SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 200 and 240

[RELEASE NOS. 34-54684; IC-27542; File No. S7-11-05]

RIN 3235-AJ50

AMENDMENTS TO THE TENDER OFFER BEST-PRICE RULES

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the language of the third-party and issuer tender offer best-price rules to clarify that the provisions apply only with respect to the consideration offered and paid for securities tendered in a tender offer. We also are amending the third-party and issuer tender offer best-price rules to provide that any consideration that is offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company that meet certain requirements will not be prohibited by the rules. Finally, we are amending the third-party and issuer tender offer best-price rules to provide a safe harbor provision so that arrangements that are approved by certain independent directors of either the subject company's or the bidder's board of directors, as applicable, will not be prohibited by the rules. These amendments are intended to make it clear that the best-price rule was not intended to capture employment compensation, severance or other employee benefit arrangements. We are also making a technical amendment to correct a cross-reference in the rules that govern the ability to delegate authority for purposes of granting exemptions under the best-price rule.

EFFECTIVE DATE: **[**Insert date 30 days after Federal Register Publication**]**.

FOR FURTHER INFORMATION CONTACT: Brian V. Breheny, Chief, or Mara L. Ransom, Special Counsel, Office of Mergers and Acquisitions, Division of Corporation Finance, at (202) 551-3440.

SUPPLEMENTARY INFORMATION: We are adopting amendments to Rule 13e-4[1] and Rule 14d-10[2] under the Securities Exchange Act of 1934[3] and making certain technical changes to a delegated authority rule that is affected by the amendments to the best-price rule.[4]

I. BACKGROUND

A. Introduction and summary

On December 16, 2005, we proposed changes to the issuer and third-party tender offer best-price rules[5] to make it clear that the best-price rule generally was not intended to apply to compensatory arrangements.[6] We believed that these amendments were necessary to alleviate the uncertainty that the various interpretations of the best-price rule by courts have produced. We also intended that the amendments would reduce a

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1 17 CFR 240.13e-4.

2 17 CFR 240.14d-10.

3 15 U.S.C. 78a et seq.

4 17 CFR 200.30-1.

5 For purposes of this release, unless otherwise indicated, our references to the "tender offer best-price rule" or the "best-price rule" are intended to refer to both Exchange Act Rule 13e-4(f)(8)(ii) (17 CFR 240.13e-4(f)(8)(ii)) and Exchange Act Rule 14d-10(a)(2) (17 CFR 240.14d-10(a)(2)).

6 Amendments to the Tender Offer Best-Price Rule, Release No. 34-52968 (Dec. 22, 2005) [70 FR 76116] (the "Proposing Release").

regulatory disincentive to structuring an acquisition of securities as a tender offer, as compared to a statutory merger, to which the best-price rule does not apply.[7] We received 11 comment letters on the proposed amendments.[8] In general, commenters supported our proposed changes to the tender offer best-price rule and believed that the proposed changes, if adopted, would meet our objectives. We did, however, receive a number of comments with regard to specific aspects of the proposed changes. The changes we adopt today are, in most respects, consistent with those proposed on December 16, 2005, but include certain revisions made in response to concerns raised by commenters.

The amendments to the best-price rule will change the language of the rule to clarify that the provisions of the rule apply only with respect to the consideration offered and paid for securities tendered in a tender offer. The amendments are premised on our view that the best-price rule was never intended to apply to consideration paid pursuant to arrangements, including employment compensation, severance or other employee benefit arrangements, entered into with security holders of the subject company, so long as the consideration paid pursuant to such arrangements was not to acquire their securities.[9] Accordingly, the amendments provide that consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company of a tender offer, where the

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[7] Statutory mergers are also known as "long-form" or unitary mergers, the requirements of which are governed generally by applicable state law.

[8] The public comments we received are available for inspection in our Public Reference Room at 100 F Street, NE, Washington DC, 20549 in File No. S7-11-05, or may be viewed at http://www.sec.gov/rules/proposed/s71105.shtml.

[9] See the definition of "subject company" at Exchange Act Rule 14d-1(g)(7) (17 CFR 240.14d-1(g)(7)).

arrangements meet certain requirements, are not prohibited by the best-price rule.

The amendments also provide for a non-exclusive safe harbor, which states that arrangements, and any consideration offered and paid according to such arrangements, that are approved by either a compensation committee of the subject company's board of directors or a committee performing similar functions, regardless of whether the subject company is a party to the arrangement, are not prohibited by the best-price rules. Alternatively, if the bidder is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the bidder's board of directors.[10] In order to satisfy the safe harbor, we have provided certain alternatives for bidders or subject companies, as applicable, that do not have a compensation committee or that are foreign private issuers.[11]

The principal changes from the proposals, as discussed in detail below, are:

- For purposes of the exemption and the safe harbor, the persons who may enter into an employment compensation, severance or other employee benefit arrangement have been expanded to include all security holders of the subject company, as opposed to only employees and directors of the subject company;
- The requirements of the exemption have been modified;
- The approval of the directors of the subject company will satisfy the safe harbor requirements, regardless of whether the subject company is a party

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[10] See the definition of "bidder" at Exchange Act Rule 14d-1(g)(2) (17 CFR 240.14d-1(g)(2)).

[11] See the definition of "foreign private issuer" at Rule 405 of the Securities Act of 1933 (17 CFR 230.405).

to the arrangement;

- A special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement may approve the arrangement and satisfy the safe harbor requirements if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of those committees is independent;
- The approving directors do not need to determine that the arrangements meet the additional requirements of the compensation arrangement exemption to qualify for the safe harbor;
- The safe harbor provides certain accommodations for foreign private issuers;
- A new instruction provides that a determination by the board of directors that the board members approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the independence requirements of the safe harbor; and
- The exemption and safe harbor are included as part of the issuer, as well as third-party, best-price rule.

B. History of the best-price rule and the reasons for today's amendments

Section 14(d)(7) of the Exchange Act[12] requires equal treatment of security holders.[13] Based on the objectives of the Williams Act[14] and the protections afforded by Section 14(d)(7), the Commission adopted Rules 13e-4(f)(8) and 14d-10 in 1986.[15] These rules codified the positions that both an issuer tender offer and a third-party tender offer must be open to all holders of the class of securities subject to the tender offer (commonly referred to as the "all-holders rule") and that all security holders must be paid the highest consideration paid to any security holder (commonly referred to as the "best-price rule").[16] The rules provided that no one may "make a tender offer unless: (1) [t]he tender offer is open to all security holders of the class of securities subject to the tender offer; and (2) [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."[17]

Since the adoption of these rules, the best-price rule has been the basis for

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12 15 U.S.C. 78n(d)(7).

13 The statute and rules governing third-party tender offers apply to tender offers for more than 5 per cent of any class of any equity security registered pursuant to Section 12 of the Exchange Act, or any equity security of an insurance company that would have been required to be registered but for the exemption contained in Section 12(g)(2)(G) of the Exchange Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940. See Section 14(d)(1) of the Exchange Act.

14 Pub. L. No. 90-439, 82 Stat. 454 (1968).

15 See Amendments to Tender Offer Rules: All-Holders and Best-Price, Release No. 34-23421 (July 17, 1986) [51 FR 25873].

16 Id.

17 Exchange Act Rules 13e-4(f)(8) (17 CFR 240.13e-4(f)(8)) and 14d-10(a) (17 CFR 240.14d-10(a)).

litigation brought in connection with tender offers in which it is claimed that the rule was violated as a result of the bidder entering into new agreements or arrangements, or adopting the subject company's pre-existing agreements or arrangements, with security holders of the subject company.[18] When ruling on these best-price rule claims, courts generally have employed either an "integral-part test" or a "bright-line test" to determine whether the arrangement violates the best-price rule.

The integral-part test states that the best-price rule applies to all integral elements of a tender offer, including employment compensation, severance and other employee benefit arrangements or commercial arrangements that are deemed to be part of the tender offer, regardless of whether the arrangements are executed and performed outside of the time that the tender offer formally commences and expires.[19] Courts following the integral-part test have ruled that agreements or arrangements made with security holders that constituted an "integral part" of the tender offer violate the best-price rule.[20]

The bright-line test, on the other hand, states that the best-price rule applies only

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[18] See, e.g., Epstein v. MCA, Inc., 50 F.3d 644 (9th Cir. 1995), rev'd on other grounds sub nom.; Matsushita Elec. Indus. Co. v. Epstein, 516 U.S. 367 (1996); Lerro v. Quaker Oats Co., 84 F.3d 239 (7th Cir. 1996); Walker v. Shield Acquisition Corp., 145 F. Supp.2d 1360 (N.D. Ga. 2001).

[19] See Epstein, 50 F.3d 644; Perera v. Chiron Corp., 1996 U.S. Dist. LEXIS 22503 (N.D. Cal. 1996); Padilla v. MedPartners, Inc., 1998 U.S. Dist. LEXIS 22839 (C.D. Cal. 1998); Millionerrors Inv. Club v. General Elec. Co., 2000 U.S. Dist. LEXIS 4778 (W.D. Pa. 2000); Maxick v. Cadence Design Sys., Inc., 2000 U.S. Dist. LEXIS 14099 (N.D. Cal. 2000); McMichael v. United States Filter Corp., 2001 U.S. Dist. LEXIS 3918 (C.D. Cal. 2001); Karlin v. Alcatel, S.A., 2001 U.S. Dist. LEXIS 12349 (C.D. Cal. 2001); Harris v. Intel Corp., 2002 U.S. Dist. LEXIS 13796 (N.D. Cal. 2002); Cummings v. Koninklijke Philips Elec., N.V., 2002 U.S. Dist. LEXIS 23383 (N.D. Cal. 2002); In re: Luxottica Group S.p.A., 293 F. Supp.2d 224 (E.D. N.Y. 2003).

[20] Id.

to arrangements executed and performed between the time a tender offer formally commences[21] and expires.[22] Jurisdictions following the bright-line test have held that agreements or arrangements with security holders of the subject company do not violate the best-price rule if they are not executed and performed "during the tender offer."[23]

These differing interpretations of the best-price rule have made using a tender offer acquisition structure unattractive because of the potential liability of bidders for claims alleging that compensation payments violate the best-price rule.[24] This potential liability is heightened by the possibility that claimants can choose to bring a claim in a jurisdiction that recognizes an interpretation of the best-price rule that suits the claimant's case. These differing interpretations do not best serve the interests of security holders and have resulted in a regulatory disincentive to structuring an acquisition of securities as

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21 See Exchange Act Rule 13e-4(a)(4) (17 CFR 240.13e-4(a)(4)) and Exchange Act Rule 14d-2 (17 CFR 240.14d-2) (relating to procedures for formal commencement of tender offers).

22 See Lerro, 84 F.3d 239; Gerber v. Computer Assoc. Int'l, Inc., 303 F.3d 126 (2d Cir. 2002); In re: Digital Island Securities Litig., 357 F.3d 322 (3d Cir. 2004); Walker v. Shield Acquisition Corp., 145 F. Supp.2d 1360 (N.D. Ga. 2001); Susquehanna Capital Group v. Rite Aid Corp., 2002 U.S. Dist. LEXIS 18290 (E.D. Pa. 2002); Katt v. Titan Acquisitions, Inc., 244 F. Supp.2d 841 (M.D. Tenn. 2003).

23 Id.

24 Commenters cited the judicial interpretations as one reason for the decline in the use of tender offers and some indicated that they do not recommend the use of tender offers if other acquisition structures are available. See, e.g., the letters from the American Bar Association, Business Law Section, Committee on Federal Regulation of Securities ("ABA"); Cravath, Swaine & Moore LLP, Davis Polk & Wardwell, Latham & Watkins LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen & Katz ("Law Firm Group"); and Association of the Bar of the City of New York, Special Committee on Mergers, Acquisitions and Corporate Control Contests ("NYCBA").

a tender offer, as compared to a statutory merger, to which the best-price rule does not apply. We believe that the interests of security holders are better served when all acquisition structures are viable options.[25] We intend for the amendments we are adopting today to alleviate this regulatory disincentive.

C. Overview of the proposed amendments

As we discussed in the Proposing Release, we do not believe that the best-price rule should be subject to a strict temporal test because such a test lends itself to abuse. However, we also do not believe that all payments that are conditioned on or otherwise somehow related to a tender offer, including payments under compensatory or commercial arrangements that are made to persons who happen to be security holders, whether made before, during or after the tender offer period, should be subject to the best-price rule. Accordingly, we proposed amendments to the best-price rule that did not follow the approach of either the integral-part or the bright-line test. Instead, we proposed to change the language of the best-price rule so that only consideration paid to security holders for securities tendered into a tender offer will be evaluated when determining the highest consideration paid to any other security holder for securities tendered into the tender offer.

Our proposed amendments to the third-party tender offer best-price rule also acknowledged that critical personnel decisions often are required to be made concurrently with decisions regarding whether to pursue a transaction with the subject company in a

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[25] As we indicated in the Proposing Release, at the time we adopted Regulation M-A (17 CFR 229.1000-229.1016) we stated that "[o]ur goals in proposing and adopting these changes are to…harmonize inconsistent disclosure requirements and alleviate unnecessary burdens associated with the compliance process…").

tender offer. We believed, and continue to believe, that these decisions generally are made independently from the consideration paid for securities tendered in the tender offer. We therefore proposed a specific exemption from the third-party tender offer best-price rule for consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with employees and directors of the subject company of a tender offer where the amounts payable under the arrangements meet certain requirements. We also proposed a safe harbor to the exemption from the third-party tender offer best-price rule for consideration offered and paid according to certain employment compensation, severance or other employee benefit arrangements that were approved by either the compensation committee or a committee performing similar functions as the compensation committee of the board of directors of either the subject company or bidder, depending on which entity was a party to the arrangement.

II. AMENDMENTS TO THE BEST-PRICE RULE

A. Amendments to the basic standard in Exchange Act Rules 13e-4(f)(8)(ii) and 14d-10(a)(2)

1. Discussion

We proposed amendments to the issuer and third-party best-price rule to address the uncertainty that the various court interpretations have produced while ensuring that the intent of the best-price rule – equal treatment of security holders – is satisfied. The amendments revise the best-price rule to state that no one may make a tender offer unless "[t]he 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." The clause "for securities tendered in the tender offer" would replace the

clauses "pursuant to the tender offer" and "during such tender offer," as the rule previously read, to clarify the intent of the best-price rule. Today, we adopt these changes as proposed.

2. Comments regarding the proposed amendments to the basic standard in Exchange Act Rules 13e-4(f)(8)(ii) and 14d-10(a)(2)

Although commenters generally favored the proposals, certain commenters expressed some concerns regarding the proposed amendments.[26] These commenters were of the view that the proposed changes likely would alter the bright-line precedent that has been established by courts. Specifically, one commenter indicated that the removal of the phrase "during the tender offer" would be used to argue that payments made at any time are for "securities tendered in" the tender offer, which would expand the application and, therefore, the potential claims that could be made under the best-price rule.[27] We believe that the amendments we are adopting today, as discussed in more detail below, will provide sufficient certainty in assuring that payments made with respect to compensatory arrangements will not be captured by the best-price rule such that any temporal certainty that may previously have been present under the "bright-line test" will no longer be necessary. As stated above, we also do not believe that the best-price rule should be subject to a strict temporal test, which could provide opportunities for evasion of the rule.

As we articulated in the Proposing Release, the flexible concept of a tender offer is consistent with the purpose of the best-price rule, in that it prevents bidders from impermissibly circumventing the rule by limiting the application of the rule to stated

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[26] See, e.g., letters from ABA; Dechert LLP ("Dechert"); and Law Firm Group.

[27] Letter from Law Firm Group.

dates.[28] The best-price rule was not intended to apply to all payments made to persons who happen to be security holders of a subject company, whether made before, during or after the formal tender offer period. Further, the amendments that we are adopting today will remove the potentially expansive concept of consideration paid "pursuant to" the tender offer in order to focus the analysis as to whether the consideration to which the best-price rule would apply was paid "for securities tendered in" the tender offer.

In response to questions that we posed about whether employees and directors who enter into arrangements with the bidder or subject company and do not tender their securities into a tender offer will avoid the strictures of the best-price rule as proposed, commenters generally agreed that no violation of the best-price rule should occur under these circumstances.[29] Commenters believed that this outcome was appropriate. We agree, because the best-price rule would not be applicable in these instances.

B. Exemption for consideration offered and paid pursuant to compensatory arrangements

1. Discussion

We are adopting an amendment to the issuer and third-party best-price rules so that consideration offered and paid pursuant to employment compensation, severance or other employee benefit arrangements that are entered into with security holders of the subject company and that meet certain substantive requirements are not prohibited by the

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28 See note 21 above.

29 See, e.g., letters from ABA; Jason A. Gonzalez ("Gonzalez"); and Law Firm Group.

best-price rules.[30] We believe that amounts paid pursuant to arrangements meeting the requirements of this provision should not be considered when calculating the price paid for tendered securities.

We have revised the proposed exemption for compensatory arrangements that meet specified substantive requirements to address a number of the comments received. We have expanded the persons who may enter into an employment compensation, severance or other employee benefit arrangement to include all security holders of the subject company, as opposed to only employees and directors of the subject company. We are also extending this exemption to issuer tender offers.[31] Finally, we have modified the requirements of the exemption so that the amounts to be paid pursuant to an arrangement will have to be "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 may "not [be] calculated based on the number of securities tendered or to be tendered in the tender offer

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30 The exemption and safe harbor were proposed as amendments to Rule 14d-10(c) of the third-party tender offer rules. The exemption and the safe harbor are adopted as new Rules 14d-10(d)(1) and 14d-10(d)(2), respectively, and Rules 13e-4(f)(12)(i) and 13e-4(f)(12)(ii), respectively. Because we are inserting the exemption and safe harbor into an existing subparagraph (and redesignating old subparagraph (d) as (e), etc.), we are also making a technical change to reflect this redesignation in the rules that govern the ability to delegate authority for purposes of granting exemptions under the best-price rule.

31 The term "issuer tender offer," as defined in Rule 13e-4(a)(2) (17 CFR 240.13e-4(a)(2)), refers to a tender offer for, or a request or invitation for tenders of, any class of equity security, made by the issuer or an affiliate of such issuer of the class of such equity security. For purposes of this release, all references to "subject company," as defined for purposes of the third-party tender offer rules are intended to refer to "issuer," for purposes of the issuer tender offer rules. Similarly, all references to "bidder," as defined for purposes of the third-party tender offer rules are intended to refer to an "issuer" and "affiliate," for purposes of the issuer tender offer rules.

by the security holder."

2. Comments regarding the compensatory arrangement exemption

a. Parties to the arrangement

As proposed, the exemption would have applied to employment compensation, severance or other employee benefit arrangements entered into with employees or directors of the subject company. We solicited comment regarding whether the exemption should be restricted to such persons. Commenters believed that the exemption should be expanded and suggested expansion of the exemption to encompass consultants,[32] independent contractors,[33] employees or directors of the bidder,[34] and/or any security holder of the subject company.[35] Commenters were of the view that it would be appropriate to expand the class of persons because arrangements entered into with the expanded class of persons are, like those entered into with employees and directors, intended to cover compensation for past services or incentives for future services and not tied to the number of shares to be tendered.[36] We agree and have expanded the exemption to apply to any security holder of the subject company. While, as a practical matter, the challenges to the best-price rule to date have focused primarily on

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32 See, e.g., letters from Law Firm Group and Shearman & Sterling LLP ("Shearman").

33 Letter from New York State Bar Association, Business Law Section, Committee on Securities Regulation ("NYSBA").

34 See, e.g., letters from Gonzalez and Society of Corporate Secretaries & Governance Professionals, Securities Law Committee ("SCSGP").

35 See, e.g., letters from ABA and Dechert.

36 See, e.g., letter from SCSGP.

employment compensation, severance and other employee benefit arrangements with employees or directors of the subject company, we believe that the role of the person who is a party to the arrangement is irrelevant.

b. Types of arrangements covered by the exemption

In the Proposing Release, we asked whether we should expand the exemption to include commercial arrangements, in addition to employment compensation, severance or other employee benefit arrangements. Several commenters favored extending the exemption to commercial arrangements.[37] In doing so, commenters generally argued that it is not uncommon for security holders of the subject company of a tender offer to enter into commercial arrangements with the bidder and, absent a specific exemption, such arrangements could be (and have been) challenged under the best-price rule.[38] Other commenters suggested that providing an express exemption for employment compensation, severance or other employee benefit arrangements but not providing a similar exemption for commercial arrangements may undermine our objectives in adopting these amendments.[39]

We do not believe that it is appropriate to provide a separate exemption for commercial arrangements. As is reflected in an instruction to the exemption, which is adopted as proposed,[40] the fact that the exemption extends to employment compensation,

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37 See, e.g., letters from ABA; Dechert; Intel Corporation ("Intel"); NYCBA; NYSBA; SCSGP; and Securities Industry Association, Capital Markets Committee ("SIA").

38 See, e.g., letters from Dechert, Intel and NYCBA.

39 See, e.g., letter from NYSBA.

40 As noted in Section II.C.2.d., the instruction now applies to both the exemption and the safe harbor.

severance or other employee benefit arrangements does not mean that an arrangement of any other nature, including a commercial arrangement, with a security holder should be treated as consideration paid for securities tendered in a tender offer. This instruction should alleviate the concerns raised by commenters about whether the perceived exclusivity of the exemption will create an unintended inference.[41] Also, because of the wide variety of potential commercial arrangements that could be negotiated at the time of a tender offer we are presently unable to craft a specific exemption for commercial arrangements – unlike the language of the compensation arrangement exemption – that could be tailored to be functional while assuring security holders of the intended benefits of the best-price rule.

In the Proposing Release, we also asked whether we should consider adopting a de minimis exception to the best-price rule whereby holders of a certain percentage of securities of the subject company would be exempt from the application of the best-price rule. Some commenters were in favor of a de minimis exception, although the commenters had differing views as to the percentage to be applied to the exception, to whom the exception would apply and what types of arrangements should be available under the exception.[42] We determined that it would not be appropriate to implement a de minimis exception because it could undermine the protections of the best-price rule.

In the Proposing Release, we also asked whether the proposed exemption should provide a definition or provide examples of what we mean when we refer to

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41 Further, the best-price rule does not apply if a security holder refrains from tendering into a tender offer. See Section II.A.2. above.

42 Letters from ABA; Law Firm Group; NYCBA; NYSBA; SCSGP; and SIA.

"employment compensation, severance or other employee benefit arrangements." Commenters were mixed in their preference as to whether or not defining the phrase or offering examples would be helpful, although most did not believe it would be necessary.[43] Some commenters expressed the view that if the phrase was defined and an employment compensation, severance or other employee benefit arrangement did not fall squarely within the definition or list of examples, potential bidders might opt to use a transaction structure other than a tender offer.[44] Others stated that the phrase "employment compensation, severance or other employee benefit arrangement" uses terms that are generally understood and an attempt to define the phrase or provide examples would raise questions of interpretation.[45] We agree and generally believe that providing a definition or a list of examples is not necessary and would invite confusion.

c. Additional requirements of the exemption

We proposed that, for purposes of satisfying the exemption, the amounts to be paid pursuant to an arrangement would have to relate "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 could "not [be] based on the number of securities the employee or director owns or tenders." As we explained in the Proposing Release, we included these requirements so that the amounts paid pursuant to employment compensation, severance or other employee benefit arrangements were

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43 See, e.g., letters from ABA; Intel; Law Firm Group; and SCSGP.

44 See, e.g., letter from Intel.

45 See, e.g., letters from ABA and SCSGP.

based on legitimate compensatory reasons.[46] We also believed that it was not appropriate to permit the exemption of any payments to be made that were proportional to or otherwise based on the number of securities held by the security holder because such a relationship between the payment and the securities tendered presented the type of situation the best-price rule was adopted to guard against.

Most of the commenters believed that excluding employment compensation, severance or other employee benefit arrangements from the application of the best-price rule would provide certainty and address the issues raised by the current legal precedent.[47] A number of commenters suggested, however, that we remove the requirements of the exemption.[48] These commenters generally were concerned that the courts would scrutinize whether the requirements were satisfied, resulting in the substitution of one set of disputed facts for another.[49] Commenters also were concerned that it might be difficult to determine whether or not the requirements have been met, given that it would require the ability to discern the intent of the parties at the time the arrangement was made.[50] At least one commenter also expressed the concern that the requirements might unnecessarily circumscribe the availability of the exemption.[51]

We have considered these comments and determined to retain the requirements

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46 Proposing Release at Section II.B.1.

47 See, e.g., letters from Dechert; Law Firm Group; and NYCBA.

48 See, e.g., letters from ABA; Dechert; Law Firm Group; NYCBA; and SIA.

49 See, e.g., letters from ABA; Dechert; Law Firm Group; and SIA.

50 See, e.g., letter from Dechert.

51 See, e.g., letter from Shearman.

with certain modifications. While we recognize that it may be difficult to determine in all instances whether or not the requirements have been satisfied, we believe making the exemption available without the requirements might subject the exemption to abuse. These requirements are designed to prevent the compensation being paid or granted under an arrangement from being for securities tendered in the tender offer.[52]

i. Requirement that the amount payable under the compensatory arrangement is being paid or granted as compensation

With respect to the first requirement, some commenters asked that we remove the reference to "solely" in order to avoid language that might unnecessarily circumscribe the availability of the exemption.[53] We agree and have substituted the first clause that read "relate solely to" with "is being paid or granted as compensation for" to clarify that it was our intent to provide an exemption only for employment compensation, severance or other employee benefit arrangements for which there is a legitimate compensatory purpose.

One commenter also asked that we consider using a term other than "services" to avoid the possibility that certain forms of consideration, which may be paid or granted

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[52] Some commenters asked us to confirm whether any compensatory arrangement that is conditioned upon the security holder, who is a party to the arrangement, tendering securities into the tender offer would render the arrangement less likely to be one that should fall within the exemption or whether it is objectionable for the compensatory arrangement to be conditioned upon consummation of the tender offer. We believe that conditioning an arrangement on a security holder tendering securities into the tender offer would most likely violate one or both of the requirements of the exemption. We do not believe that conditioning an arrangement on the completion or consummation of the tender offer, without any requirements as to the security holder who is a party to the arrangement tendering shares in the tender offer, is relevant to a determination as to whether the exemption is available.

[53] See, e.g., letters from SCSGP and Shearman.

pursuant to the arrangements, would not meet the requirements of the exemption.[54] The commenter was concerned that the use of the term "services" might exclude those arrangements that called for compensation to be paid that was unconventional, such as the purchase of assets owned or used by an employee or director. We considered this concern and note that this requirement is intended only to require that the consideration paid is for services performed or to be performed or to be refrained from being performed – not to restrict the forms of consideration to be paid under an arrangement. We believe that the inclusion of the phrase "and matters incidental thereto" also should provide flexibility to cover other service-related compensation.

ii. Requirement that the amount payable under the compensatory arrangement is not calculated based on the number of securities tendered

With respect to the second requirement, several commenters expressed concern as to whether we intended for employment compensation, severance or other employee benefit arrangements that are in the form of equity-based awards to be captured by this requirement.[55] Because equity-based awards are almost always based on the number of securities "owned or tendered," commenters argued that the grant of equity-based awards or the modification of previously granted equity-based awards generally would fall outside of the compensation arrangement exemption to the best-price rule by virtue of failing to meet this second requirement. They suggested that we clarify the intent of the requirement. For similar reasons, commenters also suggested that we remove the reference to securities "owned" and refocus the provisions of this requirement on

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54 Letter from NYCBA.

55 See, e.g., letters from ABA; NYCBA; and SIA.

securities "tendered."[56] We believe that we have addressed these concerns by adding the word "calculated" before "based" and replacing "owns or tenders" with "tendered or to be tendered" so that the exemption now requires that the arrangement "not [be] calculated based on the number of securities tendered or to be tendered…" We believe these changes address the concerns raised by commenters and clarify that we did not intend for equity-based employment compensation, severance or other employee benefit arrangements that are premised on legitimate compensatory reasons to fall outside this exemption from the best-price rule.

C. Arrangements approved by independent directors

1. Discussion

We proposed a safe harbor from the third-party tender offer best-price rule for consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with employees and directors of the subject company that are approved by certain committees of the subject company's or bidder's board of directors. As we stated in the Proposing Release, we believe that the fiduciary duty requirements of board members, coupled with significant advances in the independence requirements for compensation committee members and recent advances in corporate governance, provide safeguards to allow employment compensation, severance or other employee benefit arrangements that are approved by independent compensation committee members and groups of independent board members to be exempt from the

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[56] See, e.g., letter from ABA.

best-price rule.[57] As proposed, this provision would have operated as a safe harbor within the broader proposed exemption that included the two requirements discussed above. As we noted in the Proposing Release, we believed that providing such a safe harbor would provide increased certainty to bidders and subject companies in connection with the application of the best-price rule. We also believed that the proposed safe harbor struck the proper balance between the need for certainty in planning and structuring proposed acquisitions and the statutory purposes of the best-price rule. Most of the commenters agreed that providing the safe harbor was a good idea, although some commenters suggested certain changes to the provisions of the safe harbor to address issues on which we requested comment or that commenters identified.[58]

We are adopting the safe harbor provision with certain modifications. First, we added the safe harbor to both the issuer and third-party tender offer best-price rules. Next, we amended the language of the safe harbor so that arrangements can be approved by either a compensation committee or a committee performing similar functions of the subject company's board of directors, regardless of whether the subject company is a party to the arrangement. Alternatively, if the bidder is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the board of directors of the bidder. In the case of issuer tender offers, arrangements must be approved by either a compensation committee of the

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57 See, e.g., New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. Order Approving Proposed Rule Changes, Release No. 34-48745 (Nov. 4, 2003) [68 FR 64154] and Section 303A.05 of the New York Stock Exchange's Listed Company Manual (requiring the compensation committee to be comprised solely of independent directors).

58 See the discussion at Section II.C.2. below.

issuer's board of directors or a committee performing similar functions, regardless of whether the issuer is a party to the arrangement. Alternatively, if an affiliate is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the board of directors of the affiliate. We are also amending the safe harbor to allow a special committee of the approving entity formed to consider and approve the arrangement to approve the arrangement and meet the requirements of the safe harbor if the approving entity does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if all the members of either of those committees are not independent. All of the members of the committee used to approve an arrangement must be independent, as defined.[59] We have made certain accommodations to these requirements for foreign private issuers, as discussed below.

Most of the commenters believed that providing the safe harbor would create certainty in an otherwise uncertain environment caused by the legal precedent that has evolved in this area.[60] In this regard, commenters were of the view that the safe harbor should provide as much certainty as possible, while still retaining a certain amount of flexibility so as to allow parties to be able to take advantage of it.[61] Commenters provided significant specific guidance regarding the operation of the proposed safe

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59 Therefore, it is not necessary for the entire compensation committee of the bidder or subject company to approve the arrangement and, in fact, a subcommittee of this committee may approve the arrangement, so long as the subcommittee is comprised entirely of members that are independent in accordance with the requirements of the listing standards. See the related discussion at Section II.C.2.b. and note 72 below.

60 See, e.g., letters from ABA, Dechert and NYCBA.

61 See, e.g. letters from Law Firm Group and NYCBA.

harbor and offered suggestions regarding the most effective means of accomplishing its purpose. The safe harbor we are adopting today has been revised from the proposal to address the following concerns, as discussed in further detail below:

- The approval of the directors of the subject company will satisfy the safe harbor requirements, regardless of whether the subject company is a party to the arrangement;[62]
- A special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement may approve the arrangement and satisfy the safe harbor requirements if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of such committees is independent;
- Foreign private issuers may have the arrangement approved by any members of the board of directors or any committee of the board of directors authorized to approve the arrangement under the laws or regulations of their home country, and the members of the board or committee need not be independent in accordance with the U.S. listing standards but must be independent in accordance with the laws, regulations, codes or standards of their home country;

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[62] Alternatively, as adopted, the safe harbor is available where the arrangement is approved by the bidder's board of directors, but only if the bidder is a party to the arrangement.

- The approving directors do not need to determine that the arrangements meet the additional requirements of the compensation arrangement exemption;
- A new instruction provides that a determination by the board of directors that the board members approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the independence requirements of the safe harbor; and
- We have expanded the safe harbor to apply to issuer, in addition to third-party, tender offers.

2. Comments regarding the safe harbor

a. The committee approval required

i. Approving party

As proposed, for purposes of satisfying the safe harbor, an arrangement would have needed to be approved by the applicable committee of the board of directors of either the subject company or the bidder, depending on whether the subject company or bidder is a party to the arrangement. We requested comment on whether the safe harbor could be modified to work better with state law protections. Several commenters advocated that the safe harbor provide that the arrangement may be approved by the applicable committee of the subject company, regardless of whether the subject company is a party to the arrangement.[63] We agree with these comments and have followed this approach in the amendments we are adopting. We believe the duties owed by the subject company's board members to the security holders subject to a tender offer provide certain

[63] See, e.g., letters from ABA; Dechert; Law Firm Group; NYCBA; and SIA.

protections of security holder interests regardless of whether the subject company is a party to the arrangement because the subject company's directors have a duty to act in the best interests of the security holders of the subject company. Also, this provides additional flexibility to parties wanting to take advantage of the safe harbor; bidders that, for whatever reason, do not have a compensation committee with independent directors will be able to rely upon the safe harbor by allowing the subject company to approve the compensation arrangement whether or not the bidder is a party to the arrangement. The safe harbor adopted today also allows approval by the applicable committee of the bidder's board of directors only if the bidder is a party to the arrangement. The amendments to the issuer tender offer rules follow a similar approach with respect to the approval required by the directors of the issuer or an affiliate of the issuer.

ii. Approving body

The proposed safe harbor would have allowed a compensation committee or a committee performing similar functions comprised solely of independent members of the board of directors to approve the arrangement. The safe harbor adopted today includes this provision. In the Proposing Release, we sought comment as to whether certain entities (e.g., small business issuers, foreign private issuers) may not have established compensation committees or committees performing similar functions such that the safe harbor may not be available to them. Commenters suggested we expand the approving body to include, among others, the entire board of directors or another duly authorized committee of the board.[64]

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64 See, e.g., letters from ABA; Dechert; Law Firm Group; NYCBA; NYSBA; and SIA.

In response to these comments, the safe harbor adopted today has been expanded in two respects. First, the safe harbor allows a special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement, to approve the arrangement and satisfy the safe harbor if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee that performs functions similar to a compensation committee or does have one of these committees but none of its members is independent. The safe harbor adopted today also has been expanded to allow foreign private issuers to obtain the approval by any or all members of the board of directors or any committee of the board of directors authorized to approve the arrangement under the laws or regulations of the home country of the approving party.

We believe that expanding the safe harbor to include approvals by a special committee comprised of independent directors and the accommodation for foreign private issuers is appropriate for purposes of the best-price rule. Allowing a special committee, in lieu of a compensation or similar committee, to approve the compensatory arrangement provides additional flexibility to parties who want to rely on the safe harbor. Further, because the members of the special committee would have to be independent, we believe the approval by a special committee should not compromise investor protection.[65]

The accommodation for foreign private issuers is appropriate because those issuers may not have compensation or similar committees. Deferring to the laws and

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[65] State law also creates an incentive for board members to be disinterested from the transaction. See, e.g., 8 Del. C. §144 and Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

regulations of the home country of foreign private issuers makes it more likely that they will avail themselves of the safe harbor and, consequently, conduct tender offers that will include U.S. security holders.

b. Determining independence

In the Proposing Release, we solicited comment regarding the appropriateness of relying on the independence standards for compensation committee members as defined in the listing standards. One commenter suggested that we rely upon state law duties of directors because the approving body is already relying upon state law standards of fiduciary duties in approving the arrangement.[66] Other commenters suggested that codifying an independence definition similar to other definitions provided in some Exchange Act rules – as opposed to relying upon a definition that is determined by reference to the listing standards, as we have in other Exchange Act rules – would be a better approach because this would provide a consistent definition.[67] We disagree and are adopting the provisions related to the independence standards as proposed, with an accommodation for foreign private issuers. We believe this approach is appropriate because the definitions under the listing standards have previously been approved by us and are consistent with the approach we have followed in the past.[68] In addition, the

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66 See letter from Dechert.

67 See, e.g., letter from Shearman, which refers to Rule 16b-3(d), but we presume that the commenter is referring to the definition of "Non-Employee Director" provided in Exchange Act Rule 16b-3(b)(3) (17 CFR 240.16b-3(b)(3)).

68 See, e.g., Item 407 of Regulations S-B and S-K (17 CFR 228.407 and 17 CFR 229.407) as adopted in Executive Compensation and Related Person Disclosure, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] and Self-Regulatory Organizations; New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. Order Approving Proposed Rule Changes, Release No. 34-48745 (Nov. 4, 2003) [68 FR 64154].

amendments, as adopted, clarify that a director of a registered closed-end investment company is considered to be independent if the director is not an "interested person" of the investment company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.[69] This clarification is necessary because compensation committee listing standards typically do not apply to registered investment companies.[70]

The amendments do not require that the approving body of a foreign private issuer be comprised of members that are independent as defined in the listing standards. While foreign private issuers may rely on the listing standards when determining independence for purposes of the new rule, those issuers will have the alternative of determining the independence of the members of the board or committee approving a compensatory arrangement for purposes of the safe harbor in accordance with home country laws, regulations, codes and standards. We believe this accommodation is appropriate because foreign private issuers may not be subject to the listing standard's independence provisions as they relate to compensation committees and should be provided with the flexibility to rely on home country laws, regulations, codes and standards in adhering to independence standards. We recognize that foreign private issuers may be subject to regulatory schemes and structures that differ from those that apply to U.S. issuers and that some of these schemes and structures may have a definition that is not consistent with the definition of independence contained in U.S. listing standards. Nevertheless, we are comfortable with this approach and believe that it

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69 15 U.S.C. 80a-2(a)(19).

70 See, e.g., Section 801 of the American Stock Exchange Company Guide; NASDAQ Rule 4350(a)(2); and, Section 303A.00 of the New York Stock Exchange's Listed Company Manual.