be performed or refrained from being performed (such as non-competition arrangements) by the director or employee and
  - is not based on the number of securities the director or employee owns or tenders in the tender offer.

The proposed amendments also would provide a non-exclusive safe-harbor applicable to third-party tender offers only that would deem any employment, compensation, severance or other agreement with the target's directors and employees as satisfying the exemption discussed above if the compensation committee (or similar committee) of the board of directors of the relevant company approves the arrangements or agreements. The safe harbor is only available if the committee approving the arrangements is comprised solely of independent directors.

The proposed amendments did not contain an analogous exemption and safe harbor for issuer self-tender offers. The SEC believes that issuers (or their affiliates) that sponsor a tender offer generally do not have the same need as third parties to restructure compensatory arrangements in connection with tender offers.

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