February 21, 2006

Via email: rule-comments@sec.gov

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

Attention: Jonathan G. Katz, Secretary

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

Ladies and Gentlemen:

On behalf of the law firms named below, we are writing in response to the request by the Securities and Exchange Commission ("SEC") for comments on its release entitled "Amendments to the Tender Offer Best-Price Rule" (the "Release"), published on December 16, 2005.

Given the current disarray among courts with respect to the proper interpretation of Rule 14d-10 under the Securities Exchange Act of 1934 (the "Exchange Act") — and the significant litigation risks entailed in the tender offer process because of these court interpretations — most law firms are advising their clients not to commence tender offers if other acquisition structures are available that do not have the possible adverse consequences of the best-price rule — even if such other structures may be less economically efficient for companies and their shareholders. For U.S. target companies, merger structures are usually available. The additional costs of using merger documents rather than tender offer documents and waiting 90-120 days to deliver value to shareholders in a merger rather than approximately 30 days in a tender offer pale in significance when compared to the potential loss of hundreds of millions or even billions of dollars resulting from litigation alleging violation of the best-price rule. As a result, the economic efficiencies of tender offers have been lost as this type of acquisition structure has fallen into disuse. Moreover, for non-U.S. companies, which typically do not readily have available to them a merger alternative under their home country corporate and securities laws, the only alternative is to exclude the U.S. from a tender offer rather than accept the risk of best-price rule litigation in the U.S.

The SEC has a long history of promoting the availability of tender offer structures and of seeking to harmonize the treatment of mergers and tender offers. The SEC has acknowledged the benefits of tender offers, which allow fast and direct communication with a company's shareholders.[1] When state takeover regimes threatened to unduly burden the market for corporate control beginning in the late 1970s, the SEC took prompt and effective action, adopting Rule 14d-2 in 1979[2] for the purpose of pre-empting pre-notification provisions of state takeover laws. Later, the SEC filed *amicus* briefs in numerous cases arguing that either the applicable state law was preempted by Williams Act provisions or was a violation of the Commerce Clause.[3] In October 1999, the SEC amended the securities laws in part to "eliminate regulatory inconsistencies in mergers and tender offers" and to "enhance the attractiveness of offering securities" as

---

1 See Release No. 34-16385 finding that defensive amendments designed to deter tender offers deny security holders of such companies the "benefits of tender offers for their securities."

2 Release No. 34-16384.

3 See, e.g., Brief for the SEC and the United States as *Amici Curiae* in CTS Corp v. Dynamics Corp of Am., 481 U.S. 69 (1987).

consideration in a tender offer because it "should result in a more competitive market for target companies overall."[4]

The SEC's long-standing efforts to promote the use of tender offers and maintain a level playing field between mergers and tender offers has been seriously undermined, however, by the current judicial muddle surrounding the application of Rule 14d-10. We therefore applaud the SEC's efforts, as reflected in the Release, to address the fact that Rule 14d-10, as it has been interpreted by some courts, currently presents a very real structural impediment to the use of tender offers as a means of effecting acquisitions of publicly-traded companies. In particular, we endorse the objectives stated in the Release to amend Rule 14d-10 to (i) "remove any unwarranted incentive to structure transactions as statutory mergers" and (ii) "make it clear that compensatory arrangements between subject company employees or directors and the bidder or subject company are not captured by the application of the best-price rule."

The law firms that are signatories to this letter have extensive experience in acquisition transactions. Because the signatories strongly share the objectives identified by the SEC — and what we believe are the means to achieve those objectives — we agreed to take the unusual step of writing this joint comment letter to express our collective views.

We recognize that the SEC, as reflected in the Release, has determined to reject the bright-line temporal application of the best-price rule adopted by some courts based on the phrase "during such tender offer" in existing Rule 14d-10(a)(2). While we

---

[4] Release No. 34-42055 at 1 and 117.

continue to believe strongly that the bright-line temporal standard removes unwarranted incentives to structure transactions as statutory mergers and otherwise has much to recommend it, we respect the decision by the SEC.[5] We therefore will focus our comments on suggested changes to the proposed amendments to Rule 14d-10 set forth in the Release ("Proposed Rule 14d-10") that we believe will better achieve the SEC's objectives.

Before providing specific comments and suggestions on Proposed Rule 14d-10, we think it would be helpful to provide the rationale underpinning all of our comments. It is our shared conviction that to accomplish the SEC's stated objectives, Proposed Rule 14d-10 must contain clear and objectively verifiable exemptions and a safe harbor that is truly "safe". As the SEC stated in adopting Rule 14d-10, "[t]he Commission has recognized a need to provide *clarity and certainty* in the regulatory

---

5 The law firms that are signatories to this letter would prefer that the SEC affirm the bright-line temporal standard. We are extremely concerned that, notwithstanding the SEC's commentary in the Release rejecting the broadest application of the integral-part test, the SEC's validation of some version of the integral-part test, combined with the elimination of the phrase "during such tender offer" from Proposed Rule 14d-10(a)(2), may be used by plaintiffs' counsel seeking to broaden the application of the best-price rule and will be confusing to courts. Indeed, we fear the net effect of Proposed Rule 14d-10(a)(2), in particular the deletion of "during such tender offer," will be to expand the ability of plaintiffs to argue that payments made at any time are "in" the tender offer (perhaps even where they are not conditional on the tender and would fail the integral-part test as currently construed). We note further that elimination of the phrase "during such tender offer" is not needed given the SEC's partial validation of the integral-part test. Elimination of "during" is also inconsistent with Rule 14e-5 which employs a temporal period of prohibition from time of public announcement until the tender offer expires. Interestingly, the adopting release of Rule 14d-10 paraphrases Section 14(d)(7) as applying to all securityholders whose shares are taken up "during" the tender offer (Release No. 34-23421 at p. 5).

scheme applicable to tender offers with respect to equal treatment of security holders"[6] (emphasis added). We whole-heartedly agree. If Proposed Rule 14d-10, including, most importantly, the exemptive and safe harbor provisions, are drafted so as to remain subject to factual determinations (even far-fetched or arguable ones) that can be used by litigants to survive a motion to dismiss, we do not believe the SEC's objectives set forth in the Release will be attained. Under those circumstances, many counsel will continue to advise their clients that in most instances doing a tender offer subject to Rule 14d-10 exposes a company to needless and unjustifiable litigation risk of potentially enormous magnitude and therefore will recommend that their clients opt to do a statutory merger. This will be particularly the case in the context of a bid for a non-U.S. target by a non-U.S. bidder. Typically, the U.S. market is not necessary for a successful bid and any appreciable incremental risk could be expected to lead to the exclusion of the U.S. market.

Consistent with the structure of the Release, we have divided our letter into three parts: (1) comments on the proposed changes to Rule 14d-10(a)(2); (2) comments on the proposed exemption under Proposed Rule 14d-10(c)(2); and (3) comments on the proposed safe harbor under Proposed Rule 14d-10(c)(3).

1. SEC Proposed Changes to Rule 14d-10(a)(2)

A. *Proposed Rule 14d-10(a)(2) Will Not Eliminate Questions of Fact*

Proposed Rule 14d-10(a)(2) provides that "[t]he consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid

---

6 Release No. 34-23421 at p. 15.

to any other security holder for securities tendered in the tender offer."[7] We believe the proposed phrase "securities tendered in the tender offer" is an improvement over the phrase "pursuant to the tender offer" in current Rule 14d-10(a)(2) in as much as it should mean that the Proposed Rule will not apply to any payments made to a holder who does not tender any securities into the formal tender offer. We therefore support the proposed change. Under the Proposed Rule, however, if a person "tenders" any securities into the tender offer, it will remain a question for the trier of fact to determine whether such person received at any time any payments which constituted additional consideration for the securities tendered above the price paid for such securities pursuant to the express terms of the formal tender offer. Thus, the ability of plaintiffs to allege that certain payments constituted additional tender offer consideration — which has provided the grist for plaintiffs' actions under the current best-price rule and generally prevented such actions from being dismissed at the motion to dismiss or even at the summary judgment stage — is not rectified by Proposed Rule 14d-10(a)(2). In addition, as noted above in Footnote 5, the elimination of the phrase "during such tender offer" as contemplated by Proposed Rule 14d-10(a)(2) would significantly increase the uncertainty regarding the application of the best-price rule.

For example, assume a person who is a director and chief executive offer ("CEO") owns 30% of the outstanding common stock of a public company that is engaged in a leveraged buyout. It is agreed that the CEO will tender 20% of the

[7] Current Rule 14d-10(a)(2) provides that "[t]he 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."

outstanding shares into the tender offer and roll over her remaining 10% in exchange for stock of the buyout entity ("Newco") in order to give the CEO a meaningful stake in Newco. It is also agreed that the CEO will enter into an employment agreement with Newco to become effective upon consummation of the transaction. Because all shareholders are not offered the choice in a "going private" transaction to roll over their shares into Newco or to enter into comparable employment agreements with Newco, it is open to plaintiffs to argue under Proposed Rule 14d-10(a)(2) that the upside "value" of the CEO's interest in Newco and/or amounts to be paid under the employment agreement either were (i) paid to CEO in order to induce her to tender into the tender offer, to which the subsequent payment or exchange of shares is "integrally related" or (ii) that the subsequent rollover of the CEO's stock into bidder and/or payments to the CEO under the employment agreement were all part of bidder's "tender offer", which by virtue of the deletion of "during such tender offer" from Proposed Rule 14d-10(a)(2) can no longer even be argued is fixed in duration by the formal tender offer time periods. In short, the plaintiffs could argue that the upside "value" of the CEO's interest in Newco and/or amounts to be paid under the employment agreement were additional consideration paid to the CEO for her "securities tendered in the tender offer" and that therefore all shareholders did not receive the same price in the tender offer for their tendered securities in violation of Proposed Rule 14d-10(a)(2).

Consequently, Proposed Rule 14d-10(a)(2) still could require a trial to determine exactly what was paid to the CEO for her "tendered" securities. Thus, as proposed, we do not believe that Proposed Rule 14d-10(a)(2) will alter the current uncertainty surrounding the application of Rule 14d-10. This continuing uncertainty with respect to the language of Proposed Rule 14d-10(a)(2) only magnifies the importance of the exemptive and safe harbor provisions proposed by the SEC and addressed later in this letter.

B. *Suggested Changes to Proposed Rule 14d-10(a)(2)*

We believe the SEC could add greater clarity if it made explicit what would appear to be implicit based on the language of Proposed Rule 14d-10(a)(2): if a person, the CEO in our example, does not tender <u>any</u> securities into a tender offer *commenced under the formal tender offer rules*, no payments made at any time by the bidder to the CEO will be subject to the best-price rule.[8] To the extent that officers or directors recommend the offer but withhold tenders to avoid the best-price rule, this result should not be viewed as problematic from a best-price rule perspective (although as noted below such a situation raises a number of practical problems for which we have a proposed solution). Any such tender recommendations that are tainted by payments properly are subject to state law breach of fiduciary duty claims rather than the best-price rule. We believe this clarification, easy as it is to verify, would be helpful in many circumstances to encourage the use of a tender offer where compensation-type issues addressed by the "safe-harbor" are not the only concern.

Admittedly, however, even this modest clarification is not a complete solution. The hypothetical CEO not tendering would have the effect of delaying the receipt by the CEO of payments for securities that otherwise would have been properly

---

8 This approach is also consistent with the purpose of Rule 14d-10, which is to cover payments used in a discriminatory manner to induce a holder to tender her securities. The proposition that "support" of an offer is within Rule 14d-10 was created by the <u>Epstein</u> court without comment or citation and has no support in the adopting release.

payable in the tender offer to the CEO. In addition, in some cases, the hypothetical CEO not tendering would serve to delay by approximately 30-60 days the payment of the merger consideration to other non-tendering shareholders who are cashed out in a second-step merger. This delay would occur if the CEO's failure to tender results in acquirer owning following the tender offer less than the 90% of the outstanding shares of the target required for the acquirer to effect a "short-form" merger under applicable state law — thus forcing the acquirer instead to effect a "long-form" merger.[9] Finally, a desire to avoid the perception that the CEO or other senior executives or significant shareholders are not tendering because they do not support the tender offer may continue to cause the statutory merger to be a preferred structure.

To address these problems, in addition to the clarification suggested above, we would recommend that the SEC create a specific exemption from the best-price rule that takes advantage of the most recent changes to the tender offer rules. The exemption would provide that securities tendered by a person during a "subsequent offering period" would not be deemed "securities tendered in the tender offer" for purposes of Rule 14d-10 — provided that such subsequent offering period was made available under the tender offer rules to such person *only* if the original tender offer succeeded in attracting sufficient shares from other holders to permit the bidder, after buying all the shares tendered into the original offer, to be in a position to vote to approve a second-step merger without the affirmative vote of any other holders of shares.[10] Under

[9] See, e.g., Delaware General Corporation Law §253 and §251.

[10] Obviously, the suggested change is not intended to alter the existing requirement in Rule 14d-11(f) that the form and amount of consideration be the same in both

this exemption, it would be undeniably clear that any payments made to a person who tenders during the subsequent offering period were not made to secure the success of the tender offer (since, by definition, that was achieved before the subsequent offering period became available) and therefore there would be no reason to be concerned that such person was paid something "extra" for doing so. In addition, by tendering during the subsequent offering period, the CEO in our example has aligned her actions with those she presumably recommended to the other shareholders and increased the odds the bidder would be able to consummate a "short-form" merger.[11]

---

the initial tender and the subsequent offering period (but is intended to negate any argument that any payments outside the express terms of the formal tender offer paid to a person who only tendered in the subsequent offering period constituted additional tender consideration in violation of Rule 14d-10(a)(2) or Rule 14d-11(f)).

11 It is important to note, however, that while this proposed exemption would take advantage of the "subsequent offering period" under the U.S. tender offer rules it would not necessarily be available or useful where the target company is a foreign private issuer. Uncertainty in the application of the best price rule to tender offers in the U.S. has led acquirers of non-U.S. companies in some instances to exclude the U.S. market from their tender offers. In order to encourage acquirers to include the U.S. market, and therefore, not disadvantage U.S. holders, the SEC may want to consider adopting a bright line temporal test in the limited circumstance where the target company is a foreign private issuer and less than 10% of the target's capital stock is held in the U.S.

2. SEC Proposed Exemption under Proposed Rule 14d-10(c)(2)[12]

As previously noted, we believe the exemptive and safe harbor provisions of the Proposed Rule are critical to fostering renewed interest in the general use of tender offers for acquisitions. With some suggested modifications, we believe the exemption provided by Proposed Rule 14d-10(c)(2) would do a great deal to add clarity to the application — or non-application — of the best-price rule, at least in the area of employee compensation and benefits, broadly defined.

In response to questions posed by the SEC in the Release, we offer the following suggestions, again aimed at providing clarity and certainty of application without diluting the purpose of the exemption.

A. *Current, Former or Future Employees, Directors and Consultants*

We think it would be helpful if the exemption made clear that it applied to "current, former or future employees, directors and consultants" of the subject company and would propose that those words be added to the language of paragraph (c)(2) in lieu of "employees and directors".

---

12 Proposed Rule 14d-10(c)(2) reads as follows:

> (2) The negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement, or payments made or to be made or to be granted according to such arrangements, with respect to employees and directors of the subject company, where the amount payable under the arrangement: (i) Relates solely to past services performed or future services to be performed or refrained from performing, by the employee or director (and matters incidental thereto); and (ii) Is not based on the number of securities the employee or director owns or tenders.

B. *Delete Clause (i) of Proposed Rule 14d-10(c)(2)*

We do not believe Clause (i) of Proposed Rule 14d-10(c)(2) provides any further clarity to the substantive language of the exemption that on its face applies to all compensation or benefit-type payments. To the contrary, Clause (i) provides an opportunity for plaintiffs to create sufficient uncertainty about the application of the exemption to require further fact finding by a court. For example, it is not beyond dispute whether severance payments made to an executive are "solely" for "past" services. Such payments are clearly not for "future" services and, assuming there is already a non-compete in place, the payments are not for services the executive "refrained from performing". The use of the word "solely" also invites creative plaintiff's lawyers to argue that the amount of payment to be made to a particular executive is allegedly so "excessive" (in absolute terms or in relation to some "peer" group) that the payments cannot possibly be "solely" for either past services or future services to be performed or refrained from performing.[13]

In short, the inclusion of the qualifying language in Clause (i) serves only to turn compensation and benefit payments that we believe clearly were intended to be exempt into a question of fact to be determined at trial. Footnote 46 of the Release highlights the nature of the problem. In referring to various types of severance payments for "departing employees," the footnote says "[t]hese arrangements also *can* fall within

[13] We also note that the Release appears to contemplate that defendants will bear the burden "to prove that the agreement or arrangement relates [solely] to past or future services" (Release p. 22). We believe that Proposed Rule 14d-10 should set forth the substantive requirements of the best-price rule and its exemptive and safe harbor provisions, but should not purport to mandate which party in any litigation should bear the burden of proof.

the exemption under the proposed amendments" (emphasis added). Unless it is clear on the face of the exemption that these arrangements *do* fall within the exemption, the degree of certainty required to make the exemption useful to parties structuring a transaction will not exist. The very fact that parties to a transaction might have to concern themselves with such questions of fact if a lawsuit is brought will be, in many cases, sufficient reason in and of itself not to engage in a tender offer. They will, instead, do a merger.[14]

For the foregoing reasons, we believe Clause (i) of Proposed Rule 14d-10(c)(2) should be deleted.

C. *Delete or Modify Clause (ii) of Proposed Rule 14d-10(c)(2)*

The test set forth in Clause (ii) of Proposed Rule 14d-10(c)(2) that the amounts payable under an employment compensation, severance or other employee benefit arrangement not be "based on the number of securities the employee or director owns or tenders" is highly problematic. Given the fact that stock options and other equity grants and awards can be an important, and in some cases, the largest component of executive compensation, we can envision many circumstances where the exemption will not apply — and therefore even the safe harbor provisions will be of no utility. If, for example, an option plan provides for acceleration of vesting or a cash out upon

[14] Also, the request for comment asks whether the proposed exemption will make it less likely that cases involving an alleged violation of the Rule will "survive a *summary judgment motion*." (Release p. 23; emphasis added) This reference to summary judgment is troubling. If parties cannot have absolute confidence that these issues will be resolved at the outset of litigation upon the filing of a motion to dismiss, then parties will remain strongly incented to opt for a merger. Having to conduct discovery and file a motion for summary judgment, which may or may not be granted, will continue to present far too much uncertainty.

occurrence of a change in control (e.g., upon consummation of a tender offer to acquire more than 50% of the outstanding stock), then the payments made in respect of the plan arguably will be based on the number of securities owned by the employee. Accordingly, the exemption may be lost. Therefore, we would propose that Clause (ii) of Proposed Rule 14d-10(c)(2) be deleted.[15]

If the SEC is unwilling to delete Clause (ii) of Proposed Rule 14d-10(c)(2), we recommend that the language of Clause (ii) be modified as follows:

> "(ii) Is not expressly conditioned on tendering into a tender offer."

This qualification is readily and undisputably verifiable and assures that compensation and benefit arrangements are not designed to provide additional consideration to beneficiaries thereof in exchange for their tendering shares into a tender offer.

D. *Non-Exclusive List of Examples of Employment Compensation, Severance or Other Employee Benefit Arrangements*

In response to a request for comment in the Release, we recommend that the "Instruction to paragraph (c)(2)" contained in the Proposed Rule be revised to include

---

15 If the SEC accepts our proposed changes to the language of Proposed Rule 14d-10(c)(2), including the deletion of clauses (i) and (ii) thereof, we recommend that the Proposed Rule be recast as follows:

> The negotiation, execution, amendment or performance of an employment, compensation, consulting, severance, non-compete or any other compensation or benefit arrangement, plan or program, or payments made or to be made or benefits granted, provided or awarded or to be granted, provided or awarded pursuant to any such arrangement, plan or program, with respect to current, former or future employees, directors and consultants of the subject company.

a non-exclusive list of examples of those types of employment compensation, severance or other employee benefit arrangements that are encompassed by Proposed Rule 14d-10(c)(2). We believe this approach is preferable to attempting to define such arrangements, inasmuch as any such definition inevitably will not be comprehensive and will raise interpretational issues. We would appreciate the opportunity to comment on any such list before it becomes an official part of the Instructions.

E. *De Minimis Exclusion*

The Release requests general comment on a possible de minimis exclusion to the best-price rule to carve out of the application of Rule 14d-10(a)(2) the negotiation or execution of any employment compensation, severance or other employee benefit arrangement with an employee or director of the subject company who, together with any affiliates, beneficially owns less than a nominal threshold amount. We respectfully offer the following observations with respect to such a de minimis exclusion.[16]

First, we believe that a de minimis exclusion should be part of the Proposed Rule but would be far more useful if it provided an exclusion not only for compensation or benefit arrangements, but for any other types of arrangements or payments (e.g., commercial arrangements) between a company and a shareholder holding less than a de minimis number of shares. Such an exemption would allow parties to an

---

16 We note that, as a technical matter, if the SEC deletes Clauses (i) and (ii) of Proposed Rule 14d-10(c)(2), a de minimis exclusion technically would not provide any additive exemptive relief with respect to compensation or benefit arrangements. On the other hand, if the SEC does not delete Clauses (i) and (ii) of Proposed Rule 14d-10(c)(2), a de minimis exclusion would not provide any additive exemptive relief with respect to compensation or benefits arrangements if language parallel to such Clauses (i) and/or (ii) is included in the requirements of such de minimis exclusion.

acquisition transaction to be certain that the exemption from the best-price rule is available in many circumstances where the safe harbor contained in Proposed Rule 14d-10(c)(3) is not available and thus where the parties would otherwise steer away from using a tender offer. Thus, a de minimis exclusion would further the SEC's objectives as stated in the Release. In addition, such a de minimis exclusion would not undermine the protections of Rule 14d-10 inasmuch as a holder of a de minimis amount of shares does not present the spectre that the arrangements or compensation in question were an inducement to tender shares into the tender offer or as payment for those shares — the abuse Rule 14d-10 is intended to prevent.

Second, we believe from collective experience that a de minimis threshold of 3% (as opposed to the 1% suggested in the Release) for any individual beneficial owner of shares would provide a more meaningful scope to the exclusion while not, in our view, materially increasing the potential for abuse. This threshold is well below the 5% threshold used in Section 13 of the Exchange Act.

In sum, we believe that Proposed Rule 14d-10(c)(2) should be modified to provide for a de minimis exclusion for any arrangements or payments between a company and any individual beneficial owner of less than 3% of the company's shares.

F. *Issuer Self-Tenders*

In response to a request for comment contained in the Release, we believe that Rule 13e-4(f)(8) relating to issuer self-tender offers should be amended to add exemptive and safe harbor provisions mirroring those ultimately adopted as part of Proposed Rule 14d-10. Certain acquisition transactions (e.g., leveraged recapitalizations) are often most efficiently accomplished through a combination of a third-party tender offer and issuer self-tender or a standalone issuer self-tender. Extension of the exemptive and safe harbor provisions adopted for third-party tender offers to issuer self-tenders will remove the current artificial incentive to effect such transactions through a merger or other mechanism other than an issuer self-tender. In addition, we can see no policy or other basis for discriminating between third-party tenders and issuer self-tenders in terms of the availability of any exemptive or safe harbor relief from the otherwise applicable best-price requirements of Rule 14d-10(a)(2) and Rule 13e-4(f)(8).

3. SEC Proposed Safe Harbor under Proposed Rule 14d-10(c)(3)[17]

As noted above, the indispensable and most practically significant aspect of the Release is the "safe harbor" provided by Proposed Rule 14d-10(c)(3). Absent the safe harbor, we believe it is quite likely that a significant number of acquirers would remain reluctant to structure a transaction as a tender offer relying solely on the general language of Proposed Rule 14d-10(a)(2) and/or the exemption set forth in Proposed Rule 14d-10(c)(2). To avoid this fate, it is critical that the safe harbor be (i) flexible enough to

---

17 Proposed Rule 14d-10(c)(3) provides as follows:

> For purposes of paragraph (c)(2) of this section, pursuant to this non-exclusive safe harbor, an arrangement shall be deemed an employment compensation, severance or other employee benefit arrangement if it is *approved as meeting the requirements of paragraphs (c)(2)(i) and (ii) of this section* by *the compensation committee of the subject company's or bidder's* (*depending on whether the subject company or bidder is a party to the arrangement*) board of directors. If that company's board of directors does not have a compensation committee, the arrangement shall be deemed an employment compensation, severance or other employee benefit arrangement if it is so approved by the *committee of that board of directors that performs functions similar to a compensation committee*. In each circumstance, the arrangement shall be deemed an employment compensation, severance or other employee benefit arrangement only if the approving compensation committee or the committee performing similar functions *is comprised solely of independent directors* (emphasis added).

permit application across the broadest possible range of transactions and parties and (ii) crafted to eliminate any factual determinations as to its applicability that cannot be unambiguously satisfied prior to execution of a transaction and readily resolved at the motion to dismiss stage of any subsequent shareholder litigation. To this end, we offer the suggested modifications, simplifications and clarifications to the safe harbor contained in Proposed Rule 14d-10(c)(3) described below.

A. *Approved as Meeting the Requirements of Paragraphs (c)(2)(i) and (ii)*

The Proposed Rule provides that an arrangement will qualify for the safe harbor only if it is "approved as meeting the requirements of paragraphs (c)(2)(i) and (ii)." This language begs several questions that need to be resolved and clarified to maximize the utility of the safe harbor.

First, the phrase "approved as meeting" requires clarification. We believe that the SEC intends this to mean that, in order to satisfy the safe harbor, (i) the committee approving an arrangement must do so with awareness that it is approving for purposes of the safe harbor and (ii) the committee must make the express determination that the arrangement meets the requirements of paragraph (c)(2). We would support this intended meaning and recommend the Proposed Rule be clarified to remove any ambiguity.

Second, the phrase and its apparent intended meaning beg the question as to the consequences of a subsequent claim by a plaintiff that the committee's determination that an arrangement satisfies the requirements of paragraph (c)(2) was wrong, unreasonable, based on inadequate information, a breach of its fiduciary duties, etc. In our view, it is critical that any such claim, however resolved, should not result in retroactively undoing the availability or effectiveness of the safe harbor or be the basis to require extended disclosure in any documents filed with the SEC in connection with the tender offer.[18] To the extent a plaintiff believes the directors have failed in their duties as directors, plaintiff may make such fiduciary duty arguments under state law — the fact that the committee has made the determination is all that should be required to conclusively and irrevocably satisfy the Proposed Rule 14d-10(c)(3) safe harbor.[19] Issues relating to executive compensation arrangements are not unique to the tender offer context and are best addressed outside the mechanical application of Section 14(d)-10.[20]

Third, the requirement that an arrangement will qualify for the safe harbor only if it is "approved as meeting the requirements of paragraphs (c)(2)(i) and (ii)" means that an arrangement approved prior to the effective date of the Proposed Release will not qualify for the safe harbor by virtue of its original approval (because the approving committee could not have made a determination that the arrangement satisfied a safe

---

18 The only disclosure that should be required is a simple recital that for purposes of the safe harbor a committee of independent directors has approved an arrangement as meeting the requirements of Section 14d-10(c)(2).

19 We note that the Proposing Release creates some ambiguity on this critical point in stating that "[a]n approval in accordance with the proposed rule that comprise [a violation of a state law fiduciary duty] would, as a result, be subject to state law remedies but *would not necessarily* result in a violation of the third-party best-price rule." In our view, the word "necessarily" should be deleted.

20 Rule 14d-10 is not a reasonable tool for correcting whatever the perceived problems may be with respect to executive compensation. As a hypothetical, let's assume a chief operating officer with 100 shares receives a $2 million stay bonus contingent upon there being a change in control. Assume also that a court subsequently determines (reasonably or otherwise) that $1 million was "excessive" and that the payment was "integral" to the tender offer. Does this sort of infraction really merit the bidder having to pay every shareholder an additional $10,000 per share?

harbor that did not then exist). To avoid the requirement that all such arrangements be re-approved or ratified — and in recognition that such pre-effective date arrangements present virtually no potential for the kind of abuse that Rule 14d-10 is designed to eliminate in the context of a tender offer commenced post-effective date — we recommend that the SEC revise the Proposed Rule to treat as satisfying the safe harbor, for purposes of a tender offer commenced after the effective date, all arrangements approved prior to the effective date of the Proposed Rule by the shareholders, board of directors or any committee thereof of any company.

Fourth, we recommend that the words "approved as meeting" be expanded to make clear that approval of an arrangement by a committee at any time — whether upon initial adoption or subsequent re-adoption or ratification of such arrangement and whether concurrent with consideration of a proposed tender offer or otherwise — satisfies the safe harbor.

Fifth, we recommend that the words "approved as meeting" be clarified to provide that a general or "blanket" approval of a particular arrangement is sufficient to bring all individual transactions pursuant to, and participants in and beneficiaries under, such arrangement within the scope of the safe harbor without specific recitation of such individual transactions, participants or beneficiaries.

B. *Compensation Committee or Committee Performing Similar Functions*

The Proposed Rule provides that an arrangement will qualify for the safe harbor only if it is approved by "the compensation committee of the subject company's or bidder's (depending on whether the subject company or bidder is a party to the arrangement) board of directors" or, if no compensation committee exists, a committee of that board "that performs functions similar to a compensation committee," in each case "comprised solely of independent directors." We recommend that this requirement be modified and clarified in three important respects.

First, many private acquirers do not have compensation or similar committees and may not have independent directors. In addition, "controlled public companies," i.e., companies more than 50% of the voting power of which are held by another person or group (including public companies sponsored by private equity investors), and foreign private issuers — which could find themselves being either acquirers or targets — are exempt from the majority-independence requirements for boards and independence requirements for compensation committees promulgated by the NYSE and NASD. To avoid the safe harbor being unavailable to parties not having compensation committees composed entirely of independent directors, we recommend that the safe harbor permit a determination by either (i) any standing or *ad hoc* committee of the board of directors of the relevant party composed solely of independent directors (not just a compensation or similar committee) or (ii) by the board of directors of the relevant party if such party is not required to, and does not, have any independent directors.

Second, we recommend that approval of an arrangement by a committee of independent directors of the target should satisfy the safe harbor even if the acquirer is, or will be, the party to the arrangement.

Third, an arrangement to which the target is party but which the acquirer will assume or has agreed to "honor" should be covered by the safe harbor if a committee of independent directors (or the board, as applicable) of the acquirer approves of such arrangements to the same extent that would apply if the acquirer were technically “a party to the arrangement.”

Fourth, and perhaps most importantly, we recommend that the language of Proposed Rule 14d-10(c)(3) be modified to clarify that a board determination that each of the members of a committee satisfies the independence requirements of the safe harbor will be conclusive for purposes of effectively invoking the safe harbor. A plaintiff shareholder should not be able to subsequently successfully argue that one or more members of the committee were not, in fact, independent for purposes of the safe harbor as a means to retroactively undo the availability or effectiveness of the safe harbor.

We recognize that our proposed changes expand upon the safe harbor proposed by the SEC. We nevertheless believe such changes are necessary to make the safe harbor useful in different circumstances — especially acquisitions that involve private buyers, controlled public companies or foreign private issuers — and are consistent with the SEC’s goal of making clear that compensation and benefit arrangements should not be subject to the best-price rule.

4. Conclusion

We commend the SEC for its objectives, as reflected in the Release, to restore a level playing field between tender offers and mergers and to clarify that compensation and benefit arrangements are not captured by the best-price rule. We appreciate this opportunity to submit, and the SEC's consideration of, our comments on Proposed Rule 14d-10 — all of which are intended to further achievement of the SEC's stated objectives.

Respectfully,

/s/Cravath, Swaine & Moore LLP
Cravath, Swaine & Moore LLP

/s/Davis Polk & Wardwell
Davis Polk & Wardwell

/s/Latham & Watkins, LLP
Latham & Watkins, LLP

/s/ Simpson Thacher & Bartlett LLP
Simpson Thacher & Bartlett LLP

/s/Skadden, Arps, Slate, Meagher & Flom LLP
Skadden, Arps, Slate, Meagher & Flom LLP

/s/ Sullivan & Cromwell LLP
Sullivan & Cromwell LLP

/s/Wachtell, Lipton, Rosen & Katz
Wachtell, Lipton, Rosen & Katz