The Return of the Tender Offer

The amendments to the tender offer “best price” rule recently adopted by the SEC will become effective on December 8. The amendments are a response to the deterrent effect on the use of tender offers created by potential claims that all or a portion of the value of employment arrangements entered into in connection with an acquisition should be allocated to the price per share paid in a tender offer. Under the best-price rule, it was argued that this supposed increased price per share paid to employees should then be paid to all those tendering shares; thus, raising the specter of astronomical liability. As a result, the use of tender offers became relatively rare and the use of one-step statutory merger structure, to which the best-price rule does not apply, became widespread. By clarifying that employment compensation, severance and other employee benefit arrangements meeting certain requirements will not be treated as consideration paid in violation of the best-price rule, the use of tender offers in acquisitions should dramatically increase.

The amendments provide, in effect, that any payments or benefits granted or paid to any holder of securities subject to a tender offer shall be exempt from the rule if:

1. the benefits or payments are compensation for past services, future services, or future services to be refrained from (such as a non-compete) by the securities holder, and

2. the benefits or payments are not calculated based on the number of securities tendered or to be tendered by the security holder.

In addition, there is a non-exclusive safe harbor for arrangements approved as an employment compensation, severance or other employee benefit arrangement by the compensation committee of the company being acquired, whether or not the company is a party to the arrangement, or of the bidder if it is a party to the arrangements.

Now that the primary reason to avoid structuring acquisitions as a two-step transaction, a tender offer followed by a merger, has been largely eliminated, both acquirors and companies being acquired should review whether a tender offer is the appropriate structure for their particular situation.
Timing. The obvious reason to employ a tender offer structure is to complete the acquisition as quickly as possible. Both bidder and target companies share this objective. Bidders want to minimize the loss of target company customers, employees and other relationships pending closing, reduce the time during which a competing acquisition proposal may be made, and start integrating the acquired business into its own organization. Target companies want to reduce the time period during which events, such as a material adverse change, might occur and provide a bidder the basis for terminating the transaction or renegotiating the acquisition price, and during which target company operations are subject to the “ordinary course” restrictions contained in an acquisition agreement.

Under SEC rules, a bidder may start a tender offer without pre-clearing documents with the SEC and purchases of shares in a tender offer may be completed twenty business days after the offer formally begins. If sufficient shares are purchased to permit a bidder to unilaterally complete a “short-form merger” (generally 85% or 90% under state law), the acquisition of 100% of the target company may be completed approximately 30 to 40 days after an acquisition agreement is signed assuming no regulatory approvals are required. A statutory merger requires the filing of preliminary proxy materials with the SEC, the setting of a record date (with advance notice of typically ten days under stock exchange rules) and the calling of a stockholders meeting at which the acquisition is submitted to a shareholder vote. Assuming the SEC does not review the proxy materials, this process is likely to take approximately 40 to 50 days. On the other hand, if the SEC reviews the proxy materials, delays of two to four weeks are possible. Therefore, the preference for tender offers arises from the risk of delay created by the possibility of SEC review.

Before structuring the acquisition as a tender offer, however, a number of matters need to be considered which could make a tender offer structure less attractive:

- **Regulatory approvals** – If antitrust review under state, federal or foreign law is likely or the target company is in a regulated business (such as in insurance, banking, telecommunications or certain defense industries), then the required pre-closing clearances or approvals likely will extend past both the minimum tender offer period and the period necessary to obtain stockholder approval of a merger. In these instances, the one-step merger is the preferable structure. The one-step merger will “lock-up” the deal upon receipt of shareholder approval because the right of the target to terminate the merger agreement for a superior proposal usually expires upon shareholder approval, so that the target is foreclosed from considering alternative proposals even if the regulatory process is ongoing. In a tender offer, the transaction remains subject to competition until the target has received the regulatory approvals required to purchase shares in the offer and the offer has closed. (Also, the acquisition structured as a merger may be completed promptly after regulatory clearance; whereas, there would be a delay of at least a number of days between the purchase of shares in the tender offer and completion of the second-step merger.)

- **Short form merger requirements** – The timing advantage of a tender offer assumes that sufficient shares may be purchased in the offer to permit the bidder to complete the acquisition by short form merger. Will the bidder obtain the necessary 85% or 90% of the shares in the minimum tender offer period? If not, all tendered shares may be purchased and a “subsequent offering period” used to keep the offer open up to an additional twenty business days in an effort to attract sufficient shares to permit the short-form merger. However, if the bidder does not obtain enough shares in the tender offer to complete a short-form merger, it will need to delay completion of its acquisition until an information or proxy statement is circulated and the target company holds a stockholders meeting. The delay is likely to be twenty to thirty days. During this time, the bidder may be deterred
from integrating the target company into its own business because, depending upon relevant state law appraisal statutes, the value added to the value of target following the tender offer and prior to the second-step merger might be taken into account in valuing dissenting stockholders’ shares.

- **Disruptive Shareholders** – Certain hedge funds and other activist investors have used the assertion of appraisal rights (or the threatened assertion of these rights) as a means of either seeking a higher acquisition price for all shareholders or just for themselves. This tactic is not available if shares are tendered into an offer. Therefore, these shareholders may be given added leverage by a two-step acquisition structure – they may be able to prevent a short form merger if they collectively withhold 10% or 15% of the shares.

- **LBOs** – Private equity firms considering tender offers have a number of additional issues.
  
  - margin rules – if a tender offer structure is employed and the equity to be invested by the LBO firm is less than 50% of the price being paid to the stockholders of the target company, compliance with the margin rules may be an issue. Guarantees backed by assets other than the shares being purchased (whether from the fund itself, its portfolio companies, third parties receiving fees for the guarantee, or, perhaps, the target company) or additional equity in place only for the period bridging the purchase of shares in the tender offer and the completion of the second-step merger may be a solution.

  - fund documents – equity firms will need to confirm that tender offers and related bridge financing techniques are permitted by their fund’s organizational documents.

  - financing – the use of asset-backed and second lien financings and 144A offerings will not generally be possible in a tender offer structure (joint tender offers with the target company would permit secured financings and, perhaps, accelerated 144A offerings, although a joint tender will require a greater number of shares to be tendered in order for the acquiror to obtain a majority of the outstanding shares or the percentage ownership needed to complete a short-form merger). Whether the additional expense and complication of bridge financing techniques is appropriate for a given acquisition may depend on tactical “deal considerations” – whether strategic bidders are competing for the transaction and the aggressiveness of other funds in any auction process.

  - rollover of equity – if management or other insiders are participating on the “buy side” of the transaction and are rolling over outstanding shares, the ability to satisfy short-form merger ownership requirements need to be assessed. Caution needs to be exercised in dealing with this issue by rolling over shares upon the completion of the offer. Even under the amended best price rule, rollovers after completion of the formal tender offer may raise issues. (The rule amendments clarify that arrangements with parties not tendering into the offer should not violate the best price rule. However, the SEC did not adopt a bright-line test as to when a tender offer begins and ends. Therefore, rollovers of equity which are not considered compensatory might still be attacked even though the attack should stand little prospect of success.)

What is certain for all participants in the acquisition market is that the amendments to the best price rule add to the flexibility in structuring transactions.

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