

SEC Adopts Amendments to 'Best-Price' Rule

Overview

The SEC recently approved amendments to the tender offer “best-price” rule to address uncertainty created by a split in federal court decisions about when and how the rules are applied to compensatory arrangements. The best-price rule requires that, in a tender offer, stockholders must receive the highest price paid to any other stockholder. As a result, court decisions that treated a compensation arrangement as a tender offer payment resulted in potentially massive damages because all stockholders were arguably entitled to the same benefit calculated on a per-share basis. The risk and uncertainty created by the circuit split caused bidders and targets alike to avoid tender offers as an acquisition technique.

Under the amended rules, the only consideration that is subject to the best-price rule is consideration paid “*for securities tendered*” in the tender offer. The rule now exempts compensation, severance, and other employee benefit arrangements and provides a safe harbor for when these arrangements are approved by a committee of independent directors. The exemption and safe harbor will apply to both issuer and third party tender offers. As noted below, there remains some question as to whether the amendments go sufficiently far and provide sufficient clarity to revive tender offers as a preferred technique.

Exemption for Compensation

Under the amended rule, the negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement with any security holder of the subject company will not result in “consideration paid for securities tendered” to that holder where the amount to be paid is (i) paid as compensation for services performed, to be performed or to be refrained from being performed; and (ii) not calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.

Safe Harbor

Although at first glance the exemption for compensation seems broad and self-executing, the SEC has nonetheless provided a non-exclusive safe harbor, which suggests that it may not always be so easy to determine what is and what is not a compensatory arrangement. The safe harbor essentially states that the exception is satisfied if it receives the approval of independent directors sitting on the compensation committee, or a similar committee or special committee, of the target or the bidder. “Independence” is determined by reference to the standards of the applicable self-regulatory organization for the trading market of the target’s stock (e.g., the New York Stock Exchange). The board of directors of the target or the bidder, as the case may be, is charged with making the determination of “independence.”

Pitfalls and Perspective

It is noteworthy that under the amended rule and the accompanying SEC release:

- Commercial arrangements between the bidder and target stockholders are not clearly exempt, and presumably are not eligible for the safe harbor. Bidders who expect to enter into or amend commercial arrangements with stockholders should continue to be cautious about a tender offer structure.

- Conditioning a compensatory arrangement on the security holder's tendering securities seems to result in loss of the exemption. Agreements with management to tender and other similar arrangements can potentially raise questions here.
- The rule can be avoided altogether if the security holder does not tender any securities in the tender offer.

Conclusion

The amendments are a positive step by the SEC to achieve a level playing field between tender offers, mergers and other forms of business combinations. However, it remains to be seen whether the amended rule will put an end to the prospects of high-stakes litigation over the special arrangements that a bidder might seek to put in place with management or the directors of an acquisition target.

Contact Information

If you have any questions or would like to learn more about these rules, please contact your usual legal advisor at Ropes & Gray, or any of the attorneys listed below involved in the preparation of this SEC Alert.

Boston

David C. Chapin

617-951-7371

david.chapin@ropesgray.com

Christopher A. Klem

617-951-7410

christopher.klem@ropesgray.com

Julie H. Jones

617-951-7294

julie.jones@ropesgray.com

Keith F. Higgins

617-951-7386

keith.higgins@ropesgray.com

Paul M. Kinsella

617-951-7921

paul.kinsella@ropesgray.com

Brae R. Blackley

617-951-7174

brae.blackley@ropesgray.com

New York

William J. Hewitt

212-841-5709

william.hewitt@ropesgray.com