Corporate and Securities Law Update

M&A Development: SEC Proposes to Amend Tender Offer Best-Price Rule

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Executive Summary. In recent years cash mergers have been used more frequently than cash tender offers, in part due to concerns that target employment, severance or other compensatory arrangements might be deemed to violate the SEC's "best-price" rule requiring that equal consideration be paid to all tendering security holders. New regulations proposed by the SEC help clarify this rule and should encourage greater use of cash tender offers. Tender offers can be an advantageous acquisition structure, because they can be closed in as few as 20 business days, while a stockholder-approved cash merger will inevitably require more time to submit the proxy to the SEC and engage in an appropriate proxy solicitation period. If the SEC reviews the merger proxy statement, the time advantage of the tender offer approach will be even greater.

However, despite this long-anticipated revision of the tender offer rules, the desirability of a tender offer structure in any particular transaction must be evaluated in the context of the following:

- the regulatory approvals required (if a prolonged antitrust review is anticipated, a one-step cash merger may yield an earlier stockholder approval, eliminating "topping" risk sooner than in a tender offer);
- the corporate law of the target's jurisdiction (for California corporations, the minimum condition for most cash tender offers is 90% rather than 50%, making the one-step cash merger usually preferable from a speed-to-closing perspective); and
- whether it is necessary for the buyer to obtain stockholder approval (the need for such approval can obviate much of the speed advantage of the tender offer).

Background. The SEC recently proposed amendments to the best-price rule set forth in Exchange Act Rule 14d-10(a)(2). The rule currently states that no buyer shall make a tender offer unless the "consideration paid to any security holder pursuant to the tender offer is the highest consideration paid to any other security holder during such tender offer." Plaintiffs have used the best-price rule to challenge employment, severance, bonuses and other arrangements with target employees and directors, characterizing such compensation as unlawful additional tender offer consideration. In addition, federal circuit courts have disagreed on the proper application and interpretation of the best-price rule. This uncertainty has led buyers to prefer one-step cash mergers in many transactions. To resolve this situation, the SEC has proposed: (i) revising the current best-price rule; (ii) adding an exemption to the rule for certain compensatory arrangements; and (iii) including a new safe harbor provision for compensatory arrangements with target employees or directors that are approved by an independent compensation committee.

Revision of the Best-Price Rule. The proposed amendments would revise the best-price rule to read as follows: "the consideration paid to any 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" (emphasis added). The revision is intended to clarify that the best-price rule only applies to the consideration offered and paid to security holders *for securities tendered* in the tender offer and not to consideration paid for other purposes, such as pursuant to employment, severance and other compensatory arrangements. The purpose is to focus attention on the price paid for the securities and not on other payments made to employees and directors of the target at or around the time of the tender offer.

Exemption for Certain Compensatory Arrangements. The proposed amendments also provide a specific exemption for certain employment, severance and other compensatory arrangements made in the context of a third-party tender offer. As proposed, the new provision would exempt

from the best-price rule the "negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement, or payments made or to be made or benefits granted or to be granted according to such arrangements, with respect to employees and directors" of the target company. The exemption applies if the amount payable under such arrangements: (i) relates solely to past services performed or future services to be performed or refrained from being performed (*e.g.*, non-competition agreements) by the employee or director; and (ii) are not based on the number of securities the employee or director owns or tenders. The exemption applies to agreements entered into by employees and directors with either the buyer or the target. Although the exemption does not extend to non-compensatory arrangements (such as commercial arrangements), the proposed amendments state that the lack of such an exemption should not suggest that any non-compensatory arrangement constitutes consideration paid for securities tendered in a tender offer.

Non-Exclusive Safe Harbor. The rule proposals also include a non-exclusive safe harbor for third-party tender offers that would deem any arrangement to be an employment compensation, severance or other compensatory arrangement within the meaning of the exemption described above if the compensation (or similar) committee of the buyer or the target (as applicable) specifically approves the arrangement as meeting the requirements of the exemption. The proposed safe harbor would require that the committee be comprised solely of independent directors. Such committee approvals could still be subject to fiduciary duty challenges, so board members should exercise due care in approving these arrangements.

The SEC will accept comments on the proposal until February 21, 2006. The full text version of the amendments is available at http://www.sec.gov/rules/proposed/34-52968.pdf.

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