



KIRKLAND & ELLIS LLP

## Private Equity Newsletter

# SEC Makes Tender Offer Rules More User-Friendly

### PENpoints

Compensation is now generally excluded in determining consideration paid to shareholders under the “best price” rule.

The SEC has amended its tender offer rules so that they are now more user-friendly for all acquirers, including private equity firms, in going-private transactions and other public company acquisitions. The SEC’s “best price” rule requires that all shareholders of a target company receive the same price in a tender offer.

The “best price” rule has in the past been subject to conflicting court interpretations regarding whether compensation, retention, severance, consulting, non-compete and other benefits (“compensation”) received by an executive or other employee of the target who is also a target shareholder is counted for purposes of the rule. The November 2006 amendments clarify that compensation paid to an executive or other employee of a target who is also a target shareholder does not count as part of the price paid for his or her shares. These amendments eliminate a major legal uncertainty regarding tender offers and should result in an increased use of tender offers as a means of acquiring public targets. The primary effects of the amendments are to:

- ♦ Clarify that the SEC’s “best price” rule applies only to a payment for tendered shares,
- ♦ Exempt compensation payments, and
- ♦ Create a non-exclusive safe harbor for compensation approved by an independent compensation committee.

### **Background**

The SEC’s tender offer “best price” rule originally provided that no bidder shall make a tender offer unless the “consideration paid by a bidder to any security holder pursuant to the tender offer is the highest consideration paid to any other security holder during such tender offer.”

Litigation frequently focused on whether compensation paid to a target’s executive who was also a target shareholder was “consideration paid to [a] security holder during such tender offer” for purposes of the “best price” rule. Some federal courts reached the questionable conclusion that where such compensation is “integral” to the tender offer, the compensation is subject to the “best price” rule. Under this interpretation, the per share tender offer price required to be paid to all of target’s shareholders would apparently be increased by the amount of the compensation payment to the executive (even though constituting reasonable compensation) divided by the number of target shares owned by the executive.

Tender offers have certain advantages over mergers: tender offers do not require a stockholder vote, tender offers have less onerous disclosure requirements than mergers (unless they are subject to the SEC’s “going private” rules) and tender offers generally can be completed more quickly than mergers. But the SEC’s “going private” rules (with their significant disclosure requirements) often do apply to

private equity-sponsored going-private transactions and, in addition, arranging debt financing for tender offers will remain challenging. In any event, as a result of the uncertain application of the “best price” rule due to the federal courts’ varying interpretations of the rule, and the potentially significant cost to a bidder should executive compensation be viewed as tender offer consideration, bidders and their legal advisors have for several years favored structuring deals as mergers, rather than as tender offers.

## **Amendments**

On November 1, 2006, the SEC clarified the “best price” rule, effective on December 1, 2006:

- (1) The revised SEC rule requires a bidder to pay all tendering shareholders “the highest consideration paid to any other security holder for securities tendered in the tender offer” (underscore added). This change clarifies that the “best price” rule is limited solely to payments made for securities tendered in the tender offer, thereby resolving any ambiguity as to whether payments for other purposes (i.e., compensation) should be considered for purposes of the rule.
- (2) The revised “best price” rule exempts consideration paid to a shareholder-employee of the target pursuant to “an employment compensation, severance or other employee benefit arrangement” so long as such amount (i) is compensation for the performance of past services, the

performance of future services, or agreeing to refrain from providing future services and (ii) is not calculated based on the number of securities tendered by the shareholder-employee. The SEC commented that any arrangement contingent on a shareholder-employee tendering shares “would most likely violate one or both of the requirements of the exemption.” This exemption should permit bidders to negotiate and enter into new employment, severance and other benefit arrangements, or amend such existing arrangements, with executives of the target who are also shareholders in connection with a tender offer.

- (3) The revised SEC rule adopts a non-exclusive safe harbor for a payment of the type described in the preceding paragraph that is approved by the target’s compensation committee (or a committee performing similar functions) or the bidder’s similar committee (where the bidder is a party to the arrangement), so long as all members of the committee are independent as defined under applicable listing standards or, for a foreign private issuer, under home country regulations.

## **Conclusion**

The amendments clarify that bidders can enter into new (or amended) compensation arrangements with an executive or other employee of a target who is also a target shareholder without having to worry about whether such consideration is considered for purposes of the tender offer “best price” rule.

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Should you have any questions about the matters addressed in this Kirkland PEN, please contact the following Kirkland & Ellis authors or your regular Kirkland & Ellis contact.

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## Kirkland Named 2006 “USA Law Firm of The Year”

Kirkland & Ellis has been named “USA Law Firm of the Year” by Chambers & Partners, a highly respected international legal publisher. Kirkland was recognized for providing superior service in all of its practice areas.

The award was presented at the 2006 Chambers Global Awards ceremony in London on November 16, 2006. Other finalists were Cravath, Swaine & Moore; Greenberg Traurig; Latham & Watkins; Milbank, Tweed, Hadley & McCloy; Simpson Thacher & Bartlett; Skadden, Arps, Slate, Meagher & Flom; and Sullivan & Cromwell.

The Chambers Global Awards Program is intended to honor excellence in legal services in jurisdictions around the world. Finalists were determined by independent research performed during the prior 12 months compiling the *Chambers Global, USA* and *UK* directories. The winning firms were selected by a distinguished panel of international judges. Chambers & Partners publishes guides to lawyers and law firms that are relied upon by businesspeople worldwide.

## PENnotes

### **2nd Annual China Private Equity Forum New York, NY November 28-29, 2006**

Kirkland is a sponsor of the 2nd Annual China Private Equity Forum. Kirkland attorney James Yong Wang will be a panelist on the panel “China Funds – Fund Raising & Investing Considerations.”

### **13th Annual Conference on Distressed Investing New York, NY November 28, 2006**

Kirkland partner Marc Kieselstein will moderate a panel entitled “Situation Report: Calpine” at the 13th Annual Conference on Distressed Investing presented by Renaissance American Management and the Beard Group. The two-day program will include discussions on post-confirmation litigation, shareholder and bondholder activism, auto suppliers and the airline industry.

### **Yale School of Management Private Equity Conference Rye, NY December 1, 2006**

Kirkland partner Stephen Fraidin will participate in a panel discussion on corporate governance at the Yale School of Management’s Private Equity Conference. The discussion will address key factors that decision makers must consider when contemplating going-private transactions.

### **IVCA Annual Awards Dinner Chicago, IL December 4, 2006**

Kirkland is proud to be the Presenting Sponsor of the Illinois Venture Capital Association’s Annual Awards Dinner honoring some of the most influential individuals and outstanding supporters of the private equity industry in Illinois. 2006 Honorees will be Paul J. Finnegan and Samuel M. Menco, both of Madison Dearborn Partners, who will receive the Stanley C. Golder Medal; Keith B. Bank of KB Partners, who will be presented with the Fellows Medal; and Donald W. Phillips of WP Global Partners, who will receive the Richard J. Daley Medal. Kirkland partner Jack S. Levin received the Fellows Medal in 2002 for his contributions to the private equity industry and the IVCA.

### **Hedge Fund Activism New York, NY December 7, 2006**

Kirkland will host West LEGALworks’ “Hedge Fund Activism” conference at its New York office. Kirkland partner Stephen Fraidin will serve as co-chair, and partner Elizabeth Gottschalk will serve as a panelist at the program, which will cover all aspects of hedge fund activism, including voting issues, fund formation, special problems for general counsel of hedge funds and other emerging legal issues.

## Kirkland & Ellis LLP's Private Equity Practice

Kirkland & Ellis LLP's private equity and venture capital attorneys handle leveraged buy-outs, early-stage venture capital investments, later-stage growth capital transactions, recapitalizations and going private transactions. In addition, we have significant experience in the formation of private equity and venture capital funds. Kirkland represents more than 200 private equity firms from all industries in every major market around the world. Kirkland was named the 2006 "USA Law Firm of the Year" by Chambers & Partners for providing superior service in all practice areas.

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