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2002]

Comments

“DURING THE TENDER OFFER” (OR SOME OTHER TIME NEAR IT): INSIDER TRANSACTIONS UNDER THE ALL HOLDERS/BEST PRICE RULE

I. INTRODUCTION

A crucial element of many strategic business acquisitions is retaining the continued employment of the target company's key employees (such as senior management and star talent) by offering appropriate incentives.¹ This is often accomplished by means of employment agreements and retention packages between the acquirer and target employee-shareholder.² A potential violation of the Securities Exchange Act of 1934 (the Exchange Act) may arise when these dealings occur simultaneously with the negotiations of the terms of the acquisition.³

Specifically, side transactions with target company employee-shareholders may violate Securities Exchange Commission (SEC) Rule 14d-10. Rule 14d-10, which is commonly referred to as the All Holders/Best Price Rule, mandates that all tendering shareholders receive the “highest consideration paid to any other security holder during such tender offer.”⁴ If a court finds that an arrangement to acquire employee stock violates Rule 14d-10, it may order the acquirer to pay the difference between the tender

1. See Shearman & Sterling, *Recent Developments Related to Employment Arrangements in the Context of Public Tender Offers and Exchange Offers* 1 (Mar. 2001) (providing client publication regarding tender offers and All Holders/Best Price Rule), available at http://www.shearman.com/documents/MA_0301.pdf. Despite the fact that merger volume is currently running well below the levels of a year ago, tender offerors are still spending big money in strategic acquisitions. See *Business Brief—Temple-Inland Inc.: New Merger Deal Is Signed with Gaylord Container*, WALL ST. J., Jan. 22, 2002, at C7 (discussing \$65 million tender offer); Walter Hamilton, *New Deals May Signal Merger Resurgence; Outlook: Are Corporate Chiefs Again Willing to Take Linkup Risks?*, L.A. TIMES, Dec. 20, 2001, at C1 (noting that deals are still being made despite slow merger activity generally); Robin Sidel, *Weyerhaeuser Bid Wins 64% Support in Target Company*, WALL ST. J., Jan. 11, 2002, at B8 (discussing \$6.1 billion tender offer).

2. See Shearman & Sterling, *supra* note 1, at 1 (stating typical business practices). To ensure that future employment is secured, acquirers often “assume the stock option plans of a target company and ‘roll over’ outstanding target stock options.” *Id.* at 1 n.1. When stock prices are depressed and options are “under water,” there is “a greater need to develop and implement new incentive programs in connection with acquisition transactions.” *Id.*

3. See *id.* (notifying clients of uncertainty surrounding All Holders/Best Price Rule). For examples of transactions found in violation of federal securities laws, see *infra* notes 50-52, 60-64, 75-77, 83-86 and accompanying text.

4. See 17 C.F.R. § 240.14d-10 (2001) (stating Rule 14d-10). For a further discussion of SEC Rule 14d-10, see *infra* notes 38-39 and accompanying text.

price and the value of the employee agreement to all shareholders who tendered their stock.⁵ Such a ruling could increase the cost of the acquisition far beyond the acquirer's anticipations.⁶

Liability under Rule 14d-10 turns on whether or not the insider transaction is considered to be "during such tender offer."⁷ A classic tender offer generally involves a public announcement to purchase a specified number of shares at a specified price during a set period of time.⁸ While the provisions of Rule 14d-10 worked well in this classic sense, what has since developed are non-classic tender offers—tender offers near in time to separate transactions to acquire the stock of insiders and employees. These insider transactions do not fit the classic model, resulting in litigation as to whether such transactions occurred "during" the tender offer and under the requirements of Rule 14d-10.⁹

Because neither Congress nor the SEC has clearly defined the term "tender offer," courts have been left to decide when and if a Rule 14d-10 violation has occurred in this non-classic situation. Courts differ, however, as to what activity constitutes a tender offer for Rule 14d-10 purposes. To date, three standards for evaluating the validity of special agreements with inside shareholders tied to a tender offer have evolved. The Second Circuit has applied a "functional" test to determine if the tender offer and disputed transactions should be viewed as a single transaction.¹⁰ Other circuits have developed a very similar "integral part of the tender offer" test where the relative importance of the side transaction to the success of

5. See Shearman & Sterling, *supra* note 1, at 3 (discussing cause for concern); see also 15 U.S.C. § 78n(d)(7) (2001) (stating that "such person shall pay the increased consideration to each security holder whose securities are taken up and paid for pursuant to the tender offer. . .").

6. See Shearman & Sterling, *supra* note 1, at 3 (articulating consequences of Rule 14d-10 violation). To illustrate the cause for alarm, consider this hypothetical. Corporation X has 10 million shares outstanding. An acquirer announces a tender offer for all shares at \$100 per share. The Chief Executive Officer of Corporation X is to stay on in his current capacity after the acquisition. He owns 1 million shares and has arranged a special agreement where he is to receive an average price of \$110 per share. If a court finds that this agreement constitutes additional consideration paid during the tender offer, the court could order the acquirer to pay the additional \$10 for the remaining 9 million shares, thereby increasing the total cost of the acquisition by \$90 million.

7. See 17 C.F.R. § 240.14d-10 (2001) (providing language of Rule 14d-10).

8. See 113 CONG. REC. 855 (1967) (statement of Sen. Williams) (explaining classic tender offers).

9. See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 246 (7th Cir. 1996) (demonstrating uncertainty as to meaning of "during" the tender offer); *Epstein v. MCA, Inc.*, 50 F.3d 644, 655 (9th Cir. 1995) (same), *rev'd on other grounds sub nom. Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996); *Field v. Trump*, 850 F.2d 938, 944-45 (2d Cir. 1988) (same); *Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1367 (N.D. Ga. 2001) (same); *Katt v. Titan Acquisitions*, 133 F. Supp. 2d 632, 635 (M.D. Tenn. 2000) (same).

10. See *Field*, 850 F.2d at 944-45 (holding that purchases of stock from directors of target corporation after purported withdrawal of tender offer could constitute continuation of tender offer from "functional" perspective).

the tender offer is examined.¹¹ In contrast to these circuits are those circuits that rely on a “bright-line timing” approach in which all conduct prior and subsequent to the tender period is deemed outside the tender offer.¹² Consequently, a split has emerged among the courts of appeals, which has been exacerbated by the district courts that have given support to each of the approaches.¹³

In addition to the ambiguity created by the contrasting approaches courts follow,¹⁴ there is further uncertainty as to the result of a Rule 14d-10 challenge under the “functional” and “integral part” tests.¹⁵ The uncertainty of the current circuit split, combined with the potential severity of a Rule 14d-10 violation, necessitates the uniform adoption of a single validity test.

This Comment argues that the SEC or the United States Supreme Court should remove the ambiguity regarding the application of Rule 14d-10 by recognizing the “bright-line timing” standard as the single validity test. Part II provides background on the Williams Act and Rule 14d-10, and it discusses the problems surrounding the definition of the term “tender offer.”¹⁶ Part III identifies the different tests used to define “tender offer” and examines the courts’ reasonings in applying each of the

11. See *Epstein*, 50 F.3d at 655 (finding for plaintiff shareholders, court determined that tender offer period is not limited by any time frame and that director side transactions were integral parts of tender offer).

12. See *Lerro*, 84 F.3d at 246 (concluding that because consideration paid to majority shareholder was determined prior to commencement of tender offer, payment was not made *during* tender offer and therefore is not within Rule 14d-10).

13. See *Walker*, 145 F. Supp. 2d at 1367 (finding *Lerro* standard most persuasive); *Katt*, 133 F. Supp. 2d at 635 (dismissing defendants’ motion to dismiss investors’ class action alleging violations of All Holders/Best Price Rule after adopting and applying Ninth Circuit “integral part” test).

14. Compare *Epstein*, 50 F.3d at 657 (applying “integral part of tender offer” test), *Field*, 850 F.2d at 950 (applying “functional” test), and *Katt*, 133 F. Supp. 2d at 646 (applying “integral part of tender offer” test), with *Lerro*, 84 F.3d at 246 (applying bright-line test), and *Walker*, 145 F. Supp. 2d at 1378 (applying bright-line test). As these cases demonstrate, the test a court applies often determines the outcomes of claims under Rule 14d-10 in that defendant-acquirers fair best under the bright-line standard. Compare *Epstein*, 50 F.3d at 657 (reversing defendants’ summary judgment), and *Field*, 850 F.2d at 950 (reversing defendants’ summary judgment), and *Katt*, 133 F. Supp. 2d at 646 (denying defendants’ motion to dismiss), with *Lerro*, 84 F.3d at 246 (affirming dismissal of plaintiffs’ claim), and *Walker*, 145 F. Supp. 2d at 1378 (granting defendants’ motion to dismiss).

15. Compare *Epstein*, 50 F.3d at 656 (finding agreements integral to tender offer), and *Field*, 850 F.2d at 945 (finding single transaction after applying “functional” standard), with *McMichael v. United States Filter Corp.*, No. EDCV 99-182, 2001 U.S. Dist. LEXIS 3918, at *17 (C.D. Cal. Feb. 22, 2001) (finding transaction not integral to tender offer), and *Pridy v. Edelman*, 679 F. Supp. 1425, 1432 (E.D. Mich. 1988) (finding separate transactions because tender offer was terminated when defendant’s shares were purchased).

16. For a complete discussion of the Williams Act, see *infra* notes 25-37 and accompanying text.

different approaches.¹⁷ Part IV recommends that either the Supreme Court or the SEC permanently resolve the issue by adopting a “bright-line timing” approach.¹⁸ Finally, in the event that the “bright-line timing” approach is not uniformly adopted, Part V provides suggestions and recommendations for acquirers structuring future transactions so as to avoid the ramifications of the more subjective “functional” and “integral part of the tender offer” tests.¹⁹

II. BACKGROUND

A. *The Williams Act*

Congress passed the Exchange Act in response to the Great Depression.²⁰ Its purpose was to regulate trading transactions in order to restore and maintain the integrity of U.S. securities markets.²¹ The Exchange Act identifies a “laundry list” of problems and abuses that Congress found responsible for the 1929 crash.²² The SEC was created through section 4 of the Exchange Act and was given the responsibility of resolving the articulated abuses so as to implement the purpose of the Exchange Act.²³ One of the problem areas that developed over the years was corporate takeovers.²⁴

Before the 1960s, acquirers most often solicited proxies or utilized exchange offers of securities in order to accomplish corporate takeovers.²⁵ Section 14 of the Exchange Act regulated proxy solicitations, while section 5 of the Securities Act of 1933 imposed disclosure and registration requirements on exchange offers.²⁶ During the 1960s, cash tender offers became

17. For a further discussion of the “functional,” “integral part of the tender offer” and “bright-line timing” tests, see *infra* notes 51, 59, 91 and accompanying text.

18. For a further discussion promoting uniform acceptance of a “bright-line timing” approach, see *infra* notes 116-62 and accompanying text.

19. For a further discussion of recommended courses of action with regards to side transactions and tender offers, see *infra* notes 183-91 and accompanying text.

20. See JAMES D. COX ET AL., *SECURITIES REGULATION CASES AND MATERIALS* 3 (3d ed. 2001) (identifying Great Depression as source of political momentum behind securities regulation).

21. See *id.* at 8-9 (identifying purpose of Exchange Act).

22. See *id.* at 7 (noting that section 2 of Exchange Act summarizes abuses responsible for crash of 1929).

23. See *id.* (explaining creation of SEC).

24. For a further discussion, see *infra* notes 25-31.

25. See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 22 (1977) (examining Williams Act). Solicitations include “any other writings which are part of a continuous plan ending in solicitation and which prepare the way for its success.” *SEC v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943). An “exchange offer” refers to the part of a bilateral contract that includes “the consideration for [the] ultimate contract when the offer is accepted.” *BLACK’S LAW DICTIONARY* 563 (6th ed. 1990).

26. See *Piper*, 430 U.S. at 22 (identifying takeover vehicles); see also 15 U.S.C. § 78n (2001) (regulating proxies); 15 U.S.C. § 77e (2001) (regulating exchange offers).

the preferred method for effectuating corporate takeovers.²⁷ Tender offers, however, did not fall within existing disclosure requirements of the Securities Act of 1933 or the Exchange Act.²⁸ The lack of regulation allowed bidders to extend tender offers without disclosing information material to the offer.²⁹ In addition, bidders would restrict the offer to a limited number of shares, accept tendered shares on a first-come, first-serve basis and make the tender period very brief.³⁰ This situation, referred to as a "Saturday night special," pressures investors into making decisions based upon severely limited information.³¹

Congress reacted to the increased use of cash tender offers by enacting the Williams Act ("the Act") in 1965.³² The Act's purpose was to fill

27. See *Piper*, 430 U.S. at 22 (identifying growing use of cash tender offers as purpose of adopting Williams Act); E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 2-10 (1973) (discussing rise in use of cash tender offers as methods for acquiring corporate control); Samuel L. Hayes, III & Russel A. Tausig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 137 (Mar.-Apr. 1967) (same).

28. See *Piper*, 430 U.S. at 22 (delineating need for 1968 Williams amendments); Kahn v. Va. Ret. Sys., 13 F.3d 110, 113-14 (4th Cir. 1993) (identifying Congress' motivation for Williams Act), *aff'd on other grounds*, 13 F.3d 110 (4th Cir. 1993); Hanson Trust v. SCM Corp., 774 F.2d 47, 54 (2d Cir. 1985) (explaining reason for section 14(d)). In a cash tender offer, a bidder campaigns to buy a set number of shares of a company's stock for a specified price. See *Piper*, 430 U.S. at 22 (summarizing tender offers).

29. See *Hanson Trust*, 774 F.2d at 55 (explaining that "[p]rior to the Williams Act a tender offeror had no obligation to disclose any information to shareholders when making a bid"); see also Henry L. "Scott" Nearing, III, Note, Kahn v. Virginia Retirement System: *The Impact of Rule 10b-5's Corporate Disclosure Requirements on the Williams Act's Tender Offer and Best Price Rules*, 40 VILL. L. REV. 263, 268 (1995) (discussing investor protection under Williams Act).

30. See 113 CONG. REC. 856 (1967) (discussing need for "best-price" rule). According to Senator Williams, this provision was designed to reduce pressures on target shareholders to hastily tender their shares and eliminate the acquirer's ability to make "Saturday night special" tender offers. See *id.* (discussing need for "best-price" rule).

31. See *Hanson Trust*, 774 F.2d at 55 ("Without knowledge of who the bidder is and what he plans to do, the shareholder cannot reach an informed decision. He is forced to [act] without adequate information to enable him to decide rationally what is the best possible course of action.") (quoting S. REP. NO. 90-550, at 2-4 (1967)).

32. See *Piper*, 430 U.S. at 22 (discussing adoption of Williams Act); see also 15 U.S.C. §§ 78m(d)-(e) & 78n(d)-(f) (2001) (providing Williams amendments to Exchange Act). Senator Harrison William led the crusade to regulate tender offers. See 113 CONG. REC. 854 (1967) (statement of Sen. Williams) (discussing need for legislation to regulate tender offers). As subsequently enacted, 15 U.S.C. § 78m(d)(1) requires tender offerors to identify to the SEC the "'background and identity' of the offeror, the source and amount of funds or other consideration to be used in making the purchases, the extent of the offeror's holdings in the target corporation, and the offeror's plans with respect to the structure of the target corporation's business or corporate structure." *Piper*, 430 U.S. at 22-23 (explaining protections afforded by Williams Act). Additionally, the Act provides three benefits to those who tender their stock. See *id.* at 23. First, 15 U.S.C. § 78n(d)(5) affords tendering shareholders the right to withdraw their tender during the first

the void in federal regulations in order to protect investors.³³ Consistent with the philosophy of existing securities regulation, Congress' method for protecting investors was to require "full and adequate disclosures of tender offers . . . by imposing certain obligations on tender offerors during the tender offer period."³⁴

Section 14(d)(7) of the Act provides that if a bidder increases the amount paid for the target shares during the tender offer, all tendering shareholders are to receive the additional consideration.³⁵ The tendering shareholders are to receive the additional consideration even if they tendered their stock before the price increase was announced.³⁶ Congress designed this provision to prevent the acquirer from offering a greater price to select shareholders.³⁷

seven days of the offer and at any time after the offer has been open for sixty days. *See id.* Second, 15 U.S.C. § 78n(d)(6) requires pro rata acceptance of all tendered shares during the first ten days of the offer when then tender offer is for less than all outstanding shares and more shares are tendered than requested. *See id.* Finally, 15 U.S.C. § 78n(d)(7) mandates that all tendering shareholders are to receive the highest consideration paid for any target shares during the tender offer. *See id.*

33. *See Hanson Trust*, 774 F.2d at 55 (explaining that "[p]rior to the Williams Act a tender offeror had no obligation to disclose any information to shareholders when making a bid."). The increasing popularity of cash tender offers created a gap in the regulations because tender offers were not governed by federal securities laws current at the time. *See SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 948 (9th Cir. 1985) ("The Williams Act was intended to ensure that investors responding to tender offers received full and fair disclosure, analogous to that received in proxy contests."). *See generally* H.R. REP. NO. 90-1711, at 2-4 (1968) (discussing need for investor protection); S. REP. NO. 90-550, at 2-4 (1967) ("[B]y using a cash tender offer the person seeking control can operate in almost complete secrecy. [T]he law does not even require that he disclose his identity, the source of his funds, who his associates are, or what he intends to do if he gains control of the corporation.").

34. *Kahn v. Va. Ret. Sys.*, 13 F.3d 110, 113 (4th Cir. 1993) (reviewing Williams Act); *see also Piper*, 430 U.S. at 35 (stating that purpose of Williams Act was to protect investors by insuring "that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information. . . ." (quoting *Roundeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975))).

35. *See* 15 U.S.C. § 78n(d)(7) (providing section 14(d)(7) of Williams Act). Section 14(d)(7) states:

Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder whose securities are taken up and paid for pursuant to the tender offer or request or invitation for tenders whether or not such securities have been taken up by such person before the variation of the tender offer or request or invitation.

Id.

36. *See id.* (providing "Best Price" provision). For a further discussion on the protections of the Williams Act, see *supra* note 32 and accompanying text.

37. *See Epstein v. MCA, Inc.*, 50 F.3d 644, 657 (9th Cir. 1995) (emphasizing that purpose of Rule 14d-10 is to ensure that "holders of the same security are offered precisely the same consideration"), *rev'd on other grounds sub nom. Matsu-*

The SEC has taken a position consistent with that of Congress:

(i) a tender offer must be extended to all holders of the class of securities which is the subject of the offer (the "all holders requirement"); and (ii) all such holders must be paid the highest consideration offered under the tender offer (the "best-price rule").³⁸

Rule 14d-10 was subsequently enacted to codify both the all holders and best price provisions, thereby requiring that all tendering shareholders receive equal consideration.³⁹

shita Elec. Indus. Co. v. Epstein, 516 U.S. 367 (1996); *Field v. Trump*, 850 F.2d 938, 942 (2d Cir. 1988) (stating that purpose of 15 U.S.C. § 78n(d)(7) "is to prevent a tender offeror from discriminating in price among tendering shareholders"); S. REP. NO. 90-550, at 10 (1967) (identifying Congress' purpose "to assure fair treatment of those persons who tender their shares at the beginning of the tender period, and to assure equality of treatment among all shareholders who tender their shares").

38. *Field*, 850 F.2d at 942 (quoting Proposed Amendments to Tender Offer Rules, Securities Act Release No. 6595 [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83, at 797 (July 1, 1985)). SEC Release No. 6595 states that:

The purpose of this provision [Rule 14d-10(a)(2)] is to remove a purely fortuitous factor from the calculation of the amount security holders should receive for their securities by assuring them of the same price for their securities regardless of when they are taken up, and to avoid the discriminatory effect of paying some holders more than others, since security holders tendering their shares pursuant to a tender offer normally assume that all tendering security holders will receive the same price.

Proposed Amendments to Tender Offer Rules, Rule 14d-10(a)(2), Securities Act Release No. 6595, 33 S.E.C. Docket 762, 1985 WL 61507, at *3 (demonstrating that SEC's purpose for best-price rule was same as Congress'); *see also Epstein*, 50 F.3d at 657 (stating purpose of Rule 14d-10 is to ensure that all "holders of the same security are offered precisely the same consideration"); *Perera v. Chiron Corp.*, No. C-95-20725SW, 1996 U.S. Dist. LEXIS 22503, at *8 (N.D. Cal. May 8, 1996) ("The rule prohibits tender offers on a first-come-first-serve basis, or those in which larger or more influential shareholders are paid a premium for their shares."):

39. *See* 17 C.F.R. § 240.14d-10 (2001) (providing All Holders/Best Price Rule); *see also Field*, 850 F.2d at 942 (discussing codification of the All Holders/Best Price Rule). Rule 14d-10 states, in pertinent parts, that:

(a) No bidder shall make a tender offer unless:

- (1) The tender offer is open to all security holders of the class of securities subject to the tender offer; and
- (2) The 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. . . .

(c) Paragraph (a)(2) of this section shall not prohibit the offer of more than one type of consideration in a tender offer, *Provided*, That:

- (1) Security holders are afforded equal right to elect among each of the types of consideration offered; and
- (2) The highest consideration of each type paid to any security holder is paid to any other security holder receiving that type of consideration.

Id.

To further protect tendering shareholders from price discrimination in tender offers, the SEC also promulgated Rule 10b-13, later replaced by Rule 14e-5,

Where a bidder has allegedly purchased shares from some shareholders under an arrangement different than that of the tender offer, aggrieved parties have sought relief under section 14(d)(7) of the Williams Act and its implementing regulation, SEC Rule 14d-10.⁴⁰ For protections

both of which prohibit a tender offeror from making any side transactions to purchase shares during the tender offer on terms other than those set forth in the tender offer. See *Field*, 850 F.2d at 943 (discussing additional investor protection). Unlike the All Holders/Best Price Rule, however, Rule 14e-5 does not provide aggrieved shareholders a private right of action. For a further discussion on private rights of action, see *infra* note 40 and accompanying text. Rule 14e-5 states, in pertinent part:

(a) *Unlawful activity.* As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices in connection with a tender offer for equity securities, no covered person may directly or indirectly purchase or arrange to purchase any subject securities or any related securities except as part of the tender offer.

See 17 C.F.R. § 240.14e-5 (2001) (providing Rule 14e-5); see also Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, 64 Fed. Reg. 61,382 (Nov. 10, 1999) (summarizing new SEC rules). New Rule 14e-5 clarified the former Rule's text and codified a number of SEC staff positions with respect to old Rule 10b-13, but did not significantly change the substance of the restrictions on purchases outside a tender offer. See HAROLD S. BLOOMENTAL & SAMUEL WOLFF, *EMERGING TRENDS IN SECURITIES LAW* § 2.18 (2000-2001 ed.) (discussing new Rule 14e-5); Victor I. Lewkow, *The SEC's New M&A Rules—One Year Later*, in *CONTESTS FOR CORPORATE CONTROL* 539, 547 (2001) (same). The new Rule 14e-5 provides that, from the time a tender offer is announced until the time the offer expires, the acquirer may not purchase securities other than by the terms of the tender offer—as did old Rule 10b-13. See Lewkow, *supra*, at 547 (discussing new rule). Purchases are now permitted outside the tender offer “during a subsequent offering period so long as the form and amount of consideration for such purchases are the same as that offered in the tender offer.” *Id.* Other exceptions include: (1) “purchases pursuant to the exercise of previously owned options or convertible securities;” (2) “certain purchases by employee benefit plans of the bidder;” (3) purchases of odd-lot offers; (4) purchases as intermediary; (5) “purchases in connection with ‘basket’ transactions;” (6) purchases in covering transactions; (7) “purchases pursuant to unconditional contractual obligations entered into before the public announcement of the tender offer;” (8) unsolicited agency or riskless principal purchases by a dealer manager or its affiliates; (9) “purchases made by certain affiliates of the dealer manager that have appropriate firewalls in place to prevent the sharing of nonpublic information with the dealer manager and which are not made for the purpose of facilitating the tender offer;” and (10) certain purchases by United Kingdom market-makers and other purchases in certain cross-border tender offers. See *id.* (listing new exceptions under new Rule 14e-5); see also 17 C.F.R. § 240.14e-5 (2001) (providing Rule 14e-5).

40. See 15 U.S.C. § 78n(d)(7) (2001) (stating that acquirer who increases consideration paid to some shareholders “shall pay the increased consideration” to all other tendering shareholders). Note that the All Holders/Best Price Rule does not expressly create a private right of action for aggrieved shareholders. See *id.* (providing no explicit private right of action). Courts, however, have consistently found that the best-price provision impliedly affords a private right of action. See *Epstein*, 50 F.3d at 651 (pointing out that SEC's authority to enforce provisions of Exchange Act is limited to injunctive actions, therefore without private right of action, there would be no way “to enforce the express statutory command that a bidder ‘shall pay to each security holder’ any increased consideration paid to any other security holder”); *Field*, 850 F.2d at 946 (determining that private right of

of the Williams Act to be available, there must first be a tender offer.⁴¹ Once the existence of a tender offer is established, parties alleging a Rule 14d-10 violation have the burden of proving three elements: 1) that the bidder purchased a security that is the subject of the tender offer; 2) that this purchase occurred “during the pendency” of the bidder’s offer; and 3) that this purchase was for “more consideration than the bidder paid to other shareholders pursuant to the tender offer.”⁴²

B. “Tender Offer”

While existence of a tender offer is the first requirement in determining if the Williams Act applies to a transaction, neither Congress nor the

action exists because tendering shareholders are primary beneficiary of Section 14d-7); *Katt v. Titan Acquisitions*, 133 F. Supp. 2d 632, 639 (M.D. Tenn. 2000) (emphasizing critical factor in finding implied private right of action is legislative intent). In determining whether any given statute provides an implicit private remedy, several factors are generally considered. See *Cort v. Ash*, 422 U.S. 66, 78 (1975) (establishing four criteria as traditional analysis for determining whether or not statutory scheme provides implied private right of action). “First, is the plaintiff ‘one of the class for whose especial benefit the statute was enacted.’” *Id.* “Second, is there any indication of legislative intent, explicit or implicit,” either to create or deny a remedy? *Id.* “Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy. . . ?” *Id.* Finally, “is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?” *Id.* Further support for a Rule 14d-10 private right of action is gained from the “broad remedial purposes” of federal securities regulation. See *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) (finding implied private right of action because chief purpose of Exchange Act is to protect investors).

Plaintiffs seeking relief under a Rule 14e-5 (and former Rule 13b-10) claim have fared less successfully because courts have expressed doubt as to whether Rule 14e-5 affords a private right of action. See *Epstein*, 50 F.3d at 648 n.5 (finding no private right of action under Rule 10b-13 claim); *Beaumont v. Am. Can Co.*, 797 F.2d 79, 83-84 (2d Cir. 1986) (finding availability of private right of action under Rule 10b-13 unlikely); *Perera v. Chiron Corp.*, No. C-95-20725SW, 1996 U.S. Dist. LEXIS 22503, at *18 (N.D. Cal. May 8, 1996) (dismissing Rule 10b-13 claim with prejudice); *Gerber v. Computer Assocs. Int’l, Inc.*, 812 F. Supp. 361, 367 (E.D.N.Y. 1993) (refusing to find private right of action for 10b-13). *But see City Nat. Bank v. Am. Commonwealth Fin. Corp.*, 801 F.2d 714 (4th Cir. 1986) (implying private right of action for Rule 10b-13 claim); *C.J. Warren v. Bokum Res. Corp.*, 433 F. Supp. 1360, 1366 (D.N.M. 1977) (finding implied private right of action under 10b-13).

41. See 17 C.F.R. § 240.14d-1 (2001) (stating that Regulation 14D applies “to any tender offer . . . subject to section 14(d)(1) of the Act . . .”); see also *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 243 (7th Cir. 1996) (noting that Rule 14d-10 “demarc clearly the periods of time during which the special Williams Act rules apply”); *Kahn v. Va. Ret. Sys.*, 13 F.3d 110, 114 (4th Cir.) (“The Williams Act becomes operative when a purchaser makes a tender offer that will result in the purchaser owning more than 5% of the class of stock sought.”), *aff’d on other grounds*, 13 F.3d 110 (4th Cir. 1993); *Nearing*, *supra* note 29, at 272 (“To assert a Rule 14d-10 claim, the plaintiff must allege and prove that a tender offer commenced under Rule 14d-2 prior to the occurrence of the complained purchases.”).

42. See *Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1374 (N.D. Ga. 2001) (stating required elements of 14d-10 claim).

SEC has provided a precise definition of what a tender offer is.⁴³ The legislative history of the Williams Act demonstrates that section 14(d) was intended to apply to what can be described as a “classic” or “conventional” tender offer.⁴⁴ These classic tender offers, the kind being used at the time the Williams Act was enacted, were generally uniform and straight forward: 1) an offer to buy shares of the target company was extended, typically by means of newspaper advertisement, to all public shareholders; 2) the bidder specified the tender price, the number of shares sought, the length of the tender period, and any other conditions the offeror chose to impose; and 3) tendering shareholders were required to leave their shares on deposit until the terms of the offer had been met.⁴⁵ Applicability of

43. See *Kahn*, 13 F.3d at 114 (explaining uncertainty surrounding term tender offer); *Hanson Trust v. SCM Corp.*, 774 F.2d 47, 56 (2d Cir. 1985) (stating that “Congress’ failure to define ‘tender offer’ was deliberate.”); *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 950 (9th Cir. 1985) (“To serve the purposes of the Williams Act, there is a need for flexibility in fashioning a definition of a tender offer.”). Instead, “tender offer” was only loosely defined because Congress feared that a precise definition would not be sufficiently broad to cover all transactional variations. See *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on H.R. 14475, S. 510 Before the Subcomm. on Commerce and Financing of the House Comm. on Interstate and Foreign Commerce*, 90th Cong. 18 (1967) (statement of Manuel F. Cohen, Chairman, SEC) (expressing congressional concern). The imprecise definition provided courts ample discretion in deciding if and when there was a tender offer, but the lack of clear guidance also perpetuated problems that existed prior to the Williams Act. See *Adoption of Amendments to Tender Offer Rules*, Exchange Act Release No. 16,384, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373, at 82,582-83 (Nov. 29, 1979) (identifying pressured investor decisions resulting from pre-tender offer public announcements as enduring problem).

44. See *Hearings on H.R. 14475, S. 510, supra* note 43, at 17 (statement of Manuel F. Cohen, Chairman, SEC) (describing generally understood characteristics of tender offers). Manuel Cohen, Chairman of the SEC at the time of the enactment of the Williams Act, described a tender offer in the following terms:

A tender offer is quite different from the ordinary market transaction with which the average investor is familiar. Insofar as it is an offer at all it is subject to complex and sometimes deceptive conditions. Rather it is an invitation to the public security holder who tenders his security to give the other party an option—to be exercised only if certain minimum shares are tendered within a specified time and perhaps specifying a maximum which the original offeror is prepared to take—but giving him discretion to accept a lesser or larger amount or to extend the time limits. Tendering in response to such an offer involves deposit of the public security holder’s shares or obtaining a guarantee from a stock exchange member or other financially responsible person that they will be deposited.

Id.; see also 113 CONG. REC. 24,664 (1967) (statement of Sen. Williams) (describing traditional tender offer).

45. See Thomas J. André, Jr., *Unconventional Offers Under the Williams Act: The Case for Judicial Restraint*, 11 J. CORP. L. 499, 502 (1986) (describing traditional tender offers); see also *Hanson Trust*, 774 F.2d at 54-55 (describing “typical” tender offer). See generally Edward Aranow & Herbert Einhorn, *Essential Ingredients of the Cash Tender Invitation*, 27 BUS. LAW. 415 (1972) (discussing advantages of tender offer process); Meredith Brown, *The Scope of the Williams Act and Its 1970 Amendments*, 26 BUS. LAW. 1637 (1971) (describing broad scope and multiple applications

the All Holders/Best Price Rule is clear in this classic situation because provisions of section 14(d) clearly define when an offer commences.⁴⁶

The term “tender offer” has been broadened beyond the classic situation to include transactions lacking the characteristics of an orthodox transaction.⁴⁷ Two justifications proffered for this expansion are: “1) that Congress intentionally left the definition of ‘tender offer’ open in order to subject to regulation offers involving the same ‘evils’ as the conventional offer; and 2) that the securities laws should be interpreted liberally to reflect their remedial purposes.”⁴⁸ One non-classic situation to receive expanded interpretations of “tender offer” occurs when acquirers engage in side agreements with target employee-shareholders in the context of a traditional tender offer.⁴⁹

III. EXAMINING THE “FUNCTIONAL,” “INTEGRAL PART OF THE TENDER OFFER” AND “BRIGHT-LINE TIMING” TESTS

The lack of guidance from the SEC and the United States Supreme Court as to what constitutes a tender offer in this non-classic situation has

of Williams Act); W. McNeil Kennedy, *Tender Moment*, 23 Bus. Law. 1091 (1968) (describing procedure and principal features of tender process); Hugh Sowards & James Mofsky, *Corporate Take-over Bids: Gap in Federal Securities Regulation*, 41 ST. JOHNS L. REV. 499 (1967) (discussing inadequacy of investor protection as result of increasing use of cash tender offers).

46. See 17 C.F.R. § 240.14d-2 (2001) (providing Rule 14d-2). Rule 14d-2 states in part:

Date of commencement. A bidder will have commenced its tender offer for purposes of section 14(d) of the Act (15 U.S.C. 78n) and the rules under that section at 12:01 a.m. on the date when the bidder has first published, sent or given the means to tender to security holders.

Id.

47. See, e.g., *Carter Hawley Hale Stores*, 760 F.2d at 950 (applying eight-factor *Wellman* test to distinguish between private transactions and tender offers); *Hanson Trust*, 774 F.2d at 57 (analogizing *SEC v. Ralston Purina*, court defined tender offer by asking whether “there appears to be a likelihood that unless the pre-acquisition filing strictures of that statute are followed there will be a substantial risk that solicitees will lack information needed to make a carefully considered appraisal of the proposal put before them”); *Wellman v. Dickinson*, 475 F. Supp. 783, 817-24 (S.D.N.Y. 1979) (creating eight-factor test to determine question of private transaction or tender offer).

48. See André, *supra* note 45, at 502 (explaining expansion of term “tender offer” beyond its original meaning); see also *Pinter v. Dahl*, 486 U.S. 622, 652-53 (1988) (recognizing broad remedial goals in enacting securities laws); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 598 (5th Cir. 1974) (asserting that Congress intended definition of “tender offer” to be developed on case-by-case basis).

49. See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 245 (7th Cir. 1996) (following time table set out by Rule 14d-2); *Epstein v. MCA, Inc.*, 50 F.3d 644, 655 (9th Cir. 1995) (asking if transaction was integral to tender offer), *rev'd on other grounds sub nom. Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996); *Field v. Trump*, 850 F.2d 938, 943-44 (2d Cir. 1988) (looking at side transactions under totality of circumstances).

resulted in the circuit split that is the focus of this Comment.⁵⁰ Part III will describe and analyze the three different approaches courts have established to define the term “tender offer.”

A. The “Functional” Test

When faced with a purported withdrawal of a tender offer, followed by a private transaction to acquire stock, and then the announcement of a new tender offer, the United States Court of Appeals for the Second Circuit held that a violation of Rule 14d-10 occurred.⁵¹ In reaching this conclusion, the court in *Field v. Trump*⁵² applied a “functional test” which “scrutinizes such purchases in the context of various salient characteristics of tender offers and the purposes of the Williams Act” to determine if the purchase of a corporation’s shares are a privately negotiated transaction or part of a tender offer.⁵³

The court reasoned that the All Holders/Best Price Rule would be completely unenforceable if offerors were permitted to announce “withdrawals,” make private purchases of stock and then commence a “new” tender offer.⁵⁴ Consequently, the court determined that purchases made after the withdrawal of a tender offer may constitute a continuation of the tender offer.⁵⁵ For a withdrawal to be effective, a genuine intent to abandon the goal of the original offer is required.⁵⁶ Based on these determinations, the court concluded that in this case the acquirer’s intent to gain

50. For a further discussion of the circuit split, see *infra* notes 51-53, 59-61, 91-92 and accompanying text.

51. See *Field*, 850 F.2d at 944-45 (stating holding).

52. 850 F.2d 938 (2d Cir. 1988).

53. See *Field*, 850 F.2d at 943-45 (citing *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 950 (9th Cir. 1985); *Hanson Trust v. SCM Corp.*, 774 F.2d 47, 56-57 (2d Cir. 1985)) (noting that Williams Act does not define tender offer).

54. See *id.* at 944-45 (demonstrating how Rule 14d-10 would be undermined if every purported withdrawal was given effect).

55. See *id.* (setting forth rationale for finding one single tender offer); see also *Hanson Trust v. SCM Corp.*, 774 F.2d 47, 58-59 (2d Cir. 1985) (applying totality of circumstances test to find no tender offer). According to the *Field* court, the language of Section 14(d)(7) of the Exchange Act further supported the idea that changing the terms of a tender offer by increasing the consideration should be treated as a continuation of the original tender offer rather than as a new offer. See *Field*, 850 F.2d at 944 (“Section 14(d)(7) itself explicitly treats a material change in the terms of a tender offer in the form of an increased price as a continuation of the original offer . . .”). Additionally, in reaching its holding, the court summarily noted that the label an acquirer gives to a transaction is not determinative to the transaction’s classification as a tender offer. See *id.* at 944-45 (“Whether the acquisition of shares in a corporation is part of a tender offer for purposes of the Act cannot be determined by rubber-stamping the label used by the acquiror.”). The *Field* court’s concern was that the Williams Act could easily be evaded if acquirers could simply call any offer to purchase stock a private transaction. See *id.* at 944 (explaining ramifications of allowing rubber-stamping of labels).

56. See *Hanson Trust*, 774 F.2d at 59 (finding that termination of tender offer was not “false, fraudulent or ineffective”).

control of the company was present at all times.⁵⁷ Consequently, the Second Circuit ruled that the acquisition of shares was accomplished through a single tender offer subject to the All Holders/Best Price Rule.⁵⁸

B. *The "Integral Part of the Tender Offer" Test*

The "integral part of the tender offer" test examines whether an insider deal is so material to a tender offer that it should be characterized as part of the tender offer.⁵⁹ In making this determination, the court will weigh the relative importance of the side transaction at issue to the success of the tender offer in order.⁶⁰ In *Epstein v. MCA, Inc.*,⁶¹ the United States Court of Appeals for the Ninth Circuit conducted this balancing test and found a violation of Rule 14d-10.

In *Epstein*, a corporation executed a takeover through a tender offer.⁶² While still negotiating the sale of the company, the corporation entered into separate dealings with two high-level employee-shareholders of

57. See *Field*, 850 F.2d at 945 (stating that acquirer's actions showed persisting intent to gain control).

58. See *id.* at 944-45 (integrating tender offer, private agreement, and subsequent tender offer into single tender offer). The court determined that the stated purpose of the withdrawal, to allow for negotiations with the Stroums, was indicative of a continuing intent to pursue the acquisition. See *id.* at 945 (finding no genuine intent to abandon). The court also found guidance concerning the integration of tender offers from various registration exemptions under the Securities Act of 1933. See *id.* (citing L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 577 n.33 (1983) (suggesting comparison of integration under Securities Act and integration of tender offers)). The SEC has identified the following criteria as relevant in governing the integration of formally separate offerings: "1) 'are the offerings part of a single plan of financing; 2) do the offerings involve issuance of the same class of security; 3) are the offerings made at or about the same time. . .?'" See *id.* (discussing section 3(a)(11) exemption for local offerings). The *Field* court created analogous factors to govern integration of formally separate tender offers: 1) are the offers all small parts of one larger acquisition; 2) does each offer request the tender of identical classes of securities; and 3) are the offers made close in time to each other? See *id.* (weighing these factors to find no intent to abandon goal of original tender offer). Upon finding that the withdrawal was ineffective, the court dismissed the defendants' Rule 14d-2 claim because the rule "merely creates a window of time during which a *genuine* withdrawal leaves matters for all legal purposes as though [the] tender offer had never been commenced" and "does nothing to alter the principle that the mere announcement of a withdrawal may not be effective if followed by . . . conduct inconsistent with a genuine intent to withdraw." *Id.* at 944 (emphasis added).

59. See *Epstein v. MCA, Inc.*, 50 F.3d 644, 656 (9th Cir. 1995) (explaining that "integral part" test is met when side transaction is conditioned on tender offer terms).

60. See *id.* ("Because the terms of the Wasserman Capital Contribution and Loan Agreement were in several material respects conditioned on the terms of the public tender offer, we can only conclude that the Wasserman transaction was an integral part of the offer and subject to Rule 14d-10's requirements.").

61. 50 F.3d 644 (9th Cir. 1995).

62. See *id.* at 647 (providing facts of case).

the acquired company.⁶³ One of the employee-shareholders exchanged his shares one hour and twenty minutes after the tender offer expired.⁶⁴ The issue presented before the Ninth Circuit was whether this agreement was “during” the tender offer.⁶⁵

The employee-shareholder argued that the transaction fell completely outside Rule 14d-10 because the shares were exchanged after the tender offer period ended.⁶⁶ To the employee-shareholder’s discredit, however, neither the courts, the SEC nor Congress have limited the term “tender offer” to a specified time period.⁶⁷ In fact, to read such a mechanical provision into the securities law would encourage bidders to proffer inequitable tender offers—the result 14d-10 was implemented to avert.⁶⁸ By finalizing the more favorable agreements after the time period had passed, bidders could escape Rule 14d-10 liability.⁶⁹ Such a result, the *Epstein* court warned, “would drain Rule 14d-10 of all its force.”⁷⁰ Consequently, the court looked not at when the transaction was made, but at whether the transaction was an integral part of the tender offer.⁷¹

63. *See id.* (identifying “Capital Contribution and Loan Agreement” as arrangement to acquire executive’s stock). According to the agreement, the executive would take stock in a newly formed subsidiary of the acquirer as opposed to the cash tender price. *See id.* (explaining special arrangement). It was stipulated that this transaction was designed to save millions of dollars in tax liability. *See id.* (explaining purpose of special arrangement).

64. *See id.* at 653 (establishing when Capital Contribution and Loan Agreement was performed).

65. *See id.* at 654 (identifying possible Rule 14d-10 violations). Plaintiffs alleged that both of these transactions represented premiums paid for target stock in violation of Rule 14d-10. *See id.* at 648 (stating facts). Defendants argued that the payments were not made “during” the tender offer and therefore were outside the ambit of Rule 14d-10. *See id.* at 654 (describing facts).

66. *See id.* (arguing that liability under Rule 14d-10 is purely question of timing). While acknowledging that Rule 14d-10 does not contain any explanation of what is meant by “during such tender offer,” the executive shareholder advocated that Rule 14d-10 incorporates the time frame set out by Rule 10b-13, which prohibits side purchases “from the time [a] tender offer or exchange offer is publicly announced or otherwise made known . . . [to security holders] until the expiration of the period . . . during which securities tendered pursuant to such tender offer or exchange offer may be the terms of such offer be accepted or rejected.” *Id.* at 655 (alteration in original) (quoting former Rule 10b-13).

67. *See id.* at 654 (discarding defendant’s mechanical application of Rule 14d-10). The legislative history of Rule 14d-10 demonstrates that SEC wanted to prevent inequities in tender offers. *See S. REP. NO. 90-550*, at 10 (1967) (emphasizing need for “equality of treatment among all shareholders who tender their shares”). For a further discussion on the purpose of Rule 14d-10, see *supra* notes 35-39 and accompanying text.

68. *See Epstein*, 50 F.3d at 654 (discarding defendant’s mechanical application of Rule 14d-10).

69. *See id.* at 655 (raising concerns over defendant’s timing approach).

70. *See id.* (noting that even most blatant discriminatory offer could be structured outside tender period and Rule 14d-10).

71. *See id.* (identifying Ninth Circuit’s test).

The court found two elements of the employee-shareholder transaction especially damaging. First, the terms of the transaction alluded to the tender offer price.⁷² Second, the entire transaction rested on whether the bidder could acquire a sufficient number of shares from the tender offer.⁷³ “Because the terms of the Wasserman Capital Contribution and Loan Agreement were in several material respects conditioned on the terms of the public tender offer, [the Ninth Circuit concluded] that the Wasserman transaction was an integral part of the offer and subject to Rule 14d-10’s requirements.”⁷⁴

A year after *Epstein*, a district court in the Ninth Circuit revisited the issue in *Perera v. Chiron Corp.*⁷⁵ In *Perera*, an acquiring company proffered a \$117 per share tender offer for the stock of a target company and also promised to improve certain employee stock options.⁷⁶ The United States District Court for the Northern District of California found that there was evidence to support a claim that the option enhancements offered to employee-shareholders were paid not as compensation for employment, but rather as incentives to induce the tender of their target stock.⁷⁷ Following *Epstein*, the court deemed that payments for the purpose of inducing the tender of target stock are consideration for, and integral to, the tender offer.⁷⁸

Three elements of the enhancements supported their integration into the tender offer. First, the option enhancements were contained in the same agreement as the terms of the tender offer.⁷⁹ Second, the acquirer attached the same value to the tender offer and the option enhancements.⁸⁰ Third, receipt of the option enhancements was

72. *See id.* at 653 (explaining factors justifying conclusion that “integral part” test was met).

73. *See id.* at 656 (explaining inside transaction). Had the tender offer been unsuccessful, the executive shareholder would have retained his target stock. *See id.* (explaining importance of tender offer to insider transaction). An arrangement such as this is identical to the conditions and purposes of tender offers. *See id.* (comparing tender offer and insider transaction). If the number of tendered shares were less than what the acquirer was seeking, no shares would be purchased pursuant to the offer and each shareholder would have retained his or her target stock. *See id.* (finding insider transaction effectively same as tender offer).

74. *Id.*

75. *See Perera v. Chiron Corp.*, No. C-95-20725SW, 1996 U.S. Dist. LEXIS 22503 (N.D. Cal. May 8, 1996) (applying appellate court standard).

76. *See id.* at *3 (stating facts). Generally speaking, the option enhancements provided increased benefits and value to existing stock options owned by the target employees. *See id.* at *6-7 (describing option enhancements).

77. *See id.* at *12 (refusing to grant defendants’ motion to dismiss).

78. *See id.* (defining “consideration” for Rule 14d-10 purposes).

79. *See id.* at *9 (identifying reasons why option enhancements were not separate from tender offer).

80. *See id.* (identifying reasons why option enhancements were not separate from tender offer).

conditioned upon a successful tender offer.⁸¹ In reaching its holding, the court emphasized that Rule 14d-10 “prohibits tender offers on a first-come, first-serve basis, or those in which larger or more influential shareholders are paid a premium for their shares.”⁸²

*Katt v. Titan Acquisitions*⁸³ was the most recent case to follow the *Epstein* approach.⁸⁴ In *Katt*, a tender offer acquirer agreed to honor various golden parachute agreements, sign on bonuses and retention agreements with target company employees upon successful completion of the tender offer.⁸⁵ A shareholder of the target company alleged that these agreements constituted increased compensation paid to the employee-shareholders in order to induce their participation in the tender offer.⁸⁶

After examining all three standards in detail, the court determined that the congressional purpose as well as the SEC’s view was best served by the “integral part” approach.⁸⁷ Having discussed at length which standard is most appropriate, the court provided only a very brief explanation as to its ruling that the agreements were integral to the tender offer. The court observed that the agreements were made only months before the tender offer’s announcement and that the employees’ contractual rights under the agreements were dependent upon the tender offer.⁸⁸ From this, the court concluded that the agreements were “inextricably joined” and integral to the tender offer.⁸⁹ Furthermore, the court found the agreements to constitute additional consideration paid in violation of Rule 14d-10.⁹⁰

81. *See id.* (identifying reasons why option enhancements were not separate from tender offer).

82. *Id.* at *8 (interpreting Rule 14d-10 to ensure that all holders of same security are offered same consideration).

83. 133 F. Supp. 2d 632 (M.D. Tenn. 2000).

84. *See also* Millionerrors Inv. Club v. Gen. Elec. Co. PLC, No. Civ. A. 99-781, 2000 WL 1288333, at *5 (W.D. Pa. Mar. 21, 2000) (following “integral part” test as well).

85. *See Katt*, 133 F. Supp. 2d at 634-35 (providing facts).

86. *See id.* (stating issue). Defendants’ counter argument is that the agreements at issue were made prior to the tender offer and the awards were paid subsequently, therefore, no shares were purchased for a greater amount during the offer. *See id.* at 635 (explaining defendants’ position).

87. *See id.* at 644 (determining that controlling issue is whether golden parachute agreements were “integrally tied to successful completion of tender offer”). Despite declining to follow the “bright-line timing” test approach of the Seventh Circuit, the court noted that “there is clearly merit in a bright-line rule approach.” *See id.* (suggesting support for bright-line rule). For a further discussion on the congressional purpose and SEC view, see *supra* notes 35-39 and accompanying text.

88. *See id.* (providing court’s analysis).

89. *See id.* at 644-45 (finding that agreements were integral parts of tender offer).

90. *See id.* at 644 (finding agreements “integral parts of Titan’s tender offer and constitute additional consideration to some shareholders”).

C. *The "Bright-Line Timing" Test*

The "bright-line timing" approach relies on the plain language of Rule 14d-10 and finds all conduct prior or subsequent to the tender period permissible.⁹¹ This standard was applied by the United States Court of Appeals for the Seventh Circuit in *Lerro v. Quaker Oats Co.*⁹²

In *Lerro*, the Quaker Oats Co. sought the acquisition of Snapple, Inc.⁹³ Before announcing the tender offer for Snapple stock, the two corporations entered into a merger agreement as well as an agreement giving exclusive distribution rights of Snapple products to a third company, Select Beverages, Inc.⁹⁴ The primary shareholder/owner of Select was also a controlling shareholder of Snapple.⁹⁵ After 96.5% of the outstanding target shares were tendered, Snapple orchestrated a short-form merger of the target company into a fully-owned subsidiary.⁹⁶ Plaintiff investors, who were former Snapple shareholders, claimed that the distribution agreement provided an alleged benefit that was not offered to all other shareholders.⁹⁷ This, plaintiffs claim, amounted to additional consideration paid to the controlling shareholder during the tender offer.⁹⁸

The *Lerro* court's analysis began under the premise that, prior to the tender period, Quaker Oats could have purchased the controlling stock at any price (greater or less than the tender price) without violating the All Holders/Best Price Rule.⁹⁹ According to the court, the rule requires that "[e]veryone who tenders receives the highest price paid 'during the tender offer'—not, as plaintiffs would have it, that the minimum price 'during the tender offer' is set by a price paid at some other time."¹⁰⁰ The court emphasized that acquirers are free to buy and sell in the open market before a tender offer begins, and stressed the necessity of certainty for such transactions.¹⁰¹ From the Seventh Circuit's perspective, the required certainty can only be accomplished by a "bright-line timing" approach.¹⁰²

91. See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 246 (7th Cir. 1996) (finding that issue is about "when" rather than "what").

92. 84 F.3d 239 (7th Cir. 1996).

93. *Id.* at 240 (providing background).

94. *Id.* (explaining various agreements between Snapple and Quaker).

95. *Id.* (stating facts). The controlling shareholder had also given Quaker an option to buy his stock regardless of the success of the tender offer. See *id.* (explaining details of transaction). Success of the tender offer was certain, however, as the controlling shareholder committed to tender 35-47% of Snapple's outstanding stock (his percentage ownership was disputed). See *id.* (providing facts).

96. *Id.* (providing background).

97. *Id.* (stating issue).

98. *Id.* (stating issue).

99. See *id.* at 242 (identifying conclusion drawn by district court).

100. *Id.* at 242-43.

101. See *id.* at 243 (stressing need for precise "blackout" period when millions or billions of dollars are at stake).

102. See *id.* at 243-44 (advocating bright-line rule despite anticipated faults).

Whether the distribution agreement was “integral” to the tender offer was irrelevant to the court in determining if a payment greater than the tender price was paid “during” the tender offer.¹⁰³ Rule 14d-2(a) did provide guidance, however, and the official commencement date of the tender offer was established as November 4, 1994.¹⁰⁴ The merger and distribution agreements were entered into three days prior.¹⁰⁵ Consequently, under a bright-line application of Rule 14d-10, the distribution agreement was not during the tender offer.¹⁰⁶

Support for the “bright-line timing” standard most recently came from the United States District Court for the Northern District of Georgia in *Walker v. Shield Acquisition Corp.*¹⁰⁷ In *Walker*, a company negotiating its own acquisition simultaneously approved the payment of “Retention and Transition Awards” to certain employees following a change in corporate control.¹⁰⁸ Soon after the transition awards were approved, the company committed to an “Agreement and Plan of Merger” and then announced a tender offer.¹⁰⁹ The merger agreement contractually obligated the surviving corporation to honor the transition and retention awards.¹¹⁰ Plaintiffs were shareholders of the acquired company who claimed that the awards were a “ruse for additional payments” to employee-shareholders prohibited by Rule 14d-10.¹¹¹

103. *See id.* (dismissing plaintiff’s *Epstein* argument). The court assumed that the agreement was integral to the offer because the controlling shareholder would not have tendered his stock if he were not satisfied with the deal he was being offered. *See id.* at 244 (ignoring necessity of arrangement to tender offer). Furthermore, his commitment to the offer was necessary because the offer could not be successful without his controlling stock. *See id.* at 240 (discussing details of transaction).

104. *See id.* at 245 (stating date of public announcement as commencement date of tender offer). For a further discussion of Rule 14d-2, see *supra* note 46 and accompanying text.

105. *See id.* (stating that merger and distribution agreements were executed on November 1, 1994).

106. *See id.* at 243, 246 (affirming district court’s dismissal of plaintiff’s section 14(d)(7) claim).

107. 145 F. Supp. 2d 1360 (N.D. Ga. 2001). The *Walker* court found that the presence of a short form merger made the reasoning of *Lerro* most persuasive and most factually analogous. *See Walker*, 145 F. Supp. 2d at 1372 (finding *Lerro* most applicable). The court did not discuss the *Katt* decision, however, which presented an almost identical situation to that in *Walker*, absent the presence of a follow up short form merger. For a further discussion of *Katt*, see *supra* notes 83-90 and accompanying text.

108. *See id.* at 1362 (explaining that negotiations were underway when transition awards were approved). The agreements provided payments to thirteen key employees following a change in control. *Id.* (explaining agreements).

109. *See id.* at 1362-63 (providing facts). The tender offer was announced one day after the merger agreement was entered into. *Id.* (explaining acquisition). The tender of 55% of target stock was secured through an agreement already executed with a target executive. *Id.* (explaining acquisition). The thirteen key employees collectively owned 3.3% of the target stock. *Id.* (explaining acquisition).

110. *See id.* at 1363 (discussing merger agreement).

111. *See id.* at 1364 (identifying issue).

As in *Lerro*, the *Walker* court's analysis focused on when the transactions occurred relative to each other, and it examined Rule 14d-2 to identify the dates of commencement and termination of the tender offer.¹¹² A bright-line application of Rule 14d-10 set the tender offer period from November 19, 1999 to December 17, 1999.¹¹³ The merger agreement validating the transition awards was executed on November 14, 1999.¹¹⁴ Because no additional payments were made during the tender period, the court found that there was no Rule 14d-10 violation.¹¹⁵

IV. ADOPTION OF A "BRIGHT-LINE TIMING" APPROACH

As the above cases illustrate, ambiguity currently exists regarding application of the All Holders/Best Price Rule in acquisition practices common today. "Functional" and "integral part" approaches provide optimal investor protection, but both lack the certainty that tender offerors desire.¹¹⁶ Specifically, in applying these approaches, courts rely on subjective factors to determine what activity constitutes a tender offer for 14d-10 purposes.¹¹⁷ Consequently, acquirers cannot be certain of the result to a Rule 14d-10 challenge so long as the "functional" and "integral part of the tender offer" tests survive.¹¹⁸ This uncertainty, combined with the potential severity of a Rule 14d-10 violation, necessitates that either the Supreme Court or the SEC settle the matter by fully adopting the "bright-line timing" approach. Support for a "bright-line timing" standard can be found in the plain language of section 14(d)(7) and Rule 14d-10, in the legislative history of the Williams Act and in public policy.

A. Plain Language of Rule 14d-10

The plain language of section 14(d)(7) provides some support for a "bright-line timing" approach.¹¹⁹ Section 14(d)(7) applies when a bidder varies the terms of a tender offer "before the expiration thereof."¹²⁰ A

112. *See id.* at 1372 (agreeing with Seventh Circuit's use of Rule 14d-2 as benchmark for defining "during the tender offer").

113. *See id.* at 1374-75 (stating tender period).

114. *See id.* (stating date transition agreements were entered into).

115. *See id.* at 1361 (finding that plaintiff failed to identify any payment made during pendency of bidder's tender offer).

116. *See, e.g., Lerro v. Quaker Oats Co.*, 84 F.3d 239, 243 (7th Cir. 1996) ("With millions or even billions of dollars at stake, precise definition of the black-out period is essential . . .").

117. *See, e.g., Perera v. Chiron Corp.*, No. C-95-20725SW, 1996 U.S. Dist. LEXIS 22503, at *11-12 (N.D. Cal. May 8, 1996) (examining factors to determine if option enhancements were designed to induce tender of employee stock).

118. *See* Stephen G. Jacobs et al., *Special Deals Tied to Tender Offers* (Apr. 2001) (April 2001) (asking "who knows what a court applying the 'functional' or 'integral part' test would conclude?"), at http://www.weil.com/weil/pub_frames.html.

119. For a further discussion of section 14(d)(7), see *supra* notes 35-37 and accompanying text.

120. *See* 15 U.S.C. § 78n(d)(7) (2001) (providing language to best-price provision).

literal reading of this section does not cover any transaction subsequent to the close of the tender offer.¹²¹ The SEC also limited application of Rule 14d-10 to purchases made “during such tender offer.”¹²² This language suggests that all conduct outside the time period when shareholders may tender their shares pursuant to the offer is outside the ambit of the Rule.

Courts choosing not to adopt a “bright-line timing” approach avoid these requirements by redefining the term “tender offer” to extend beyond what Congress, and the bidders who made the offers, had originally intended.¹²³ As the *Lerro* court correctly pointed out, however, “[t]he difference between ‘during’ and ‘before’ (or ‘after’) is not just linguistic. It is essential to permit everyone to participate in the markets near the time of a tender offer.”¹²⁴ Including transactions that take place near in time to a tender offer as part of the tender offer unjustly creates a minimum floor price that must be paid to shareholders tendering pursuant to the offer.¹²⁵ The objective of section 14(d)(7) and Rule 14d-10 is to make certain that all *tendering* shareholders receive the same consideration.¹²⁶

121. See generally *Gustafson v. Alloyd Co.*, 513 U.S. 561, 588-90 (1995) (Thomas, J., dissenting) (commanding respect for language of securities statutes and regulations); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994) (same).

122. For a further discussion of Rule 14d-10, see *supra* notes 38-39 and accompanying text.

123. See André, *supra* note 45, at 504 n.29 (suggesting that congressional intent was to vest rulemaking authority in SEC to regulate withdrawal and proration, not to regulate what constitutes tender offer) (citing *Takeover Bids: Hearings on H.R. 14475, S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong. (1968) (statement of Chairman Cohen)).

While it was abundantly clear that the Commission, at least during the early years of the Williams Act, preferred not to define the term “tender offer,” there is in fact very little evidence to support the view that Congress intentionally left the definition open to allow regulation of unorthodox transactions having the same impact as conventional offers.

Id. at 503-04 (citing 113 CONG. REC. 854 (1967); *Hanson Trust v. SCM Corp.*, 774 F.2d 47, 56 (2d Cir. 1985)). In introducing the Williams Bill before the Senate, Senator Williams stated: “This legislation will close a significant gap in investor protection under the Federal securities laws by requiring the disclosure of pertinent information to stockholders when persons seek to obtain control of a corporation by a cash tender offer or through open market or negotiated purchases of securities.” 113 CONG. REC. 854.

124. See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 243 (7th Cir. 1996) (emphasizing that such participation is essential to transactions that all investors find beneficial).

125. See *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 778-79 (2d Cir. 1991) (finding no continuation of tender offer); *Hanson Trust*, 774 F.2d at 57 (same); *Kahn v. Va. Ret. Sys.*, 783 F. Supp. 266, 269-70 (E.D. Va. 1992) (same), *aff'd on other grounds*, 13 F.3d 110 (4th Cir. 1993); *Priddy v. Edelman*, 679 F. Supp. 1425, 1431-32 (E.D. Mich. 1988) (permitting transactions prior to and after tender offer), *aff'd on other grounds*, 883 F.2d 438, 446 (6th Cir. 1989).

126. For a further discussion explaining the purpose of the Best Price provision, see *supra* notes 33-37 and accompanying text.

These provisions do not eliminate a bidder's ability to purchase stock in the open market near in time to a tender offer.¹²⁷

Furthermore, purchases near in time to a tender offer will often be essential to an acquisition, and therefore "integral," just by the fact that acquisitions are accomplished by buying up stock.¹²⁸ But, "integral to" is not the same as "during," and the Rule's plain language speaks of conduct "during."¹²⁹

B. *Legislative History*

There is also legislative history support to interpreting the phrase "during such tender offer" as establishing a rigid time period.¹³⁰

Proposed section 14(d)(7) would provide that where a person making a tender offer increases the consideration offered to shareholders *before the expiration of the tender offer*, he must pay the increased consideration to those who tendered their securities prior to the increase in price, whether or not he had taken up any of the securities before the increase of consideration was announced. The purpose of this provision is to assure fair treatment of those persons *who tender their shares at the beginning of the tender period*, and to assure equality of treatment among all shareholders who tender their shares.¹³¹

This supports the conclusion that Congress intended section 14(d)(7) to denote a rigid time period.¹³² The passage speaks of protection against

127. See *Hanson Trust*, 774 F.2d at 56 (holding that open market purchases prior to tender offer are not within scope of Williams Act).

128. See, e.g., *Epstein v. MCA, Inc.*, 50 F.3d 644, 647-48 (9th Cir. 1995) (noting that CEO and COO held more than six million shares of target stock), *rev'd on other grounds sub nom. Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996).

129. See *Lerro*, 84 F.3d at 244-46 (distinguishing between "what" and "when" regarding commencement of offer); see also André, *supra* note 45, at 504-05 (suggesting that best-price rule only makes sense in context of conventional tender offer).

130. See André, *supra* note 45, at 503-05 (suggesting that conventional tender offers considered by Congress had clear commencement dates).

[I]t would appear that Congress, in the withdrawal, proration, and best price provisions, was addressing specific concerns that had arisen in the context of the conventional offer. Where these statutory safeguards cannot be applied because of the mechanical process by which an offer is made renders them meaningless, the case for finding that Congress intended to regulate the offer as a tender offer becomes much weaker.

Id. at 505 (citing *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1207 (2d Cir. 1978) ("It seems unlikely that Congress intended 'tender offer' to be so broadly interpreted as to make these provisions unworkable."); *Brascan, Ltd. v. Edper Equities, Ltd.*, 477 F. Supp. 773, 790-91 (S.D.N.Y. 1979); Wurzinger, *Toward a Definition of Tender Offer*, 19 HARV. J. ON LEGIS. 191, 201 (1982)).

131. H.R. REP. NO. 90-1711 (1968), *reprinted in* 1968 U.S.C.C.A.N. 2811, 2821 (emphasis added).

132. See *Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1375-76 (N.D. Ga. 2001) (analyzing legislative history).

price discrimination from the “beginning of the tender period” up until “expiration of the tender offer.”¹³³ The following SEC release regarding Rule 14d-10 provides further support:

If more than one type of consideration is offered pursuant to the tender offer, the types of consideration must be substantially equivalent in value. *The date for making the initial determination as to substantial equivalence in value is the earlier of the date of public announcement as specified in Rule 14d-2(b), or the date of commencement as defined in Rule 14d-2(a).*¹³⁴

This release strongly suggests that the All Holders/Best Price Rule is targeted at conduct during the tender period, as defined by Rule 14d-2's timing provisions.¹³⁵

It is also important to consider other securities regulations and actions that are contingent upon the commencement of a tender offer.¹³⁶ The disclosure requirements of Rules 14d-3 and 14d-6 require bidders to file a tender offer statement with the SEC and to disseminate this information to shareholders.¹³⁷ These requirements become effective upon commencement of a tender offer and cannot be met by a potential bidder during the negotiation period.¹³⁸ Thus, if the “integral part” standard establishes commencement of the offer during the negotiations, then the offer will have taken place in violation of these rules because the required disclosures were not made.¹³⁹ Moreover, Rule 14e-1 requires a tender offer to stay “open for [twenty] days from the time it is first published or sent or given to security holders.”¹⁴⁰ If the offer commences upon negotiations of private transactions, the twenty-day window may expire just

133. *See id.* at 1376 (drawing timing conclusions).

134. *Id.* (citing SEC Release Nos. 33-6595; 34-22198, 50 Fed. Reg. 27976, 27978-9 (July 9, 1985) (emphasis added)).

135. *See id.* at 1377 (supporting application of Rule 14d-2 to Rule 14d-10). The passage incorporates Rule 14d-2's timing provision as to when the tender offer is deemed to have commenced. *Id.* (examining SEC release). It also indicates that “the purpose of the Rule was to prevent a decrease in the share price by the bidder during the offer period, focusing again on the time during the pendency of the offer.” *Id.*

136. *See* André, *supra* note 45, at 504 (identifying discrepancies that support application of Williams Act only to conventional tender offers); *see, e.g.*, 15 U.S.C. § 78n(d)(5) (2001) (providing withdrawal rights); 15 U.S.C. § 78n(d)(6) (2001) (affording proration protection); 15 U.S.C. § 78n(d)(7) (2001) (creating Best Price rule).

137. *See* 15 U.S.C. § 78n(d)(3), (6) (2001) (providing regulation on filing and transmitting of tender offer statement, and disclosure of tender offer information to security holders).

138. *See* Lerro v. Quaker Oats Co., 84 F.3d 239, 246 (7th Cir. 1996) (discussing other Williams Act timetables).

139. *See id.* (discussing other Williams Act timetables).

140. *See id.* (finding purpose of this provision is to give unsophisticated investors opportunity to study documents and make informed decisions).

prior to the date that acceptance of tendered shares begins.¹⁴¹ Such a situation would revive “Saturday night specials” and the pressures the Williams Act was designed to eradicate.¹⁴² Because of the time sensitivity of Regulation 14D, it would “wreak havoc to say that the operation of all clocks cannot be known until, years after the events, a judge declares when negotiations became sufficiently serious to mark the commencement of the offer.”¹⁴³ Rule 14d-2 eliminates confusion regarding tender offer timetables by clearly establishing the commencement of tender offers.¹⁴⁴

C. *Public Policy*

Securing clarity and finality of acquisitions provides a strong policy argument in favor of a “bright-line timing” approach.¹⁴⁵ “In a business setting, it is impractical to leave the validity of [arrangements to acquire employee stock] and the legality of ensuing tender offers subject to endless litigation.”¹⁴⁶ With millions and even billions of dollars on the line, a precise definition of “tender offer” is essential.¹⁴⁷ Any application of the All Holders/Best Price Rule to transactions outside the plain meaning of “during such tender offer” destroys clarity and finality.

Treating negotiations and private transactions prior to actual tender periods as commencement of the offer risks more than just an immediate Rule 14d-10 violation.¹⁴⁸ Doing so would forbid many of the pre-tender

141. *See id.* (explaining need for clear commencement date for other Williams Act provisions).

142. *See id.* (discussing need to avoid pressured investor decisions). Timetables for withdrawal and proration rights begin to run upon commencement of the offer as well, and would also be befuddled by a conclusion that private negotiations commence a tender offer. *See id.* (reasoning that commencement cannot be established during negotiations). Closing the proration pool prior to public announcement of the offer would defeat the purposes of the Williams Act and SEC regulation. *See id.* (asserting that tender offer must commence upon announcement to public).

143. *Id.*

144. *See id.* (supporting incorporation of Rule 14d-2 timetable into Rule 14d-10).

145. *See Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1377-78 (N.D. Ga. 2001) (recognizing “a need to provide clarity and certainty in the regulatory scheme applicable to tender offer with respect to equal treatment of security holders”) (citing SEC Release Nos. 33-6653; 34-23421, 50 Fed. Reg. 25873, 25881 (July 17, 1986)).

146. *See id.* (stating need for certainty).

147. *See Lerro*, 84 F.3d at 243 (stating need for certainty).

148. *See id.* at 246 (stating that effects of vague commencement dates would be far reaching). Because side transactions are unlawful once the offer begins, treating private transactions as commencement of the tender offer would outlaw a bidder from participating in the market prior to a tender offer completely. *See* 17 C.F.R. § 240.14e-5 (2001) (prohibiting all side transactions once tender offer commences). For a further discussion of the potential effects of treating negotiations and private transactions as commencement of the tender offer, see *supra* notes 134-40, 145 and accompanying text and *infra* notes 146-49 and accompanying text.

bargains necessary to a successful acquisition.¹⁴⁹ Inability to complete private transactions would also lessen the attractiveness of acquisitions generally, thereby reducing the tender price bidders offer.¹⁵⁰ Finally, leaving the commencement issue ambiguous will encourage litigants to challenge any agreement executed in close proximity to a tender offer.¹⁵¹ Accordingly, holding these transactions out as extensions of tender offers, subject to the Williams Act, will have a chilling effect on tender offers and impact negatively on investors.¹⁵²

The “bright-line timing” approach, by allowing essential transactions both before and after a tender offer, provides the certainty that bidders require. In accomplishing this objective, the “bright-line timing” approach also fulfills the purposes of the Williams Act and Rule 14d-10.¹⁵³

149. See Jacobs et al., *supra* note 118, at http://www.weil.com/weil/pub_frames.html (identifying threatened transactions such as equity rollover, stay-bonuses, and retention and employment agreements); see also *Lerro*, 84 F.3d at 246 (proffering that effects would go beyond having to pay additional consideration in one instance).

150. See *Lerro*, 84 F.3d at 246 (explaining consequences of ambiguous commencement dates).

151. See *Walker*, 145 F. Supp. 2d at 1377-78 (expressing concern over integrating tender offers and second-step mergers).

152. See Jacobs et al., *supra* note 118, at http://www.weil.com/weil/pub_frames.html (“Ultimately, the only way that a target and bidder may be able to shield a side deal from a potential Rule 14d-10 attack is to abandon the tender offer entirely and to effect the transaction as a long-form merger.”). Such a course of action would have the detrimental effect of causing public shareholders to wait longer to receive consideration for their target shares and this additional time period may encourage interlopers. See *id.* (identifying consequence of long-form mergers). “It . . . seems troubling that Rule 14d-10 could have such a large impact on choice of form for the transaction because that was not the rule’s intended purpose when enacted.” *Id.*; see also *Lerro*, 84 F.3d at 242-43 (positing consequences of finding Rule 14d-10 violation). In a hypothetical offered by the court in *Lerro*, the court considered a firm whose stock is trading for \$20. See *id.* at 243 (setting out hypothetical). “Insiders who hold 30 percent of the firm would not sell for less than \$30, and a potential bidder values the entire firm at \$25 per share.” *Id.* An offer extended to everyone at \$25 per share would not be successful because it would not have the support of the controlling shareholders. See *id.* (explaining hypothetical). If the acquirer could pay \$30 per share to the controlling shareholders and extend a tender offer for the remaining shares at \$22 per share, however, the tender offer would be successful and all parties would benefit. See *id.* (explaining benefits of situation described in hypothetical). In this manner, the controlling shareholders received their required price, the bidder obtained all shares at an average price of \$24.40 per share (sixty cents less than what they were willing to pay) and the remaining shareholders earned \$2 above the current market value. See *id.* (describing results of hypothetical). The \$30 per share transaction with the insiders was integral to the success of the tender offer, but “[t]reating the Williams Act as a mandate for an identical price across the board . . . would make all investors worse off.” *Id.*

153. For a further discussion of the purposes of the Williams Act and Rule 14d-10, see *supra* notes 32-39 and accompanying text.

This standard does not create the pressure decisions of “Saturday night specials” that Regulation 14D was designed to eliminate.¹⁵⁴ Coercion in these situations stemmed from offers being extended for very brief time periods and by the practice of accepting only a limited number of shares on a first-come, first-serve basis.¹⁵⁵ Such pressures are not created by special transactions made with inside shareholders before the tender offer because investors who participate in the tender offer still get full disclosure of the terms of the offer and the bidder. Furthermore, they are guaranteed the prorated acceptance of their tendered shares at the highest price paid during the offer.¹⁵⁶

The Williams Act does not entitle shareholders participation in a private transaction extended to other parties before the tender offer.¹⁵⁷ Just as those who sell their stock in the open market for \$20 today cannot complain if their trading partner purchased the same stock for \$30 from another person yesterday, those who tender their shares pursuant to an offer cannot claim that they are entitled to a price paid during a private transaction before the tender offer.¹⁵⁸ A “bright-line timing” standard supports this idea, while an “integral part” approach allows for its abuse.

Proponents of the “functional” and “integral part” tests often criticize the “bright-line timing” approach for the opportunity it provides unscrupulous investors to evade the All Holders/Best Price Rule merely by timing their transaction so that they take place outside the tender period.¹⁵⁹ While this may be true in certain situations, the need for certainty outweighs the potential for abuse.¹⁶⁰ Furthermore, competing interests in

154. For a further discussion of “Saturday night specials” and other concerns, see *supra* notes 29-31 and accompanying text.

155. For a further discussion of coercive situations, see *supra* notes 30-34 and accompanying text.

156. See *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 948 (9th Cir. 1985) (identifying purpose of Act to “provide shareholders an opportunity to examine all relevant facts to . . . reach decisions without . . . unwarranted pressure”). For a further discussion on the protections afforded by the Williams Act, see *supra* note 32 and accompanying text.

157. See, e.g., *Lerro*, 84 F.3d at 239 (finding such transactions outside tender offer). Gratifying the desire of any given shareholder to obtain a deal extended only to another shareholder is not the purpose of the Williams Act. *But see* *Maxick v. Cadence Design Sys.*, No. C-00-0658-PJH, 2000 U.S. Dist. LEXIS 14099, at *3 (N.D. Cal. Sept. 21, 2000) (finding timing irrelevant).

158. See *Lerro*, 84 F.3d at 243 (providing illustration).

159. See generally *Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995) (demonstrating concern for “bright-line timing” standard), *rev’d on other grounds sub nom. Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996); *Field v. Trump*, 850 F.2d 938 (2d Cir. 1988) (same); *Katt v. Titan Acquisitions*, 133 F. Supp. 2d 632 (M.D. Tenn. 2000) (same); *Perera v. Chiron Corp.*, No. C-95-20725SW, 1996 U.S. Dist. LEXIS 22503 (N.D. Cal. May 8, 1996) (same).

160. See *André*, *supra* note 45, at 502 (supporting restricted interpretation of “tender offer” to original meaning for certain provisions of Regulation 14D); *Jacobs et al.*, *supra* note 118, at http://www.weil.com/weil/pub_frames.html (arguing for adoption of bright-line); *Shearman & Sterling*, *supra* note 1, at 1 (criticizing “integral part” and “functional” tests).

“avoiding undue interference with the free and open market in securities” supports a “bright-line timing” standard.¹⁶¹ In any event, allowing transactions to take place prior to a tender offer under a mechanical application of Rule 14d-2 will still not pressure shareholders into making uninformed decisions of the kind that the Williams Act was concerned with.¹⁶²

V. IDENTIFYING ELEMENTS OF THE “BRIGHT-LINE TIMING” APPROACH TO PLAN FUTURE TRANSACTIONS

Until the “bright-line timing” approach is uniformly accepted, results of a Rule 14d-10 challenge will be unpredictable. While this uncertainty is highly unappealing to those attempting to structure inside dealings close in time to tender offers, several commentators have identified steps that may be taken when structuring insider transactions.¹⁶³ For instance, identifying transactional elements common to each disparate approach for defining tender offer should increase the likelihood of receiving favorable “bright-line timing” treatment if the transaction is later challenged under Rule 14d-10.¹⁶⁴ Some degree of certainty can thus be achieved by structuring employment and retention arrangements in a manner that avoids situations found to be crucial to courts in applying the “integral part of the tender offer” and “functional” standards.¹⁶⁵

A. Transactional Elements Indicative of the “Functional” and “Integral Part” Approaches

As demonstrated in *Field*, the “functional” approach appears limited to three-part “step transactions.” First, the bidder makes a tender offer. Then, the bidder drops the tender offer in order to negotiate a private purchase. Finally, the bidder announces a second tender offer.¹⁶⁶

161. See *Carter Hawley Hale Stores*, 760 F.2d at 948 (citing *City Investing Co. v. Simcox*, 633 F.2d 56, 62 n.14 (7th Cir. 1980) (noting less burdensome regulations in cases involving certain open market purchases)).

162. For a further discussion of the concerns that the Williams Act was designed to remedy, see *supra* notes 33-34 and accompanying text.

163. See *Jacobs et al.*, *supra* note 118, at http://www.weil.com/weil/pub_frames.html (discussing confusion regarding Rule 14d-10); *Shearman & Sterling*, *supra* note 1, at 3 (“The [*Kati*] Court’s reluctance to dismiss the plaintiff’s action is troubling given the importance of, and the current market practice of, structuring appropriate employment arrangements with key personnel as a significant part of the acquisition process.”). For a further discussion of the consequences of committing a Rule 14d-10 violation, see *supra* notes 5-6 and accompanying text.

164. For a further discussion on factual distinctions, see *infra* notes 166-82 and accompanying text.

165. For a further discussion on structuring future transactions with tender offers, see *infra* notes 183-91 and accompanying text.

166. See *Lerro*, 84 F.3d at 243 (limiting *Field* application to step-transactions); *Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1370 (N.D. Ga. 2001) (“*Field*’s broad language purporting to define tender offer for purposes of the Williams Act is limited to cases involving interrupted tender offers.”). Note, however, that the offers will only be integrated if there was never a genuine intent to aban-

Identifying the distinguishing elements of the “integral part of the tender offer” line of cases from *Lerro* and *Walker* (the “bright-line timing” cases) is less clear.¹⁶⁷ The *Lerro* court determined that the distribution agreement was neither entered into nor executed during the tender period.¹⁶⁸ Likewise, the *Walker* court found that the promise to pay and the actual payment of retention awards occurred outside the tender offer.¹⁶⁹ Defendants in each of the “integral part” cases (*Epstein*, *Katt* and *Perera*) made this same argument to no avail.¹⁷⁰

One explanation for this disparity is that both *Lerro* and *Walker* involved a tender offer and a short-form merger governed by state law.¹⁷¹ Second-step statutory mergers following a successful tender offer do not constitute a continuation of the tender offer for purposes of section 14(d)(7).¹⁷² The lack of follow-up mergers in the “integral part” cases prevented the courts from linking the challenged transactions to anything but the tender offers, thereby allowing for application of section 14(d)(7).¹⁷³ In contrast, consummating agreements with insiders pursuant to merging allowed the courts in *Lerro* and *Walker* to view the transactions outside the context of the tender offer.¹⁷⁴

don the offer. See *Hanson Trust v. SCM Corp.*, 774 F.2d 47, 57 (2d Cir. 1985) (illustrating that transactions near in time to tender offer are permissible if such transactions standing alone would not constitute tender offer).

167. Compare *Epstein v. MCA, Inc.*, 50 F.3d 644, 654 (9th Cir. 1995) (applying “integral part” test), *rev'd on other grounds sub nom. Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367 (1996), and *Katt v. Titan Acquisitions*, 133 F. Supp. 2d 632, 641 (M.D. Tenn. 2000) (same), and *Perera v. Chiron Corp.*, No. C-95-20725SW, 1996 U.S. Dist. LEXIS 22503, at *9 (N.D. Cal. May 8, 1996) (same), with *Lerro*, 84 F.3d at 243 (adopting bright-line test), and *Walker*, 145 F. Supp. 2d at 1370 (adopting “bright-line timing” test).

168. For an explanation of the *Lerro* holding, see *supra* notes 99-106 and accompanying text.

169. For an explanation of the *Walker* holding, see *supra* notes 112-15 and accompanying text.

170. See *Epstein*, 50 F.3d at 654 (claiming “Rule 14d-10 is without effect” outside tender period); *Katt*, 133 F. Supp. 2d at 640 (“[D]efendants argue that the agreements at issue were neither made nor paid “during [its] tender offer.”); *Perera*, 1996 U.S. Dist. LEXIS 22503, at *8 (claiming option enhancements were made prior to tender offer).

171. See *Lerro*, 84 F.3d at 240-41 (setting-forth facts); *Walker*, 145 F. Supp. 2d at 1364 (same).

172. See *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 779 (2d Cir. 1991) (“[W]e perceive no basis in the language, structure or legislative history of the Act for viewing a second-step statutory merger following a successful tender offer for 51 percent of a target’s shares as a continuation of the tender offer.”).

173. See *Epstein*, 50 F.3d at 656 (finding material aspects of capital loan agreement conditioned to, and therefore integral to, tender offer); *Katt*, 133 F. Supp. 2d at 646 (ruling that agreements may have been designed to induce tender offer); *Perera*, 1996 U.S. Dist. LEXIS 22503, at *12 (finding sufficient evidence to support conclusion that enhancements were premiums to encourage tender of shares).

174. See *Lerro*, 84 F.3d at 244 (refusing to integrate any tender offer and follow-up merger); *Walker*, 145 F. Supp. 2d at 1374 (rejecting argument that tender offer and merger could constitute single transaction).

Differences also exist in the ways in which the agreements in each case related to the tender offer.¹⁷⁵ In *Lerro* and *Walker*, “conditioning the effectiveness of the [agreements] on the successful consummation of the tender offer was seemingly necessary and logical.”¹⁷⁶ In both cases, the court was satisfied that the transactions were not designed to induce success of the tender offer.¹⁷⁷ This was not the case in *Katt*, *Epstein* or *Perera* because no independent basis or purpose beyond the context of the tender offer existed for any of these agreements. Consequently, it was found that each was designed to induce the benefited shareholders’ participation in the offer.¹⁷⁸

Another factor proven to be damaging in the “integral part” cases is setting the amount to be paid under the agreement as a function of the tender price. Both *Epstein* and *Perera* found that incorporating the tender offer price by reference in the disputed agreements demonstrated that the agreements were material to the tender offer.¹⁷⁹ In contrast, in *Lerro* and *Walker*, the alleged additional consideration was irrespective of the tender price.¹⁸⁰ Finally, proximity in time of the agreements to the tender offer has been a relevant factor for courts finding the “integral part” test more

175. See *Epstein*, 50 F.3d at 653-57 (noting that agreement was not binding if tender offer was not successful, that exchange was to take place upon consummation of tender offer and that redemption value set as tender price); *Katt*, 133 F. Supp. 2d at 644-45 (observing that agreements only paid if tender offer was successful); *Perera*, 1996 U.S. Dist. LEXIS 22503, at *9 (noting that tender price and option price were identical and all provisions of enhancement agreement were conditioned on tender offer).

176. See Jacobs et al., *supra* note 118, at http://www.weil.com/weil/pub_frames.html (distinguishing *Lerro* and *Epstein*); see also *Lerro*, 84 F.3d at 240 (explaining distribution agreement). Quaker could not grant Select exclusive rights to distribute Snapple until it owned Snapple. See *id.* (describing distribution agreement). Consequently, the distribution agreement had to be conditioned on a successful tender offer because Quaker did not have the ability to assign the rights if it was not. See *id.* (explaining distribution agreement); see also *Walker*, 145 F. Supp. 2d at 1364 (explaining retention awards). Because the retention bonuses became effective upon merger if the employees stayed with the new Vallen Corporation, they were implicitly contingent on the success of the tender offer because there would be no merger if the tender offer failed. See *Lerro*, 84 F.3d at 240 (describing distribution agreement).

177. See *Lerro*, 84 F.3d at 246 (finding transaction valid); *Walker*, 145 F. Supp. 2d at 1364 (same).

178. See *Epstein*, 50 F.3d at 656 (holding transaction as integral to tender offer); *Katt*, 133 F. Supp. 2d at 646 (finding possible inducement); *Perera*, 1996 U.S. Dist. LEXIS 22503, at *12 (same). “It seems that these agreements could not be considered anything other than additional consideration” to induce the tender of shares because they had no other justifiable purpose. See Jacobs et al., *supra* note 118, at http://www.weil.com/weil/pub_frames.html (distinguishing *Lerro* and *Epstein*); see also *Lerro*, 84 F.3d at 240 (distinguishing “integral part” cases).

179. See *Epstein*, 50 F.3d at 653 (noting that redemption value set as tender price); *Perera*, 1996 U.S. Dist. LEXIS 22503, at *9 (noting that tender price and option price were identical).

180. See *Lerro*, 84 F.3d at 240 (identifying distribution agreement as potential source of additional consideration); *Walker*, 145 F. Supp. 2d at 1364 (identifying retention bonuses as alleged ruse to pay insiders more).

appropriate.¹⁸¹ In the “bright-line timing” cases, the agreements at issue naturally followed the respective changes in control.¹⁸²

B. *Planning Future Transactions*

Having identified these elements, future transactions should be structured in a manner that avoids resemblance to transactions that have received “functional” and “integral part” scrutiny. Companies should structure employment or retention arrangements in a manner that facilitates the independence of the agreements from the tender offer.¹⁸³ As *Field* demonstrates, acquirers should never withdraw a tender offer, negotiate a private purchase of stock and then announce a new tender offer.¹⁸⁴ Agreements should not be contingent upon the outcome of the tender offer, but instead should become binding without regard to the offer’s success.¹⁸⁵ If this is not an option, arrangements should be made prior to the tender offer to consummate any such agreement pursuant only to a follow-up merger, as opposed to the tender offer itself.¹⁸⁶

Companies should not associate the number of shares owned by a target employee to the employee’s compensation.¹⁸⁷ Insider transactions should never pay the employee an amount referenced by the tender

181. See *Epstein*, 50 F.3d at 653 (noting that Wasserman exchange to take place “immediately following” tender offer); *Katt*, 133 F. Supp. 2d at 644-45 (emphasizing that agreements were entered into months shortly before tender offer); *Perera*, 1996 U.S. Dist. LEXIS 22503, at *9 (finding relevant fact that tender offer provisions and option enhancements were contained in same investment agreement).

182. See *Lerro*, 84 F.3d at 244 (noting that Quaker could not enter into distribution agreement prior to acquiring Snapple); *Walker*, 145 F. Supp. 2d at 1375 (finding promise to pay and actual payment of transition awards fell outside tender period).

183. See *Jacobs et al.*, *supra* note 118, at http://www.weil.com/weil/pub_frames.html (offering guidance in structuring future transactions). For a further discussion explaining the greater likelihood of finding a Rule 14d-10 violation under an “integral part” or “functional” approach, see *supra* notes 14-15 and accompanying text.

184. For a further discussion suggesting that step-transactions will never stand apart from tender offers, see *supra* note 166 and accompanying text.

185. See *Shearman & Sterling*, *supra* note 1, at 1 (offering suggestions on structuring future transactions). Compare *Lerro*, 84 F.3d at 240 (committing to tender shares regardless of outcome), with *Epstein*, 50 F.3d at 653-54 (conditioning transfer on successful tender offer).

186. See *Shearman & Sterling*, *supra* note 1, at 1 (offering suggestions on structuring future transactions). For a further discussion illustrating the importance of conducting a second-step merger, see *supra* notes 171-74 and accompanying text.

187. See *Shearman & Sterling*, *supra* note 1, at 1 (offering suggestions on structuring future transactions). Compare *Perera v. Chiron Corp.*, No. C-95-20725 SW, 1996 U.S. Dist. LEXIS 22503, at *3 (N.D. Cal. May 8, 1996) (offering enhancements to options owned by employees), with *Walker*, 145 F. Supp. 2d at 1364 (offering fixed-price retention awards that were not function of shares owned).

price.¹⁸⁸ Additionally, tender offer documents should disclose any agreements reached with employee-shareholders of the target corporation.¹⁸⁹ Finally, any award or agreement offered to an employee-shareholder should serve as an incentive for continued employment only.¹⁹⁰ Such agreements should never be used to induce an employee-shareholder to partake in the offer.¹⁹¹

VI. CONCLUSION

In light of the current ambiguities surrounding the application of the All Holders/Best Price Rule, it would be beneficial for the Supreme Court or the SEC to put the matter to rest. Uncertainties pertaining to the result of a Rule 14d-10 claim under the “functional” and “integral part of the tender offer” approaches, combined with the market’s need for clarity, necessitates the adoption of the “bright-line timing” approach. The plain language of Rule 14d-10, its legislative history and public policy each offer further support for the “bright-line timing” standard. “The line is arbitrary, to be sure; it invites transactions that use the rules for personal advantage . . . but some line is essential, and it had best be a bright one.”¹⁹² Therefore, the SEC or the Supreme Court should act and recognize the “bright-line timing” standard as the single validity test. Through this standard, Rule 14d-10’s ambiguity would finally be removed.

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188. For a further discussion on the damaging effects of linking employee compensation to the tender price, see *supra* notes 179-80 and accompanying text.

189. See Shearman & Sterling, *supra* note 1, at 1 (offering suggestions on structuring future transactions); see also *Lerro*, 84 F.3d at 240 (providing distribution agreement in offering document); *Walker*, 145 F. Supp. 2d at 1363-64 (offering Solicitation/Recommendation Statement to shareholders).

190. See Shearman & Sterling, *supra* note 1, at 1 (offering suggestions on structuring future transactions).

191. See, e.g., *Gerber v. Computer Assoc. Int’l, Inc.*, 2000 WL 307379 at *4 (E.D.N.Y. 2000) (finding that result in *Lerro* turned on fact that formal announcement of tender offer had been made). For a further discussion proposing that inducements will almost always render transactions part of tender offer, see *supra* notes 175-78 and accompanying text. Other courts have found different distinctions between the “bright-line” and “integral part” cases.

192. *Lerro*, 84 F.3d at 243.