

**SEC APPROVES AMENDMENTS TO BEST-PRICE RULE TO ELIMINATE BIAS
AGAINST TENDER OFFERS**

On October 18, 2006, the Securities and Exchange Commission (the “SEC”) unanimously approved amendments to its “best-price rule”¹ for third-party and issuer tender offers. The adopting release was issued on November 2, 2006, and the rules will become effective 30 days after publication in the Federal Register.

I. Background

The best-price rule was adopted in 1986 to ensure equal treatment of shareholders by requiring that the consideration paid to any security holder in a tender offer be the highest consideration paid to any other security holder in the offer. However, application of the rule has not been as simple as its concept. In a number of cases, shareholders have challenged tender offers in the federal courts, complaining that employment, severance, noncompete and other payments to target insiders have in reality been hidden payments of additional consideration for the insiders’ shares. The plaintiffs have alleged, often successfully, that the best-price rule requires the per share amount represented by these “side” payments to be paid as well to all other shareholders who participated in the tender offer.

To complicate matters, the federal courts have disagreed on the proper interpretation of the best-price rule and the circumstances under which “side” payments should be considered additional consideration for tendered stock. The confusion engendered by these decisions raised the concern that legitimate payments to target insiders – often a commercial necessity – could be recharacterized by the courts and that acquirors would be forced to pay substantial additional consideration after an acquisition has closed. This concern has often led acquirors to favor merger structures, to which the best-price rule does not apply, and has discouraged the use of tender offers, even when a tender offer might otherwise be preferable. With the adoption of these amendments, the SEC has provided clear guidelines on how compensatory payments can be made to target company executives in the context of a tender offer without triggering the rule.

II. The SEC’s Approach to the Best-Price Rule

The federal courts had developed two principal approaches to the best-price rule. One, referred to as the “integral parts” test, held that the best-price rule applied to all integral parts of a tender offer and sought to determine whether a particular payment was an integral part of the tender offer that should be recast as tender offer consideration. The other approach was a bright-line test that held that the best-price rule applied to all arrangements executed or implemented between commencement and completion of the tender offer.

¹ The “best-price rule” is actually two rules – one for third-party tender offers (Rule 14d-10(a)(2)) and another for issuer tender offers (Rule 13e-4(f)(8)(ii)). Amendments have been adopted to both rules, which we collectively refer to as the “best-price rule.”

The SEC found fault with both of these judicial approaches and instead adopted amendments based on the view that the best-price rule should not apply to employment compensation, severance and other employee benefit arrangements. The SEC concluded that these arrangements, whether they are made before or during the pendency of a tender offer, often are integral to an acquisition, but that they should not be recast as tender offer consideration unless they are based on the shareholdings of the insiders who benefit from them.

To implement its approach, the SEC has taken three separate tacks: clarifying that the best-price rule applies only with respect to the consideration paid for tendered securities; exempting certain compensation, severance and benefit arrangements from the best-price rule; and creating a safe harbor for these arrangements when they are approved by an independent compensation committee.

III. Specifics of the Best-Price Rule Amendments

A. Clarification of the Best-Price Rule

The amendments revise the language of the rule to make it clear that its scope is limited to payments “for securities tendered in the tender offer” rather than payments made “during” the tender offer. Although helpful and certainly an improvement, this change alone does not completely resolve concerns with the rule because it may not prevent courts from concluding, as they have done in the past, that “side” payments are in fact disguised consideration for insiders’ shares.

B. Exemption for Certain Employment Compensation, Severance and Other Employee Benefit Arrangements

The amendments also specifically exempt from the issuer and third-party best-price rules:

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 an arrangement, with respect to any security holder of the subject company, where the amount payable under the arrangement: (i) [i]s being paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto); and (ii) [i]s not calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.

As adopted, the amendments expand the exemption to cover compensatory arrangements with all security holders of the target company. As originally proposed, the exemption would have applied only to arrangements with the target company’s employees or directors.

C. Safe Harbor for Certain Employment Compensation, Severance and Other Employee Benefit Arrangements

The SEC also adopted its proposal for a non-exclusive safe harbor that deems any arrangement to be “an employment compensation, severance or other employee benefit arrangement” within the meaning of the exemption described above if the safe harbor’s requirements are met. The safe harbor is satisfied in all cases by approval of the target company directors and, where the bidder is a party to the arrangement, by approval of the bidder company directors. Approval may be given by a compensation or similar committee, or, if the company does not have such a committee (or does, but none of its members are independent), approval may be made by a special committee of the board of directors that is comprised solely of independent members and formed to approve the arrangement. For this purpose, independence is determined by the relevant listing standards for listed companies (*e.g.*, NYSE or NASDAQ rules) and by the listing standards of any national securities exchange or national securities association for non-listed companies (so long as the non-listed company uses the same standard for all committee members). The independence requirements for the safe harbor are satisfied when the board of directors determines that the committee or board members approving a compensatory arrangement are independent.

In the case of a foreign private issuer, compensation arrangements may be approved by any member of the board of directors, or any committee of the board of directors, authorized to make such approvals under the laws of the issuer’s home country. Foreign private issuers may rely on the independence standards, codes and regulations of their home countries.

Commentary

The best-price rule amendments will bring a welcome change and will once again allow acquirors to readily consider structuring transactions with first-step tender offers. The safe harbor is a particularly welcome addition because it will allow the parties to a transaction to eliminate interpretive uncertainty surrounding compensatory payments to employees and directors that are made or committed to during or around the time of a tender offer.

If you have any questions about the revisions to the tender offer rules, or would like further information, please contact Michael A. Schwartz (212-728-8267, mschwartz@willkie.com), Steven J. Gartner (212-728-8222, sgartner@willkie.com), John S. D’Alimonte (212-728-8212, jd'alimonte@willkie.com) or the corporate partner with whom you regularly work.

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