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SPECIAL COMMITTEE ON MERGERS, ACQUISITIONS
AND CORPORATE CONTROL CONTESTS

February 14, 2006

Via email: rule-comments@sec.gov

Securities and Exchange Commission
450 Fifth Street NW
Washington, D.C. 20549-0609

Attention: Jonathan G. Katz, Secretary

File No: S7-11-05; Release Nos. 34-52968; IC-27193
Amendments to the Tender Offer Best-Price Rule

Ladies and Gentlemen:

This letter is submitted on behalf of the Special Committee on Mergers, Acquisitions and Corporate Control Contests of the Association of the Bar of the City of New York (the "Committee") in response to the request by the Securities and Exchange Commission (the "Commission") for comments on its December 16, 2005 release entitled "Amendments to the Tender Offer Best-Price Rule" (the "Proposing Release"). The Committee is composed of members whose practices focus on mergers and acquisition transactions and related corporate law, corporate governance, executive compensation and securities regulation matters. The Committee includes lawyers in private practice as well as from corporate and investment fund law departments and academia.

INTRODUCTION

First and foremost, we support the Commission's laudable proposal to amend the tender offer "all-holder, best-price" rule embodied in Rule 14d-10 under the Exchange Act to provide an exemption and non-exclusive safe harbor for employment compensation, severance, or other employee benefit arrangements. As noted in the Proposing Release, a series of conflicting court decisions have created significant uncertainty in the application of the best-price rule, influencing acquirors to avoid tender offers despite the fact that tender offers are a quick and efficient takeover mechanism. These amendments, if clarified and adopted, should provide much welcome relief from the uncertainties of litigation in this area and the resulting concerns that have led acquirors to favor mergers over tender offers as acquisition structures. We very much appreciate the opportunity to comment on the proposed amendment. In addition to expressing our support for the proposed amendment, we provide below our suggestions with respect to areas in which we believe the Commission's proposal can be refined and clarified to further the goal of

providing a "level playing field" as between transactions structured as tender offers and those structured as one-step mergers.

COMMENTS

1. ***We recommend expansion of the types of bodies that may make a safe harbor determination, and clarification of the effect, permitted timing and required specificity of any such determination.***

(a) Bodies that may make a safe harbor determination

Proposed paragraph (c)(3) provides that approval of the compensation committee (or similar committee) of the counterparty to the employment arrangement (whether the target or the bidder) is necessary for a target or an acquiror to rely on the "deemed compliance" provisions of the safe harbor. We believe this approach overlooks certain practicalities of the current M&A market, namely that some bidders may not have such committees. First, private acquirors, and specifically foreign or private-equity buyers, are unlikely to have compensation committees or any committee performing similar functions and will rarely have independent directors. Second, controlled public companies (i.e., a listed company of which more than 50% of the voting power is held by an individual, a group, or another company) are exempt from the majority-independence requirement for boards of directors and the independence requirements relating to compensation committees mandated by both NYSE and NASD listing rules. These examples demonstrate important gaps in the coverage of the proposed safe harbor.

To avoid instances where the currently proposed rule does not provide for appropriate review, we believe the body with the power to bring an arrangement within the coverage of the safe harbor should include any committee of independent directors of the relevant party (e.g., to encompass an *ad hoc* committee of independent directors, and not only a compensation or similar committee), and where such party (or its parent, as described below) is not a public company or otherwise required by applicable listing regulations to have any independent directors, the board of directors of such party. As a technical matter, where the formal counterparty is a subsidiary (such as a newly formed special purpose acquiror) controlled by another corporation, partnership or similar entity, the question of whether an independent committee is required should be determined by reference to the ultimate parent entity that controls that subsidiary. We also believe that, regardless of whether the target is a party to the arrangement, and regardless of whether the acquiror has an independent committee or board of directors, it would be appropriate for the rule to provide that approval by a committee of independent directors of the target would also always be sufficient to ensure that the protections of the safe harbor are extended to any particular plan or arrangement. In this regard, we believe that the fiduciary duties of directors of the public target will provide equal protection to target shareholders regardless of whether the target or the acquiror is the counterparty in the arrangement. Thus, we would propose that paragraph (c)(3) of the rule require approval of a "safe harbor committee," which would be defined to include (i) any committee comprised solely of independent directors of the counterparty (whether bidder or acquiror) to the applicable arrangement or of any person controlling that

counterparty; (ii) any committee of independent directors of the target company (whether or not the target company is a counterparty to the applicable arrangement); and (iii) where the counterparty to the applicable arrangement is not, and is not controlled by, a publicly traded company that is required by applicable law or exchange rules to have any independent directors, the board of directors of that company or of its controlling stockholder.

(b) Effect of safe harbor determination

Regardless of the approving body, in order to be effective, the rule and the adopting release should make absolutely clear that approval by the applicable safe harbor committee is all that is necessary to bring an arrangement into the safe harbor. While we believe this was the Commission's intention, we note that the Proposing Release states that a compensation committee's approval that violates a fiduciary duty would be subject to state law remedies but "would not necessarily result" in a violation of the third-party best-price rule.[1] The inclusion of the word "necessarily" may raise the implication that the best-price rule itself could be violated as a result of an imperfect process or otherwise mistaken conclusion by the safe harbor committee that the safe harbor should apply. As a result (and as underscored by the Commission's question as to whether the safe harbor would merely shift scrutiny), we believe the Commission should steer the rule away from any ambiguity that might permit plaintiffs to argue that courts should examine whether the safe harbor committee was properly composed and has properly exercised its duties, and to further argue that because any such determination would be largely based on the underlying facts the issue could not be disposed of at the pleadings stage. If a potential outcome of such an examination were that the best-price rule had been violated, lawyers likely would continue to advise their clients to avoid the uncertainty of a tender offer and the best-price rule and instead utilize the merger format. Therefore, we believe the Commission should revise the rule and the adopting release to make clear that it intends to leave issues of fiduciary breach to be determined under state law fiduciary concepts, with the sole remedy being provided under state law. Moreover, we believe the rule or adopting release should make clear that a conclusion by the board of directors that each member of the safe harbor committee is independent under applicable stock exchange standards should be sufficient to determine conclusively that such committee meets the applicable independence standard of the rule. In this regard, we note that existing stock exchange regulations require companies to disclose which of their directors are independent.

(c) Timing and specificity of safe harbor determination

The Commission has posed a number of questions concerning the time at which a safe harbor determination should be made and the level of specificity that might be required in such determination. We believe the rule should be clarified to provide that approval of a safe harbor committee at any time, whether in connection with the initial adoption of the arrangement, in connection with a transaction or otherwise, is sufficient for purposes of the safe harbor.

[1] Proposing Release, Section II.B.2 (text following footnote 51).

We also believe that "blanket" approvals of all transactions pursuant to specific plans that have been adopted by the target should be sufficient.

Moreover, we believe that, as a transition measure, any plan or arrangement that has been adopted or entered into by a target, with the approval of an independent committee, in each case prior to the adoption of the safe harbor (or if the Commission deemed it necessary, prior to a date several months in advance of the adoption of the safe harbor) should be automatically exempted by the rule. If the rule is adopted without such a transitional temporal safe harbor, we believe that the compensation committees of many issuers will consider it advisable to meet following adoption of the safe harbor, to consider a resolution extending the benefits of the safe harbor to previously approved arrangements. While we believe this would be a permissible and advisable means of addressing previously adopted arrangements, we also believe that it should not be necessary for these committees to allocate the resources necessary to do so in respect of "old and cold" arrangements that were adopted outside of the context of a tender offer. A temporal safe harbor would provide issuers a clear starting point from which they, as a matter of course going forward, will consider the best-price rule safe harbor in connection with the adoption of employment related plans and arrangements.

We believe all of these clarifications would ensure the efficient operation of the safe harbor and help avoid unnecessary litigation over items that are clearly not intended to be covered by the best-price rule. Moreover, we do not believe adoption of any of these clarifications would make the safe harbor susceptible to abuse.

2. ***We recommend deletion or clarification of the requirements concerning "Relates solely to services," "severance" and "not based on the number of securities."***

We believe that the Commission's goal of removing unwarranted incentives to structure transactions as statutory mergers, instead of as tender offers, can be met only if the safe harbor can be relied on with the same degree of certainty achievable through a merger structure and that deletion or clarification of these requirements is necessary to afford that level of certainty to the determinations of well-advised directors that employment arrangements are entitled to the benefit of the rule.

(a) Relates solely to services; severance

The Commission has raised the question of whether the requirement of clause (i) of proposed Rule 14d-10(c)(2), that compensation eligible for the safe harbor relate "solely to past services or future services to be performed or refrained from performing, by the employee or director (and matters incidental thereto)," is appropriate. We believe that the Commission's focus on "services" raises a number of issues that will make it difficult if not impossible for committees to conclude that customary employment arrangements are covered by the safe harbor. First, the rule overlooks the fact that employment arrangements commonly include provision for the purchase of assets owned or used by an executive or director, other than shares tendered into the offer. Such assets may include, for example, homes, automobiles, office furnishings and

other assets that may be sold to the company or to an executive in connection with a corporate transaction. Consideration paid in respect of such transactions would not be "solely" related to services, and may not be viewed as "incidental" thereto. Nevertheless, the purchase of such assets may still have legitimate compensatory purposes, and would not as a matter of course have any relationship to the number of shares tendered into an offer. In addition, although "severance" arrangements are clearly intended to be covered by the rule (as noted by their inclusion in the lead-in to paragraph (c)(2)), it is not always manifestly clear that the full amount of a severance payment is consideration for any specific services provided or to be provided or refrained from providing as the proposed rule appears to require.

We believe that the most effective way to address this issue is to delete the requirement that the safe harbor committee conclude that the requirements of clauses (c)(2)(i) and (ii) have been met, and instead simply require a determination by that committee that the relevant arrangement is an "employment compensation benefit or other employee benefit arrangement" for purposes of the best-price rule. This would be consistent with the view that the Commission has taken in connection with the rules promulgated under Section 16(b) of the Securities Exchange Act, by which independent directors have the ability to exempt certain transactions from the strictures of those rules. Moreover, to the extent that state fiduciary obligations limit the "shifting" of compensation for shares from shareholders in general to directors or employees, the obligation to adhere to such limitations would continue regardless of whether the directors were required to make the factual conclusions currently contemplated by clauses (i) and (ii).

In the alternative, clause (i) of the rule could be clarified to permit consideration in respect of services (whether provided or to be provided or refrained from providing), severance (including the termination of any employment or consulting arrangement) and the acquisition of assets by or from the employer or related parties, so long as the committee (or other body) determines that such consideration is "employment compensation benefit or other employee benefit arrangement" and not compensation for shares tendered into the offer.

(b) Stock-based incentive plans

Clause (ii) of proposed Rule 14d-10(c)(2) states that the exemption to the best-price provision shall not apply if the employee compensation arrangement is "based on the number of securities the employee or director owns or tenders." Frequently, in connection with acquisition transactions, vesting of outstanding equity or equity-based awards is accelerated, or such awards are "cashed out" or otherwise converted into the consideration being paid for the shares generally or into equity awards based on the shares of the acquiror or a party related thereto (and such terms are frequently incorporated into employment agreements and other benefit arrangements). The consideration received by an employee-stockholder who also holds such awards would necessarily be based, to some extent, on the number of such securities underlying such awards. Indeed, with respect to termination of "out of the money" options in connection with a takeover transaction (where the relevant option plan does not specifically provide for cancellation of these options), acquirors frequently seek to ensure that some amount of consideration is paid to the holders of the awards specifically in respect of such cancellation, to avoid the pos-

sibility that less than the entire equity interest is acquired in the transaction. Acceleration of stock options, termination of options (including out of the money options) and similar transactions are important and appropriate parts of takeover transactions, are extremely common in connection with takeovers and are permitted in transactions structured as mergers. We believe that if these types of transactions make the exemption from the best-price rule, and the related safe harbor, unavailable, these revisions to the best-price rule will not meet the Commission's goal of placing tender offers on a level playing field with merger structures.

As noted above, we believe that clause (ii) should be deleted, because we believe it is unnecessary in the context of the fiduciary obligations of directors. In the alternative, this clause could be clarified to ensure that acceleration of equity or equity-based awards, or if applicable generally to similarly situated holders of awards, conversion (or termination) of such awards into (or in consideration for) cash, different equity awards or a combination thereof, should not disqualify an arrangement from the benefits of the safe harbor.

3. *We recommend expansion of the proposed exemption and safe harbor to cover bona fide commercial arrangements.*

As proposed, the exemption and non-exclusive safe harbor embodied in Rule 14d-10(c) would expressly apply only to "employment compensation, severance or other employee benefit arrangements," and not to other arrangements, such as commercial arrangements. We believe that the exemption and non-exclusive safe harbor should not be so limited.

It is neither unusual nor undesirable for a supplier, customer, joint venture partner or other person having a *bona fide* commercial relationship with an issuer to own stock of that issuer, particularly in circumstances where the commercial relationship is important to the business of the issuer. The terms of these relationships may need to be adjusted or waived in connection with the negotiation or consummation of a takeover transaction (including, for example, agreements to refrain from exercising termination rights arising upon a change of control). To the extent that any such relationship either is amended or terminated in connection with a takeover transaction, or as a matter of course is entered into, extended or terminated at a time that is temporally near the takeover but not in business terms "in connection with" the takeover, there is always the prospect of litigation as to whether that transaction would violate the best-price rule. In contrast, such arrangements could be freely amended in connection with the same acquisition structured as a statutory merger without a similar risk. Should such arrangements become subject to challenge under the best-price rule, the question of whether consideration with respect to a commercial arrangement is "for securities tendered in the tender offer" would frequently, as it currently is with respect to employment arrangements, be a question of fact that could not be disposed of at the pleadings stage. The facts underlying the *Lerro* case, cited in the Proposing Release, is a clear example of this type of situation.

In light of the Commission's rejection of the "bright line" analysis applied by the Seventh Circuit in *Lerro*, the susceptibility to best-price challenges for the amendment of commercial arrangements will likely force practitioners, faced with similar facts to *Lerro*, to recom-

mend to their clients that the safe course would be to proceed with a one-step merger, as opposed to a tender offer.

We believe that the Commission's express rejection of both a strict temporal test and an integral-part test, coupled with a textual change in the rule, from "pursuant to the tender offer" and "during the tender offer" to "for securities tendered in the tender offer," evinces a clear intent that payments made contemporaneously with and/or contingent on a tender offer, to individuals or entities who happen to also be shareholders of the target company, but that are not in respect of securities tendered, should be excluded from the strictures of the best-price rule. It is unclear, however, without a more expansive exemption, that plaintiffs or courts will respect such intent. While we recognize the Commission's implicit acknowledgment that commercial arrangements do not raise a *prima facie* inference of tender offer consideration, we believe that an instruction to this effect does little to assuage the fears of parties commencing a tender offer, and that extension of the specific exemption and safe harbor to these types of relationships would in no way interfere with the intended efficacy of the rule. Moreover, we believe once again that the same fiduciary responsibilities that protect shareholders in circumstances involving approval of employment arrangements will operate to protect shareholders equally in circumstances involving general commercial undertakings.

We thus recommend that the exemption be expanded to cover entry into, amendment of or termination of commercial arrangements (whether with directors, officers, employees or other shareholders) that are not dependent upon the tendering by the counterparty of shares into the tender offer, and that the safe harbor be available for transactions that are determined by a committee of independent directors (or in the circumstances described in Section 1(a) above, the entire board) to meet those criteria.

4. *Issuer self-tenders; de minimis exclusion.*

The Commission has posed questions concerning whether the proposed exemption and safe harbor should apply to issuer self-tender offers. We believe that Rule 13e-4(f)(8) should be amended to mirror the proposed Rule 14d-10 exemption and safe harbor. Creating parity in the rules, as has been the historical practice, decreases the chance for confusion and misinterpretation. Moreover it is often desirable to structure acquisition transactions as a combination of an issuer repurchase with a third-party tender offer. In these instances, the failure to make this change increases risk that such transactions will be either subject to litigation or structured instead as mergers.

The Commission has asked whether it would be appropriate to include a *de minimis* exclusion to the best-price rule that would carve out of the application of the rule the negotiation or execution of any employment compensation, severance or other employee benefit arrangement with an employee or director who beneficially owns less than a nominal threshold amount of issuer securities. We believe that it would be appropriate and desirable to include such a *de minimis* exclusion to the best-price rule. Most officers and directors of public companies beneficially own less than 1% of the stock of the issuer. Notwithstanding that *de minimis*

ownership level, acquirors have avoided tender offers where a merger structure has been available because of the possibility that a customary compensation payment to a manager for services rendered could be misconstrued as compensation for shares and the associate risk of a significant cost to the acquiror as a result of the best-price rule, with the potential damages increasing as the share ownership level of that manager decreases. Under the currently proposed safe harbor, practitioners will be required to undertake an extensive analysis of all compensation payable to employees and directors who are also shareholders, in order to determine that the safe harbor or exemption applies. We believe that an exemption applicable to owners of a de minimis amount would enable transactions to proceed without this extensive analysis, and would be both efficient and practical. We do not believe that the type of significant abuses that may be possible when an acquiror is able to purchase a large block of stock from a single shareholder is applicable in situations that would be exempted by such a *de minimis* exclusion.

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We hope the Commission finds these views and suggestions helpful. We would be happy to meet to discuss any questions the Commission may have with respect to this letter.

Respectfully submitted,

Special Committee on Mergers, Acquisitions and
Corporate Control Contests

By: Daniel S. Sternberg, Committee Chair