

“DURING THE TENDER OFFER” OR SOME TIME AROUND IT: HELPING COURTS INTERPRET THE BEST-PRICE RULE

Michael A. Akiva*

I. INTRODUCTION

Over the past three decades, tender offers have gained appeal as a means of acquiring corporations. With this development came an increase in regulations surrounding the tender offer process. Unlike proxy contests, which have long been subjected to extensive disclosure requirements,¹ tender offers were once conducted with almost complete freedom due to the minimal paperwork necessary to effectuate the offer.² In addition, the offeror was able to coerce shareholders into tendering by threatening to decrease the price offered per share.³ Seeing a need for regulation, Congress enacted the Williams Act⁴ to deal with these problems. The Act was intended to protect investors from being forced into making hasty decisions by requiring bidders to publicly disclose information about the tender offer.⁵

* J.D. Candidate, UCLA School of Law 2006; B.S., University of Southern California, 2003. I would like to thank Professor Lynn Stout for her assistance and guidance in writing this Comment. I would also like to thank Professor _____ for her help and guidance, and Steve Hardle for _____ valuable input.

¹ 113 CONG. REC. 854, 855 (1967) (statement of Sen. Williams):

[W]here control is sought through a proxy contest, information must be filed under the Securities Exchange Act which tells shareholders the identity of the participants and their associates, their stockholdings and when they acquired them, the extent to which the shares were purchased with borrowed funds and the identity of the lender if the funds were obtained otherwise than through a bank loan or margin account.

² *See id.* (“But no information need be filed where a cash tender offer is made to stockholders”).

³ Senator Williams noted this situation in his address to Congress. *Id.* at 856.

⁴ Pub. L. No. 90-439, 82 Stat. 454 (1968). The Act added §§13(d)-(e) and 14(d)-(f) to the Securities Exchange Act of 1934.

⁵ 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams).

In the mid-1980s, Congress added the “best price, all-holders” rule to the Act.⁶ Essentially, this addition required *all* shareholders of the target class to be treated equally “during [the] tender offer.”⁷ However, given the Securities and Exchange Commission’s and Congress’s reluctance to define the term “tender offer,”⁸ the courts have struggled to determine what transactions should be included in the tender offer.⁹ This struggle has resulted in a circuit split, with circuits falling into one of two groups, each endorsing a competing interpretation of the best price rule. The Ninth Circuit has decided “best price” cases by questioning what transactions should be included in the tender offer.¹⁰ On the other hand, the Seventh Circuit has framed the issue by asking when the tender offer occurs.¹¹ In doing so, the Seventh Circuit looked to the text of other regulations in the Williams Act and determined that there is a specific start date for tender offers.¹² These competing interpretations have produced dichotomous judicial consequences. In subsequent decisions, the Ninth Circuit’s test has been ambiguous and difficult to apply consistently, whereas the Seventh Circuit’s test has often been too rigid to allow shareholders a cause of action.

Given that the Williams Act was intended partly to protect investors and partly to protect the tender offer process,¹³ this debate has been costly from both the corporate and the investor perspective. By protecting investors, Congress presumably meant to allow them free and equal access to information and the open markets. However, by excluding all transactions that occur before the start of the tender offer, the Seventh Circuit’s test is easily manipulated and, consequently, acquiring companies can easily avoid the rule. Conversely, the Ninth Circuit’s test

⁶ See 17 C.F.R. § 240.14d-10 (2005).

⁷ See § 240.14d-10(a)(2) (2005).

⁸ See Note, *The Developing Meaning of “Tender Offer” Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973) (hereinafter “*Developing Meaning*”).

⁹ See *infra* Part III.

¹⁰ See *Epstein v. MCA, Inc.*, 50 F.3d 644, 656 (9th Cir. 1995), *rev’d on other grounds sub nom. Matsushita Electric Indus. Co., Ltd. v. Epstein*, 516 U.S. 367 (1996).

¹¹ See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 246 (7th Cir. 1996).

¹² *Id.* at 245.

¹³ See *infra* Part II.1.

does not facilitate or protect the tender offer process because it is too ambiguous to apply consistently, which results in costly protracted litigation concerning the motivation behind private transactions between the acquiring company and target executives.

This divergence between the two circuits stems in part from Congress's and the SEC's reluctance to define a tender offer. The Ninth Circuit tried to define the term but did so in a piecemeal fashion, incorporating only those transactions occurring in the case before it. The Seventh Circuit, on the other hand, tried to clarify what the Act already made clear; namely when a tender offer begins. The question of *when* a tender offer begins, however, seems moot when looking at the text and legislative history of the Williams Act. Because both Circuits have done an imperfect job in interpreting Rule 14d-10, judicial resolution of this matter seems unlikely, and either the SEC or Congress should intervene.

Section II of this article discusses the Williams Act and the history of the "best price, all-holders" rule. Section III discusses the split that arose from the Act's ambiguity. Section IV addresses the problems with the current judicial tests and discusses a recent district court decision that some feel has provided clarity to the application of those tests. Section V recommends more clarity, not in drawing dates, but by defining what a tender offer is and creating a safe harbor so that bidders and investors know what is permissible under the Act.

II. THE WILLIAMS ACT AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934

A. The Williams Act Amendment to the Securities Exchange Act of 1934

The Williams Act amended the Securities Exchange Act of 1934 by adding, among other regulations, section 14(d).¹⁴ In doing so, Congress intended to "close a significant gap in investor protection."¹⁵ However, Senator Williams maintained that the Act "balance[d] the scales equally to protect the legitimate interests of the corporation, management, and shareholders."¹⁶ As such, the goals of the Act were

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

¹⁵ 113 CONG. REC. 854, 851 (1967) (statement of Sen. Williams).

¹⁶ *Id.* See also 33 S.E.C. Docket 762, Release No. 6,595 (July 1, 1985) (stating that "[i]n implementing this policy of neutrality, the [Securities and Exchange] Commission has administered the Williams Act in an even-handed fashion favoring neither side in a contest").

twofold. First, the Act aimed to increase investor protection by informing investors about the merits of tender offers.¹⁷ Before the Act, acquiring companies were not required to disclose important information about the tender offer to target shareholders. In addition, they were able to coerce shareholders into tendering their shares by structuring tender offers so that the shareholders would have insufficient time to evaluate what little information they were given.¹⁸ By ordering bidders to disclose all relevant information to shareholders and give shareholders at least twenty days to examine these materials, the Act gave shareholders time to make a more informed, less hasty decision.

Second, the Act was concerned with protecting the tender offer process.¹⁹ Observing that tender offers serve important business functions, Senator Williams took “extreme care...to balance the scales equally” so that he would not “unduly impeded[e] cash takeover bids.”²⁰ The Act thus aimed to provide businesses with some certainty in the tender offer process by demarcating when the tender offer begins and what information must be disclosed to shareholders when making a bid.²¹

1. The Best-Price, All-Holders Amendment

In 1985, the Securities and Exchange Commission recommended amending the Williams Act.²² In administering the Williams Act, the SEC had implicitly read into the Act the requirements that the bidder “make a tender offer to *all* security holders...and that the offer be made to all holders on the same terms.”²³ Upon the SEC’s recommendations that these requirements be formalized, Congress enacted

¹⁷ 113 CONG. REC. 854, 851.

¹⁸ For instance, the acquiring companies would buy shares on a first-come, first-served basis. This put pressure on shareholders to tender so that they would not forego the premium offered by the bidder. *See* 113 CONG. REC. 854, 856. To address this problem, the Act requires a bidder to buy shares on a pro rata basis if shareholders tender more shares than the bidder requested. 17 C.F.R. § 240.14d-8 (2005).

¹⁹ 113 CONG. REC. 854, 851.

²⁰ *Id.* (“In some instances, a change in management will prove a welcome boon for shareholder and employee”).

²¹ *See* 17 C.F.R. §§ 240.14d-2(a), 240.14d-3 (2005).

²² 33 S.E.C. Docket 762, Release No. 6,595 (July 1, 1985).

²³ *Id.* (emphasis added).

Rule 14d-10.²⁴ It believed this rule, also known as the “best-price, all-holders rule,” was necessary to fully achieve investor protection and implement the Act because it “expressly preclude[s] bidders from discriminating among holders of the class of securities that is the subject of the offer.”²⁵

There are two main provisions within Rule 14d-10: the “all-holders” provision and the “best-price” provision. Without the former provision, the disclosure requirements of the Williams Act would be useless because a bidder could solicit shares from only a few select shareholders without offering information to all shareholders.²⁶ “Such discriminatory tender offers could result in the abuses inherent in ‘Saturday Night Specials,’ [or] ‘First-Come First Served’ offers...since security holders who are excluded from the offer may be pressured to sell to those in the included class in order to participate.”²⁷ The “best price” provision was enacted because the Williams Act was silent on the topic of consideration. Therefore, a bidder could make an offer to all shareholders, but at different prices. One specific and growing problem was the “two-tiered, coercive tender offer,” also known as the “First-Come First Served” offer. This type of tender offer is distinguishable from general tender offers by the fact that the bidder breaks up the acquisition into two parts; the first is a tender offer at one price per share, and the second is a subsequent short-form merger at a lower price per share. As a result, the value of the initial tender offer is higher than the value a shareholder would receive if he or she did not tender at that time. This type of tender offer coerces a shareholder into tendering because

[e]ven a shareholder who is convinced that the initial premium is too low will tender for fear that other...shareholders will tender leaving her, if the takeover succeeds, with the inferior back-end position of a nontendering shareholder. The greater the difference between the

²⁴ 17 C.F.R. § 240.14d-10 (2005).

²⁵ 36 S.E.C. Docket 96, Release No. 6,653 (July 11, 1986).

²⁶ The all-holders requirement of rule 14d-10 reads, “No bidder shall make a tender offer unless...[t]he tender offer is open to all security holders of the class of securities subject to the tender offer.” 17 C.F.R. § 240.14d-10(a)(1) (2005).

²⁷ 36 S.E.C. Docket 96, Release No. 6,653 (July 11, 1986).

front-end premium and the back-end position, the greater the potential cost to nontendering shareholders.²⁸

The best-price provision was intended to remedy that legislative gap by requiring a bidder to offer the same consideration to all shareholders.²⁹

Courts have interpreted the best-price provision, Rule 14d-10(a)(2), as having four elements: “(1) that the bidder, (2) during the pendency of the bidder’s tender offer, (3) purchased a security that is the subject of the tender offer, (4) for more consideration than the bidder paid to other shareholders pursuant to the tender offer.”³⁰ Essentially, the best-price and all-holders amendments³¹ were added in order to further the Act’s purpose of investor protection by requiring full disclosure and uniform treatment among investors. One noteworthy aspect of the best-price rule is that, as it currently stands, it only allows actions against the acquiring corporation, not the target company or target executives. Therefore, the shareholders’ only recourse is to sue the bidding company if they believe they were offered a lesser amount than other shareholders.

III. BEST PRICE JURISPRUDENCE: THE INTERPRETIVE DEBATE

Although the law surrounding tender offers has developed over the past forty years, Congress has not yet defined the term “tender offer.”³² Before the adoption of the best-price rule, courts faced the problem of determining what transactions were covered by the Act by defining what constituted a tender offer.³³

²⁸ Dale Arthur Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 127 (1986).

²⁹ See 17 C.F.R. § 240.14d-10(a)(2) (2005) (“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”).

³⁰ *Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1374 (N.D. Ga. 2001).

³¹ This Comment will refer to both provisions as the “best price rule.”

³² See *Developing Meaning*, *supra* note 8. The author discusses four possible definitions of the term “tender offer” and argues that an offer to buy another corporation should be defined as a tender offer if it is “found capable of exerting the same sort of pressure on shareholders to make uninformed, ill-considered decisions to sell which Congress found the conventional tender offer was capable of exerting.” *Id.* at 1275. This definition, the author argues, advances the purposes of the Williams Act better than the more restrictive alternatives. *Id.*

³³ See *Epstein v. MCA, Inc.*, 50 F.3d 644, 656 (9th Cir. 1995).

The problem courts face today involves interpreting the phrase “during such tender offer.”³⁴ This situation has led to ambiguous results because some courts have tried to determine what transactions are included “during” the tender offer period by defining the term “tender offer,” while other courts leave the term undefined.³⁵ Consequently, the courts are now in an “interpretive dichotomy,”³⁶ with one group of circuits interpreting the Rule to include transactions entered into before the commencement of the tender offer³⁷ and the other group arguing that any transaction that occurs outside the tender offer period cannot be included in the tender offer.³⁸

A. The “Integral Part” Test

The Ninth Circuit adopted the former, broader interpretation in *Epstein v. MCA, Inc.*,³⁹ which involved the acquisition of MCA by Matsushita Electrical Co., Ltd. (“Matsushita”) for \$71 per share.⁴⁰ The target shareholders brought suit against MCA and Matsushita when they learned of a series of transactions that enriched two executive stockholders of MCA (Lew Wasserman, MCA’s chief executive officer, and Sidney Sheinberg, MCA’s chief operating officer).⁴¹ At the time of the offer, Wasserman owned approximately five million shares.⁴² Rather than tendering those shares at the offer price, he entered into a separate agreement under which he traded

³⁴ See 17 C.F.R. § 240.14d-10(a)(2) (2005).

³⁵ See, e.g., *Epstein*, 50 F.3d at 654; *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 246 (7th Cir. 1996). In *Epstein*, suit was brought against the target company, MCA. The suit was later dropped because Rule 14d-10 holds only the bidder liable for violations. See 17 C.F.R. §240.14d-10(a) (2005).

³⁶ Rusty A. Fleming, *A Case of “When” Rather than “What:” Tender Offers Under the Williams Act and the All Holders and Best Price Rules*, 27 S. ILL. U. L.J. 263, 266 (2003).

³⁷ *Epstein*, 50 F.3d at 655.

³⁸ *Lerro*, 84 F.3d at 246.

³⁹ 50 F.3d 644 (9th Cir. 1995).

⁴⁰ *Id.* at 647. The offer price consisted of \$66 in cash and \$5 in stock of WWOR-TV, a spin-off company of MCA. *Id.* at 647 n.1.

⁴¹ *Id.* at 648.

⁴² *Id.* at 647.

his shares for preferred stock in a subsidiary company of Matsushita, MEA Holdings.⁴³ In the agreement, Matsushita was to fund MEA Holdings with 106% of the tender price multiplied by the number of shares Wasserman exchanged.⁴⁴ The MEA shares would pay Wasserman an annual dividend of 8.75% and were intended to be a tax-free exchange of Wasserman's MCA stock.⁴⁵

The Sheinberg transaction allegedly involved the tendering of MCA shares at a premium.⁴⁶ At the time of the tender offer, Sheinberg owned approximately a million shares, which he tendered at the \$71 per share offer.⁴⁷ However, unlike the general shareholders, he received an additional \$21 million dollars, which was ostensibly paid to cash out Sheinberg's unexercised stock options.⁴⁸

The Ninth Circuit noted that it had no Congressional guidance or judicial precedent for determining whether either transaction should be considered a part of the tender offer.⁴⁹ Thus, it turned to the administrative history of the Rule and found that "the SEC emphasized the need for 'equality of treatment among all shareholders who tender their shares.'"⁵⁰ The Court also found that the SEC thought the Rule necessary to realize the "investor protection purpose of the [Securities Exchange Act of 1934] and the Williams Act."⁵¹ With this in mind, it explicitly rejected the defendant's timing argument, which the Seventh Circuit would later adopt.⁵² Essentially, the defendants' proposed timing test commences a tender

⁴³ *Id.* at 647-48.

⁴⁴ *Id.* at 648.

⁴⁵ *Id.*; see also I.R.C. § 351(a) (2006). This transaction provided Wasserman with more compensation than participating in the tender offer.

⁴⁶ *Epstein*, 50 F.3d at 648.

⁴⁷ *Id.*

⁴⁸ *Id.* The purpose of the \$21 million dollar payment is disputed. See *infra* text accompanying notes 67-68.

⁴⁹ *Id.* at 654.

⁵⁰ *Id.* at 655 (quoting S. REP. NO. 90-550, at 10 (1967)).

⁵¹ *Id.* at 655.

⁵² *Id.* The Seventh Circuit adopted this test in *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 243-44 (7th Cir. 1996).

offer under the guidelines of Rule 14d-2 at 12:01 a.m. on either the date the tender offer is publicly announced or the date it is sent to the shareholders, whichever comes first.⁵³ Any transaction that fell before that date or after the close of the tender offer would be considered outside the tender offer period and, thus, outside the scope of the rule.⁵⁴

The Ninth Circuit rejected this test because it “would drain Rule 14d-10 of all its force.”⁵⁵ The Court then proposed a different inquiry: “whether the Wasserman transaction was an integral part of Matsushita’s tender offer.”⁵⁶ The Ninth Circuit gives little guidance on how to determine what transactions are to be included in the tender offer.⁵⁷ The Ninth Circuit noted that courts have applied a “functional test,”⁵⁸ which is a fact-specific and fact-intensive inquiry that deems a transaction part of the tender offer if it served an integral part of it.⁵⁹ For instance, a

⁵³ See 17 C.F.R. § 240.14d-2 (2005) (“A bidder will have commenced its tender offer for purposes of section 14(d) of the Act...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”).

⁵⁴ *Epstein*, 50 F.3d at 655.

⁵⁵ *Id.* As an example of the injustice the rule would serve, the Court stated,

Under Matsushita’s reading, even the most blatantly discriminatory tender offer – in which large shareholders were paid twice as much as small shareholders – would fall outside Rule 14d-10’s prohibition, so long as the bidder waited a few seconds after it accepted all of the tendered shares before paying the favored shareholders.
Id.

⁵⁶ *Id.*

⁵⁷ *Id.* at 656. The only guidance given by the Ninth Circuit was quoted from the Second Circuit, which stated that whether a transaction “is part of the tender offer for purposes of the Act cannot be determined by rubber-stamping the label used by the acquiror.” *Id.* (quoting *Field v. Trump*, 850 F.2d 938, 944 (2d Cir. 1988)).

⁵⁸ Hereinafter referred to as the “Integral Part Test.”

⁵⁹ See *Epstein*, 50 F.3d at 655-56:

An inquiry more in keeping with the language and purposes of Rule 14d-10 focuses not on when Wasserman was paid, but on whether the Wasserman transaction was an integral part of Matsushita’s tender offer. If it was, Matsushita violated Rule 14d-10 because it paid him...different, and perhaps more valuable consideration than it offered to other shareholders. *Id.*

transaction that is conditional on the success of the tender offer will likely be an integral part of the tender offer.⁶⁰

On that basis, the Court concluded that the Wasserman transaction was part of the tender offer because the terms of the agreement were conditioned on the success of the offer.⁶¹ With respect to the Sheinberg payment, the parties alleged two different motives behind the transaction. The plaintiffs argued that the payment was a premium “designed to induce Sheinberg to tender his shares.”⁶² If so, then under the Ninth Circuit’s functional test, it would likely be a part of the tender offer. However, the defendants argued that the \$21 million Sheinberg received was “designed both to cash out stock options...and to compensate Sheinberg for agreeing to amend his employment contract with MCA.”⁶³ Given the conflicting accounts, the Ninth Circuit denied the defendant’s summary judgment motion.⁶⁴

B. The “Bright Line” Rule

The Seventh Circuit adopted a different test to determine whether a specific transaction should be included in the tender offer period. Confronted by Snapple investors, who argued that a major shareholder was given additional consideration, the Seventh Circuit rejected the integral part test in its decision in *Lerro v. Quaker Oats Co.*⁶⁵ The case concerned a tender offer and a subsequent merger agreement between Quaker Oats Company and Snapple.⁶⁶ Before Quaker would enter into a merger agreement with Snapple, it required Snapple to enter into an exclusive distributorship agreement with Select Beverages, Inc. (“Select”).⁶⁷ The conflict arose

⁶⁰ *Id.* at 656 (“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”).

⁶¹ *Id.* at 656.

⁶² *Id.* at 657.

⁶³ *Id.*

⁶⁴ *Id.* at 658. After this case, the Ninth Circuit will deem transactions conditioned on the success of the tender offer and premiums designed to induce tendering to be part of the tender offer.

⁶⁵ 84 F.3d 239, 240, 246 (7th Cir. 1996).

⁶⁶ *Id.* at 240. The tender offer was \$14 cash for a share of Snapple stock.

⁶⁷ *Id.*

because a major stockholder of Snapple, the Thomas H. Lee Company (“Lee”), held 20 percent of Select’s common stock.⁶⁸ Consequently, the plaintiffs argued that the agreement with Select provided Lee additional compensation for his Snapple shares.⁶⁹

The plaintiffs contended that the Seventh Circuit should adopt the Ninth Circuit’s functional test.⁷⁰ However, the Court rejected their argument, stating that the case was about “when” as opposed to “what.”⁷¹ The Court drew this distinction because *Epstein’s* functional test tries to determine what a tender offer is by determining what transactions should be included.⁷² The Seventh Circuit stated that this determination was irrelevant because the time period for a tender offer is “rigorously defined.”⁷³ The Williams Act is filled with timetables that require companies to file forms and schedules once a tender offer commences.⁷⁴ According to the Seventh Circuit, the Integral Part Test would make the start and end dates for a tender offer uncertain by allowing courts to make *ex ante* judicial determinations of what transaction started the tender offer.⁷⁵ As a result, the Court argued that the Integral Part Test would subvert both the investor protection and clarity purposes of the Williams Act.⁷⁶

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *See id.* at 245.

⁷¹ *Id.* at 246.

⁷² *See Epstein v. MCA, Inc.*, 50 F.3d 644, 656 (9th Cir. 1995).

⁷³ *Lerro*, 84 F.3d at 246.

⁷⁴ *Id.*; *see also* 17 C.F.R. §§ 240.14d-3, 240.14d-4, 240.14d-6 (2005).

⁷⁵ *Lerro*, 84 F.3d at 246. The Court argued that the Integral Part Test would “wreak havoc” because the clocks could not be known until “years after the events, [when] a judge declares when negotiations became sufficiently serious to mark the commencement of the offer.” *Id.*

⁷⁶ *Id.* at 243. The purpose of Rule 14d-10 “is to demark clearly the periods during which the special Williams Act rules apply.” *Id.*

On that basis, the Seventh Circuit contended that best-price cases are about *when* the tender offer begins.⁷⁷ The Court noted that the tender offer starts at 12:01 a.m. on the date of general publication for purposes of Rule 14(d) of the Act.⁷⁸ The Court then looked at the text of Rule 14d-10 and held that, because Congress used the phrase “*during* the tender offer,” it wanted to cover only those transactions occurring within the tender offer period, not before or after.⁷⁹ Noting that the Supreme Court has mandated deference to securities statutes and regulations, the Seventh Circuit believed that a bright line rule rejecting those transactions that occur outside the tender offer period would be most in accordance with the text of the statute.⁸⁰ The court believed that this line, drawn by Congress, was a strict, but necessary, rule because “[i]t is essential to permit everyone to participate in the markets near the time of a tender offer.”⁸¹ Consequently, the Seventh Circuit’s rule absolves all transactions outside the tender offer period from liability.

IV. CURRENT PROBLEMS

As it now stands, investors are left with two rules, both purporting to protect them, yet both doing an imperfect job. This section discusses the problems with both tests. It then discusses one case in particular, *Katt v. Titan Acquisitions, Inc.*,⁸² that has been particularly influential in the best-price debate. Specifically, the case is said to clarify the application of the best-price rule to private transactions around the time of the tender offer.⁸³ However, this section discusses why that case does *not*

⁷⁷ *Id.* at 246.

⁷⁸ *Id.* For a summary of the text of Rule 14d-2, see *supra* text accompanying note 30.

⁷⁹ *Lerro*, 84 F. 3d at 243; see also, 17 C.F.R. § 240.14d-10(a)(2) (2005) (“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”) (emphasis added).

⁸⁰ *Lerro*, 84 F.3d at 243 (citing *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995); *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994)) (Courts are to “respect the language of the securities statutes and regulations”).

⁸¹ *Id.* The Court explained, “Bidders are forbidden to buy or sell on the open market or via negotiated transactions during an offer...but they are free to transact until an offer begins, or immediately after it ends.” *Id.*

⁸² *Katt v. Titan Acquisitions, Inc.*, 244 F. Supp. 2d 841 (M.D. Tenn. 2003).

⁸³ See Christopher E. Austin & Justin S. Anand, *Federal Court Clarifies the Application of the “Best Price Rule,”* 6 M&A LAW. 10 (2003).

clarify best-price jurisprudence, but instead adds more confusion to an already muddled problem.

A. Problems with Best-Price Jurisprudence

Although the Williams Act was enacted for two purposes, both the Ninth and Seventh Circuits' tests seem to frustrate at least one of those purposes. In *Epstein*, the Ninth Circuit focuses only on the fact that the Williams Act was promulgated to protect investors.⁸⁴ The Court seemed to believe that creating a broad rule would best advance that objective.⁸⁵ However, its subjective factual investigation makes it difficult for bidders and corporations to predict when a tender offer period begins and ends, thus making the process murky.⁸⁶ The *Epstein* holding provides no clear results for future cases⁸⁷

This ambiguity deters bidders from making tender offers, hurts both investors and corporations, and disregards Senator Williams' intentions. In his address to Congress, Senator Williams stated that “[t]his measure is not aimed at obstructing legitimate takeover bids,” because he recognized that tender offers may be necessary for a company’s survival.⁸⁸ For instance, tender offers can be a useful mechanism for achieving efficiency and growth by fighting against entrenched and

⁸⁴ *Epstein v. MCA, Inc.*, 50 F.3d 644, 655 (9th Cir. 1995).

⁸⁵ *Id.*

⁸⁶ *See id.* at 656 n.19 (stating that if a private agreement “is deemed a part of the tender offer, the tender offer does not end, by definition, until that agreement is performed”); *see also supra* notes 56-59 and accompanying text.

⁸⁷ *See* Fleming, *supra* note 36, at 290-91 (the Integral Part Test “impact[s] practitioners, acquiring corporations, and target corporations leading to confusion in deciding how the tests will be applied”); *see also* Walker v. Shield Acquisition Corp., 145 F. Supp. 2d 1360, 1369 (N.D. Ga. 2001) (rejecting “the Ninth Circuit’s broad holding, which requires a subjective analysis of transactions occurring outside the tender offer period to determine if they should be deemed ‘integral’ to the tender offer.”); Mark Khmelnskiy, *Structuring Transactions Outside All Holders/Best Price Rule*, 9 FORDHAM J. CORP. & FIN. L. 501, 515 (2004) (stating that even though the Ninth Circuit allows courts to scrutinize transactions on an individual basis, it “failed to articulate any definite factors that would distinguish legitimate transactions from mere efforts to escape Rule 14d-10”); John Mueller, *The “All-Holder-Best Price” Rule: Executive Compensation Agreements and Their Place in Tender Offers*, 1 DEPAUL BUS. & COM. L.J. 287, 303 (2003) (arguing that “the test is completely void of structure and, thus, fails to establish any discernible guidelines for future tender offers”).

⁸⁸ 113 CONG. REC. 854, 851 (1967) (statement of Sen. Williams).

inefficient managers.⁸⁹ In addition, bidders often wage bidding wars against one another to buy a target's shares, which can yield higher premiums for target shareholders.⁹⁰ Deterring tender offers has the potential to deter multiple bids for corporations, thereby resulting in lower premiums to target shareholders. This can be especially detrimental for the target shareholders because this decrease may be replaced with an increase in mergers.⁹¹ It is doubtful that Senator Williams or Congress ever intended these negative effects.

Additionally, the subjectivity of the Ninth Circuit's test might spur protracted litigation that is costly for the bidding company. In fact, most courts that have adopted this test have rejected a defendant's summary judgment motion.⁹² As a result, these cases proceeded to discovery, costing companies valuable time and money. Although courts are trying to protect investors, such litigation is harmful when considering that many of these suits concern legitimate business agreements⁹³

⁸⁹ See THOMAS HOLLIS HOPKINS, *MERGERS, ACQUISITIONS, AND DIVESTITURES: A GUIDE TO THEIR IMPACT FOR INVESTORS AND DIRECTORS* 14 (1983) (stating that replacing "incompetent management by the competent is another classic justification for acquisitions"); William C. Tyson, *The Proper Relationship Between Federal and State Law in the Regulation of Tender Offers*, 66 NOTRE DAME L. REV. 241, 251 (1990). Recognizing this fact, Congress resisted any bias in favor of target management. S. REP. NO. 90-550, at 3 (1967).

⁹⁰ See Tyson, *supra* note 89, at n.48 (writing that "Congress also was convinced that tender offers fostered competitive bidding for target stock, thus affording target shareholders the opportunity to tender their shares at a premium") (citing 113 CONG. REC. 24, 666 (1967) (statement of Sen. Javits)). Regardless of whether there is a bidding war, however, target shareholders experience positive returns on their shares from tender offers. A study done by Michael Jensen and Richard Ruback found that, on average, shareholders gained between 16.9 and 34.1 percent return on their shares for successful tender offers. Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 8 (1983).

⁹¹ Empirical evidence suggests that target shareholders gain about 10 percent more in a tender offer than in a merger. See David W. Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153, 175 (1986).

⁹² See *Gerber v. Computer Assocs. Int'l, Inc.*, 303 F.3d 126 (2d Cir. 2002); *Karlin v. Alcatel, S.A.*, No. SA CV 00-0214 DOC EE, 2001 WL 1301216 (C.D. Cal. Aug. 13, 2001); *Maxick v. Cadence Design Sys., Inc.*, No. C-00-0658-PJ-H, 2000 WL 33174386 (N.D. Cal. Sept. 21, 2000); *Millionerrors Inv. Club v. Gen. Elec. Co.*, No. Civ.A. 99-781, 2000 WL 1288333 (W.D. Pa. Mar. 21, 2000); *Padilla v. Medpartners, Inc.*, No. CV 98-1092-RSWL, 1998 U.S. Dist. LEXIS 22839 (C.D. Cal. July 27, 1998); *Perera v. Chiron Corp.*, No. C-95-20725 SW, 1996 WL 251936 (N.D. Cal. May 8, 1996) (denying in part and granting in part defendant's summary judgment motion to dismiss plaintiffs' claim that insiders received additional consideration). *But see Harris v. Intel Corp.*, No. C 00-1528 CW, 2002 U.S. Dist. LEXIS 13796 (N.D. Cal. July 8, 2002) (granting defendant's summary judgment motion).

⁹³ For instance, both *Karlin* and *Millionerrors Investment Club* concerned the target board of director's decision to grant two executives stock options around the time of the tender offer. See *Karlin*, 2001

that companies use to recognize a manager's accomplishments.⁹⁴ By hindering a company's efforts at recognition, courts may make it more difficult for the company to obtain and retain quality management. Golden parachutes in particular are useful and often necessary to keep a target company's executives from seeking another position during the course of a takeover.⁹⁵ During times of transition, it is particularly important to have strong management to keep a company stable. In addition, volatile industries can use golden parachutes to attract quality management.⁹⁶ On the other hand, many scholars have criticized the use of golden parachutes as a means of serving executive greed⁹⁷ and have characterized them as corporate "waste."⁹⁸ However, the vast majority of scholars are in agreement that reasonable golden parachutes can be useful and desirable from both the corporate and investor perspectives.⁹⁹ Consequently, a broad, subjective rule that judges these agreements on a case-by-case basis may interfere with legitimate corporate needs by making companies more reluctant to draft these agreements. Surely neither Senator Williams nor Congress intended this result.

Although the Seventh Circuit attempted to clarify the best-price rule by creating an unambiguous test, its test does not accomplish what Senator Williams set

WL 1301216, at *2; *Millionerrors*, 2000 WL 1288333, at *1; see also *Padilla*, 1998 U.S. Dist. LEXIS 22839, at *3 (concerning a golden parachute incentive agreement that the target company enacted for its executives).

⁹⁴ Golden parachutes, or "change-in-control severance agreement plans," provide top executives with compensation when they leave or are fired from a company that has been taken over. HENRY R. CHEESEMAN, *BUSINESS LAW: THE LEGAL, ETHICAL, AND INTERNATIONAL ENVIRONMENT* 784 (4th ed. 2001).

⁹⁵ *Id.*

⁹⁶ See Richard P. Bress, Note, *Golden Parachutes: Untangling the Ripcords*, 39 STAN. L. REV. 955, 959 (1987); Kenneth C. Johnson, Note *Golden Parachutes and the Business Judgment Rule: Toward a Proper Standard of Review*, 94 YALE L.J. 909, 917 (1985) (arguing that without a golden parachute agreement, "executives may hesitate to invest their human capital in corporations that require the acquisition of a great deal of firm-specific knowledge and experience, because such knowledge and experience cannot be transferred if the executives are displaced by a takeover").

⁹⁷ See Johnson, *supra* note 96, at 917.

⁹⁸ See Bress, *supra* note 96, at 961.

⁹⁹ See *id.* at 979; Johnson, *supra* note 96, at 917.

out to do.¹⁰⁰ The Court argued that setting a clear date upon which all transactions would be considered “during” the tender offer would protect both investors and corporations.¹⁰¹ However, the benefits seem one-sided. First and foremost, the test creates a *win-win situation* for bidders. Under it, a bidder is *allowed* to pay an insider or major shareholder a premium for tendering his or her shares so long as this payment occurs outside the tender offer period. Additionally, the Seventh Circuit’s rule contains no restriction on conditioning transactions on the success of the tender offer. As a result, a bidder can give an insider or shareholder a premium to gain support for the tender offer but later recoup the payment if the tender offer fails to meet its threshold.¹⁰² The Court urges that this situation is acceptable because Rule 14d-2 specifies when the tender offer clock begins and thus defines what transactions should be included in the tender offer period.¹⁰³ But this, too, misses the purpose of the Williams Act, which was “meant to have a substantial remedial component, a significant substantive dimension, and strong preemptive force.”¹⁰⁴ As it stands, the Seventh Circuit’s test does not provide shareholders with a suitable means of suing bidders who allegedly violate the best-price rule because the bright-line test dismisses all transactions that occur outside the tender offer period—if a transaction occurred outside the tender offer period, the Seventh Circuit would grant summary judgment for the defendant.¹⁰⁵ However, such a rule allows for easy manipulation and maneuvering around the test so that otherwise illegal transactions could escape judicial scrutiny.¹⁰⁶ For instance, a bidder could negotiate payments

¹⁰⁰ See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 243 (7th Cir. 1996); see also Mueller, *supra* note 90, at 304-05 (stating that the Seventh Circuit “recognized that the approach was rather mechanical, but held that the critical need for certainty in the regulation of tender offers justified its use”).

¹⁰¹ *Lerro*, 84 F.3d at 243.

¹⁰² See *id.* (stating that “[p]ersons who make tender offers do not lose their ability to participate as investors for undefined periods ‘near’ the time of the offer”). This seems unfair to outside stockholders given the remedial nature of the best-price rule.

¹⁰³ *Id.* at 246; see also *supra* notes 77-82 and accompanying text. The Seventh Circuit’s test merely interprets and formalizes the text of Rule 14d-2 into case law.

¹⁰⁴ Tyson, *supra* note 89, at 353.

¹⁰⁵ *Lerro*, 84 F.3d at 246 (“[O]ur case is about ‘when’ rather than ‘what.’ Quaker Oats made a traditional tender offer. The commencement is rigorously defined. This offer commenced at 12:01 A.M. on November 4, 1994.... From this conclusion everything else follows”).

¹⁰⁶ See Fleming, *supra* note 36 at 292 (offering examples of how creative business people can structure transactions outside the Seventh Circuit’s rule. For instance, they can demand terms “in an employment or incentive agreement that become cost prohibitive for a potential bidder” or offer lower premiums if the bidder is forced to enter into expensive employment agreements with insiders).

with inside executives before the start of the tender offer and pay them after the tender offer succeeds. This could result in lower overall premiums paid to outside investors.¹⁰⁷

Moreover, the Court argued that paying a premium to insider shareholders at the expense of outside investors is permissible because it is better than the alternative—a doomed tender offer.¹⁰⁸ For instance, the Court maintained that a transaction where general investors receive \$25 per share and inside investors receive \$30 per share for stock worth \$22 is permissible.¹⁰⁹ This begs the question: what *protects* investors? If we assume that by protecting investors, Senator Williams and Congress intended to maximize a shareholder's return on his or her investment, then the Seventh Circuit has failed to advance this goal.¹¹⁰ By permitting a situation in which an investor receives less than his or her entitlement, the Seventh Circuit has hurt, rather than protected, the investor, a situation that the Williams Act was intended to remedy.¹¹¹

Allowing the payment of premiums to only one shareholder or a group of shareholders has another indirect effect. Senator Williams' address to Congress shows that the Act was passed in part to better inform investors.¹¹² However, by permitting premiums to be paid to target executives, the Seventh Circuit has indirectly stifled the disclosure of information to shareholders because those executives will be less inclined to voice opposition to the tender offer. Because they will be less likely to give counterarguments to outside shareholders, the rule will bias

¹⁰⁷ For instance, if a company whose stock is trading at \$22 per share is valued at \$25 per share by the bidder, and the insiders receive a premium of \$5 on their shares, then the outside shareholders will have to accept a price lower than \$25 per share because giving them that price per share would raise the total spent on the target above its projected value. Outside shareholders will thus be forced into either tendering at a lower price or not tendering at all.

¹⁰⁸ *Lerro*, 84 F.3d at 243.

¹⁰⁹ *See id.*

¹¹⁰ *See Fleming*, *supra* note 36, at 279.

¹¹¹ *See supra* notes 17-19 and accompanying text. Senator Williams intended on closing “a significant gap in investor protection.” 113 CONG. REC. 854 (1967) (statement of Sen. Williams).

¹¹² *See* 113 CONG. REC. 854, 855 (1967) (statement of Sen. Williams).

the disclosures to only pro-tender offer information. Consequently, investors might end up tendering their shares when it is not in their best interests to do so.¹¹³

B. Discussion and Critique of *Katt*—Why the Middle District of Tennessee Has Not Solved the “Best-Price” Debate

Since *Lerro* and *Epstein*, many 14d-10 cases have been brought by disgruntled investors—including *Katt v. Titan Acquisitions, Inc.*¹¹⁴ Heard by a district court in Tennessee, this case concerned United Technologies Corporation’s (“UTC”) fulfillment of International Comfort Products’ (“ICP”) golden parachute agreements with insider shareholders.¹¹⁵ The plaintiffs were a group of outside stockholders in ICP.¹¹⁶ After a decline in the early 1990’s, ICP hired new managers to revitalize the company.¹¹⁷ As part of its efforts, the board adopted an executive compensation plan and incentive strategy that was based on management performance.¹¹⁸ The plan included golden parachute agreements that “guaranteed between 12 and 24 months of salary and benefits in the event of a change in control.”¹¹⁹ The board adopted this plan in 1997 and considered revising it in 1998, but the revision ultimately did not take place.¹²⁰ As the company became profitable, two of its largest shareholders considered selling their stock.¹²¹ In response, the board decided to sell the company in the beginning of 1999.¹²²

¹¹³ For instance, because of the additional premiums to target executives, outside investors might receive a substantially smaller premium on their shares than that to which they are entitled.

¹¹⁴ 244 F. Supp. 2d 841 (M.D. Tenn. 2003).

¹¹⁵ *Id.* at 846-47.

¹¹⁶ *Id.* at 843.

¹¹⁷ *Id.* at 846.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

With the aid of Credit Suisse First Boston (“CSFB”), the company contacted about forty potential bidders.¹²³ While CSFB was discussing potential takeovers with the bidders, the ICP board reviewed its executives’ golden parachute agreements and decided to provide its senior managers with additional benefits.¹²⁴ The new agreements extended each severance period by one year, extended benefits by a year, added a bonus component to the salary calculation, and accelerated unvested options.¹²⁵ Plaintiffs estimated the value of these agreements at about \$11 million.¹²⁶ Plaintiffs argued that these agreements were approved in order to provide ICP executives with additional consideration for their shares from the company’s ultimate acquirer.¹²⁷

In June, three companies submitted binding bids, and the defendant UTC was the highest bidder at \$11.25 per share.¹²⁸ After subsequent negotiations with CSFB, UTC agreed to increase its bid to \$11.75 per share.¹²⁹ UTC’s subsidiary, Titan, commenced the tender offer on June 30, 1999, when it filed its statement with the SEC.¹³⁰

Before the tender offer period, however, UTC negotiated additional service agreements with ten ICP executives, entitling them to bonuses ranging from \$50,000 for junior executives to \$500,000 for the CEO, provided that the executive worked

¹²³ *Id.* at 847.

¹²⁴ *Id.*

¹²⁵ *Id.* The revision took place in March 1999.

¹²⁶ *Id.* This figure is the value that the revised agreements added in excess of the original severance agreements.

¹²⁷ *Id.*

¹²⁸ *Id.* at 848.

¹²⁹ *Id.* This provided shareholders with a 65 percent premium over the January 1999 stock price, and a 37.4 percent premium over the average stock price for the three-month period prior to that date. *Id.* UTC entered into a pre-acquisition agreement with ICP that detailed a two-tiered transaction. First, UTC would offer \$11.75 per share to ICP shareholders. Then, if UTC acquired at least 71 percent of ICP stock, it would merge with ICP using a short-form merger, acquiring the remaining shares at the tender offer price. *Id.*

¹³⁰ *Id.* at 849.

ninety days after the acquisition and used his or her best efforts to assist in the transition.¹³¹ These bonuses were all contingent on the success of the tender offer: if UTC was not successful in acquiring 71 percent of ICP stock, management would not receive these bonuses.¹³² Ultimately however, UTC's tender offer was successful, and the company acquired 98 percent of ICP's stock.¹³³

The plaintiffs contended that these agreements provided the executives with compensation for work they were already required to do—namely, manage the company.¹³⁴ As such, they alleged that the service agreements were nothing more than additional compensation to ICP management to induce them to tender their shares and to solicit other shareholders to tender shares of ICP.¹³⁵ Defendants argued that these agreements were legitimate compensation for work done during the transition and denied any allegations that they were intended as additional compensation for their shares.¹³⁶

Given that the service agreements were negotiated and executed outside the tender offer period, the district court framed this case in terms of what interpretation best conforms with Congress's and the SEC's views on the best-price rule.¹³⁷ The Court rejected *Epstein's* Integral Part Test because it found “no language in the administrative or legislative history supporting the expansive reading of...Rule 14(d)-10 [sic].”¹³⁸ Consequently, the Court applied *Lerro* to the facts of the case and granted the defendants' motion for summary judgment.¹³⁹ With respect to the

¹³¹ *Id.* Plaintiffs argue that in exchange for the bonuses, ICP executives were to “cooperate fully with [UTC] on all matters required to bring the [tender offer] to closing and successfully solicit ICP shareholders.” *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.* at 850.

¹³⁵ *Id.* at 849-50.

¹³⁶ *Id.* at 850.

¹³⁷ *Id.*

¹³⁸ *Id.* at 854 (quoting *Walker v. Shield Acquisition Corp.*, 145 F. Supp. 2d 1360, 1376 (N.D. Ga. 2001)).

¹³⁹ *Id.* at 856.

golden parachute agreements, the court noted that they “occurred after the tender offer had expired.”¹⁴⁰ Because *Lerro’s* rule dismisses agreements that occur outside the tender offer period, the court rejected plaintiffs’ reliance on these agreements as evidence of a discrepancy in payment.¹⁴¹ With respect to the transition service agreements, the Court granted summary judgment for the defendants because the plaintiffs did not provide evidence to show a genuine issue concerning the fourth element of Rule 14d-10.¹⁴² The court asserted that the plaintiffs’ argument boiled down to an argument about “waste;” essentially that the payments were only to compensate the executives for work done during the transaction and those payments were unnecessary because the target company was already compensating the executives for that work.¹⁴³ However, the Court rejected this argument not because it was wrong, but because “question[s] of business judgment and corporate law [were] beyond the scope of this lawsuit.”¹⁴⁴

In dicta, the court attempted to clarify how *Epstein’s* Integral Part Test should apply to best-price cases.¹⁴⁵ It should be noted that the Court accepted the *Lerro* test and rejected *Epstein’s* test, applying and elucidating the Ninth Circuit’s “malleable standard” only “in the interests of clarity and comprehensiveness.”¹⁴⁶ In proceeding, the Court contended that under *Epstein*, a plaintiff cannot successfully argue that an agreement was integral to the tender offer merely because it was conditional upon the success of the offer.¹⁴⁷ Rather, the Court stated that this inquiry, as to whether the agreement was conditional, “is only one part of the Best Price Rule inquiry.”¹⁴⁸

¹⁴⁰ *Id.* at 857.

¹⁴¹ *Id.*

¹⁴² *Id.* at 859. The fourth element reads “for more consideration than the bidder paid to other shareholders pursuant to the tender offer.” *See supra* text accompanying note 30.

¹⁴³ *Katt*, 244 F. Supp. 2d at 859-60.

¹⁴⁴ *Id.* at 859.

¹⁴⁵ *See id.* at 857-60.

¹⁴⁶ *Id.* at 857.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

Another part of the inquiry requires the plaintiff to show that the agreement was intended to be additional consideration above the tender offer price in order to induce the executive to tender his or her shares and support the offer.¹⁴⁹ Therefore, *Katt* rejected the notion that a conditional payment raises the presumption of an intent to induce the executives to tender. The court requires the plaintiffs to show more than a conditional payment, thus making it more difficult for plaintiffs to defeat summary judgment. Additionally, in order to show a violation of the best-price rule, *Katt* required that the payment made to the executive shareholder not be the acquiror's merely honoring a pre-existing duty of the target,¹⁵⁰ a condition *Epstein* never stipulated.¹⁵¹

For the above reasons—namely, its “clarification” of *Epstein* and its adoption of *Lerro*—*Katt* is viewed as a clarification of the best-price rule.¹⁵² Scholars have advanced three arguments in favor of this case. First, the adoption of *Lerro* is helpful because it joined many other courts applying the bright-line test, reversing an earlier decision in the same case.¹⁵³ As such, it provides additional support for moving away from the Integral Part Test.¹⁵⁴ Second, the court clarified the application of the Integral Part Test by requiring a plaintiff to prove that the bidder *intended* to induce target executives to tender.¹⁵⁵ Finally, the Court determined that a bidder “does not violate the best price rule as a matter of law, even under the Integral Part Test, by simply honoring preexisting golden parachutes and other contracts inherited from

¹⁴⁹ *Id.* at 857-58.

¹⁵⁰ *Id.* at 858. “[U]nder *Epstein*, Plaintiff could defeat summary judgment on its claim that the golden parachutes violated the Williams Act only by alleging sufficient facts to establish a question whether UTC was involved in the ICP Board’s adoption of the agreements.” *Id.* Therefore, payments made according to an agreement negotiated solely within the target company do not violate Rule 14d-10.

¹⁵¹ *Id.* at 859. “*Epstein* itself lends little support to Plaintiff’s case, given in that case, the acquiror consulted with the target and expressly approved its grant of new stock options to a dominant shareholder on the day the tender offer was announced.” *Id.*

¹⁵² See Austin & Anand, *supra* note 83, at 10.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

the target.”¹⁵⁶ As a result, a plaintiff must show that the bidder was involved in enacting the agreements.¹⁵⁷

Katt, however, does nothing more than increase support for *Lerro* by adopting its test. This does not make the test more accurate or correct—just more popular. In addition, the Court really does not clarify the application of *Epstein’s* Integral Part Test. By requiring the plaintiffs to show the bidder’s intentions behind making payments to target executives, *Katt* makes *Epstein’s* broad test even harder to apply. As it stands, *Epstein’s* test allows a plaintiff to survive summary judgment by providing evidence that a payment, made solely to a target executive, was conditioned on the success of the tender offer.¹⁵⁸ However, if *Katt’s* suggestions are taken, a plaintiff would also have to show that the payment provided was intended to induce the target executive to tender his or her shares. This is a difficult threshold, especially during the summary judgment stage when the plaintiff has not had the opportunity for discovery. *Katt’s* new standards thus remove much of the force plaintiffs originally wielded under *Epstein*.

Nevertheless, *Katt* makes one valid and important point: A payment made pursuant to an agreement negotiated between the target company and its executives does not violate the best price rule. This allows a bidder to avoid expending unnecessary time and money in litigation by showing that it was not involved in negotiating the agreements. The best price rule was not intended to cover such agreements. Rather, it was intended to prevent a more prominent situation: the coercive, two-tier tender offer.¹⁵⁹

The best price provision also prevents additional payments to one shareholder that exceed the payment to any other shareholder as long as the payments are pursuant to the tender offer. One example of this is the payment of a

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Epstein v. MCA, Inc.*, 50 F.3d 644, 656 (9th Cir. 1995). Note that the plaintiff must still prove that the compensation provided to the target executive was more than that provided to other shareholders to succeed. *Id.* at 654. The additional consideration must also be shown to have been pursuant to the tender offer. *Id.*

¹⁵⁹ 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams) (noting that his proposed rule “would outlaw tender offers on a first-come, first-served basis and [would] thus eliminat[e] pressure on shareholders to make hasty deposits”); see also *supra* text accompanying notes 27-30.

bonus to target executives under an agreement negotiated between the acquiring corporation and the executives. For instance, the Wasserman transaction in *Epstein* involved negotiations between the acquiring company and target executives.¹⁶⁰ Under the *Katt* standard, a court would probably find that this agreement violates the best price rule because it took place during the tender offer. However, if the target company and its executives negotiated the agreements independently, *Katt* would uphold the agreements as a matter of law. As such, the Court alleviates a substantial burden on the acquiring company and allows it to legitimately takeover another company's existing agreements.

However, the debate is still wide open. After *Katt*, two tests remain, one of which is broad and mutable, and the other of which is rigid. Courts are still left with the discretion to decide which is correct, with little guidance because the phrase "during the tender offer" has still not been defined. Meanwhile, investors are still at a loss because both tests seem to reject their needs, especially if other circuits adopting the *Epstein* test also heed *Katt's* additional considerations. Due to judicial inconsistencies, either the SEC or Congress must make a proper resolution to the best-price debate.

V. RECOMMENDATIONS

Given the diversity of the individuals and parties involved in best-price cases, resolution of this matter is difficult and requires a careful balancing of all interests. Senator Williams noted this much when he recognized "that the administrative approach of neutrality in the regulation of proxy contests...would also be appropriate for tender offer regulation."¹⁶¹ As such, this section will proceed with a brief discussion of the important issues involved in regulating tender offers. It will then argue that defining the term "tender offer" is an unnecessary task with respect to best-price litigation. Rather, it will discuss the usefulness of defining the phrase "during the tender offer" and will propose a definition. Finally, it will recommend that a safe harbor provision is necessary to fulfill the interests of all involved and will suggest provisions for consideration.

¹⁶⁰ *Epstein*, 50 F.3d at 647-48.

¹⁶¹ See Tyson, *supra* note 89, at 251; see also 113 CONG. REC. 854, 855 (1967) (statement of Sen. Williams).

A. Issues Involved with Regulating Tender Offers

The regulation of tender offers was intended to cover the smallest period of time possible, thereby allowing¹⁶² and encouraging¹⁶³ private or open market transactions outside of the tender offer period. Three things are important to note here. First, privately negotiated transactions were occurring at the time Senator Williams was considering his bill. Second, the Senator did not want private transactions disclosed until after they occurred so as to maintain and encourage private negotiations. Third, he did not object to the occurrence of private negotiations. As a result, an overarching policy of protecting the tender offer process should be taken into consideration when regulating tender offers. Tender offers serve as useful tools to promote efficiency and growth.¹⁶⁴ Commentators argue that “competition among managerial teams for the rights to manage resources limits divergence from shareholder wealth maximization by managers and provides the mechanism through which economies of scale or other synergies available from combining or reorganizing control and management of corporate resources are realized.”¹⁶⁵ As such, acquiring corporations need to know what is legal before making a tender offer in order to sustain the benefits of the process. Otherwise, the courts could jeopardize the whole process, as some have argued in referring to the Ninth Circuit’s broad Integral Part Test.¹⁶⁶

B. The Irrelevance of Defining a Tender Offer

The Ninth Circuit noted in *Epstein* that courts have been forced to create a functional test because neither Congress nor the SEC has defined the term “tender offer.”¹⁶⁷ The test has been necessary, according to the Ninth Circuit, because it

¹⁶² 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams) (stating that “[s]ubstantial open market or privately negotiated purchases of shares may precede or accompany a tender offer”).

¹⁶³ *Id.* (“While some people might say that this information [private purchases] should be filed before the securities are acquired, disclosure after the transaction avoids upsetting the free and open auction market where buyer and seller normally do not disclose the extent of their interest”).

¹⁶⁴ *See* Tyson, *supra* note 89, at 251 n.48.

¹⁶⁵ Jensen & Ruback, *supra* note 90, at 6.

¹⁶⁶ *See* Austin & Anand *supra* note 83, at 10.

¹⁶⁷ *Epstein v. MCA, Inc.*, 50 F.3d 644, 656 (9th Cir. 1995).

scrutinizes private transactions “in the context of various salient characteristics of tender offers.”¹⁶⁸ However, defining a tender offer will accomplish little for purposes of Rule 14d-10 because a tender offer still begins on the date set by Rule 14d-2. Regardless of the definition, an acquiror must file forms with the SEC only when he intends to purchase a block of shares from the target corporation. The Seventh Circuit argues that the purpose of Rule 14d-10 “is to demark clearly the periods during which the special Williams Act rules apply.”¹⁶⁹ Because the Act is filled with disclosure requirements that a bidder must file once the offer commences, a court would “wreak havoc” by declaring that the tender offer actually began before the general announcement date.¹⁷⁰

On the other hand, proponents of the Ninth Circuit’s rule might argue that defining a tender offer would lead to the clearest results of what “during” means because courts would have assistance in determining what transactions are included in the tender offer. This would lead to clearer results than leaving the definition open and the duration fixed. By defining the term “tender offer,” bidders would know what they could and could not do before disclosing their intent to make a tender offer to the public under Rule 14d-2. This would be clearer for all parties involved and would be more protective of investors.

However, the difficulty involved in defining a tender offer is that transactions surrounding the tender offer period are numerous and varied. Some transactions involve paying bonuses to managers, while others involve fulfilling pre-existing golden parachute agreements. Any workable definition of a tender offer could not enumerate all of the possible agreements and would thus run the risk of being too narrow. In fact, the conventional definition of a tender offer, a “publicly made invitation addressed to all shareholders of a corporation to tender their shares for sale at a specified price,”¹⁷¹ has always been seen by commentators as being too narrow.¹⁷² Although one might broaden that definition by defining the tender offer

¹⁶⁸ *Id.* (quoting *Field v. Trump*, 850 F.2d 938, 943-44 (2d Cir. 1988)).

¹⁶⁹ *Lerro v. Quaker Oats*, 84 F.3d 239, 243 (7th Cir. 1996).

¹⁷⁰ *Id.* at 246. Rule 14d-2 requires a bidder to file documents with the SEC upon commencing a tender offer. According to the rule, the tender offer commences on the date of general announcement. 17 C.F.R. § 240.14d-2 (2005). However, if a court could potentially determine that the commencement date should have been before the general announcement date, then a bidder would not know when to file the required disclosures.

¹⁷¹ *Developing Meaning*, *supra* note 8, at 1251.

¹⁷² *See id.* at 1271 (“[A]ny attempt to return to [the conventional definition] would be unrealistic in view of the growing number of authorities taking a more expansive approach”).

as including *all* transactions that accompany the conventional tender offer, this would burden and stifle many transactions that surround the time of a tender offer. Additionally, it would deter corporations from making tender offers in the first place because potential bidders would be fearful that a court would later deem transactions surrounding the tender as part of the tender offer. As a result, any definition of a tender offer would accomplish little in this context, and defining the term becomes tangential to this debate with the real issue centering on when the tender offer actually occurs.¹⁷³

C. 'When' the Tender Offer Occurs

The two competing interpretations of the best price rule dispute when the tender offer period actually begins. Unlike the Seventh Circuit, the Ninth Circuit rejected any test that examined only those transactions that occurred after the official commencement of the tender offer period under Rule 14d-2(a).¹⁷⁴ Consequently, the Court implicitly acknowledged that a tender offer can potentially begin before the tender offer is publicly announced.

Given the sharp divide among the circuits¹⁷⁵ and the dichotomous nature of the split, either Congress or the SEC should clarify the meaning of “during the tender offer” because “[t]he difference between ‘during’ and ‘before’ (or ‘after’) is not just linguistic.”¹⁷⁶ Courts give great deference to the language in securities statutes and regulations.¹⁷⁷ Thus, an SEC pronouncement could end the current debate.

For purposes of clarity and as a matter of administrative and judicial convenience, the SEC should adopt the Seventh Circuit’s Bright-Line Rule when defining the phrase “during the tender offer.” Even if the Ninth Circuit’s flexible

¹⁷³ See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 246 (7th Cir. 1996).

¹⁷⁴ *Epstein v. MCA, Inc.*, 50 F.3d 644, 654 (9th Cir. 1995).

¹⁷⁵ The Seventh and Eleventh circuits have both adopted the bright line test; whereas the Second, Third, Sixth, and Ninth circuits have adopted the fact intensive, integral part test.

¹⁷⁶ *Lerro*, 84 F.3d at 243.

¹⁷⁷ See *id.* (citing *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995); *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994)) (noting that these cases “tell us to respect the language of securities statutes and regulations”).

and mutable standard were limited solely to best-price cases, its rule is still too indefinite to create workable and consistent results. If the tender offer period were dependent on the facts of each case, courts and corporations would still have no guidance in determining what transactions are permitted around the time of a tender offer. Any negotiation or transaction could potentially be recognized as violating the best-price rule, even if the bidder's intentions were to comply with the rule.¹⁷⁸ In addition, the Supreme Court has noted that "the 1934 [Securities Exchange] Act cannot be read 'more broadly than its language and the statutory scheme reasonably permit.'" ¹⁷⁹ The Ninth Circuit's test, in leaving so much open to judicial determination, may be too expansive to be acceptable under this pronouncement.

Additionally, the Williams Act sets forth a number of disclosure and filing requirements that a bidding corporation must fulfill in order to commence a tender offer.¹⁸⁰ If the commencement date of each tender offer remained unknown until determined by the courts, then a bidder would be unable to comply with the disclosure requirements of the Act. Furthermore, an unclear line regarding the commencement of a tender offer would inhibit open market and privately negotiated transactions. Senator Williams went to great lengths to ensure the stability and integrity of the open market by not unduly impeding private interests.¹⁸¹ The Senator noted in his address to Congress that "[t]his bill...regulates [the] 'taking up' of shares pursuant to a tender offer."¹⁸² Moreover, it is generally recognized that "open

¹⁷⁸ This is so given *Epstein's* acceptance of conditional transactions as a proxy for an intention to induce target executives to tender. However, bidders constantly make conditional offers. It is a matter of business sense that an acquiring corporation condition its contracts on the success of a tender offer because otherwise, it would be wasting assets.

¹⁷⁹ *Chiarella v. United States*, 445 U.S. 222, 234 (1980) (quoting *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979)).

¹⁸⁰ See, e.g., 17 C.F.R. §§ 240.14d-3(a), 240.14d-6 (2005).

¹⁸¹ See 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams):

To avoid hindering casual acquisitions which are not substantial, I propose an exemption from these reporting requirements for any acquisition or proposed acquisition which...does not exceed 2 percent of the outstanding shares. I am also including a provision giving the SEC authority to exempt any transaction if the...transaction will not change or influence the control of the issuer.

See also 17 C.F.R. § 240.14d-3(a) (2005) (exempting acquisitions of less than five percent from the disclosure requirements of a tender offer).

¹⁸² 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams).

market purchases made without advance publicity of the buyer's intent are generally not tender offers."¹⁸³ As such, the Rule was not meant to regulate or impede *all* transactions, just those that occur during the tender offer.

The SEC should adopt a bright-line rule with respect to the commencement of a tender offer. This rule would define "during" in the literal sense, only covering transactions that occur after the commencement of the tender offer and through its end. This rule would also resolve the conflict in a clear manner, consistent with the disclosure and filing requirements set forth in the other provisions of the Act. Additionally, it would protect the integrity of the open market by not impeding casual transactions. *Katt* stated that,

"With millions or even billions of dollars at stake, precise definition of the [offer] period is essential, and the SEC has accordingly consistently differentiated actions 'during' an offer from those close to the offer's beginning or end. The line is arbitrary...but some line is essential, and it had best be a bright one."¹⁸⁴

However, because there are *two* stated purposes to the Williams Act, namely investor protection and clarity, and because the Act attempted to be neutral in its application, any definition could bias the application of the rule.¹⁸⁵ The bright-line rule, as stated before, may compromise the investor protection purpose of the Act in favor of clarity. Thus, in conjunction with this definition, Congress should enact a safe harbor provision in order to better protect investors, thereby making the application of the bright-line rule more neutral.

D. Safe Harbor

Any safe harbor provision should address two main issues: management capture and procuring a reasonable price per share for investors that is not reduced because of collusion between the acquirer and target executives. Although both issues are interrelated, the former concerns target executives who support the tender

¹⁸³ EDWARD N. GADSBY, FEDERAL SECURITIES EXCHANGE ACT OF 1934 § 7A.03 (2004)

¹⁸⁴ *Katt v. Titan Acquisitions, Inc.*, 244 F. Supp. 2d 841, 854 (M.D. Tenn. 2003) (quoting *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 243 (7th Cir. 1996)).

¹⁸⁵ For instance, adopting the Seventh Circuit's Bright Line Rule would endorse the clarity purposes of the Act at the expense of investor protection. Likewise, accepting the Ninth Circuit's definition would compromise the clarity envisioned by Senator Williams in favor of investor protection.

offer solely because of self-dealing. The concern is that they might not be acting in stockholders' best interests with respect to the acquisition. The latter issue is partly what the Williams Act intended to address. By creating new disclosure requirements, the Act attempted to make stockholders more informed so that they could make a better tendering decision. But the Act was also meant to secure an unvarying price per share for all investors so that none could be coerced into tendering. Collusion between target executives and the acquiring company that results in bonus payments to executives may reduce the compensation given to non-insider investors. A safe harbor provision should remedy these situations without unduly impeding the market for acquiring companies.

One scholar has suggested applying a safe harbor provision when the bidder values the target before entering into employment or incentive agreements.¹⁸⁶ This would create a "floor" for the tender offer, thereby protecting the valued price per share from being "cannibalized" by "employment and incentive payments to target insiders."¹⁸⁷ However, savvy bidders could take into account any anticipated agreements and value the company lower than it otherwise might have. Effectively, the "floor" created would be lower than it should have been. Another alternative would be to provide "general guidelines governing the employment and incentive agreements."¹⁸⁸ For instance, apply the safe harbor provision when the bidder increases the number of stock options by no more than a certain percentage of existing options, or when the bidder increases compensation or performance bonuses by no more than a certain percentage of current compensation.¹⁸⁹ Although such regulations are helpful, they do not address the main aim of the best-price rule, which is to secure a uniform price per share for all investors. Such recommendations serve only to limit the amount that target executives can receive above and beyond the tender offer price.

To accomplish the goal of ensuring that shareholders receive the best price for their stock, the safe harbor provision could apply when managers procure or attempt to obtain more than one bid for their company. Although the best-price rule does not currently apply to target executives, the actions of these executives are integral to the tender offer process. As a result, the safe harbor provision should structure their actions. This provision would provide shareholders with a reasonable

¹⁸⁶ See Fleming, *supra* note 36, at 293.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

estimate of the value of their shares. Under current law, target executives do not have an incentive to find multiple bidders. In fact, many executives might refuse to solicit additional bids for their company because of a contractual obligation to support one company's attempt to acquire the corporation. This safe harbor provision would discourage those agreements and also provide target shareholders with a reasonable estimate of their shares. For instance, in *Katt*, the target company and its investment banker contacted over forty potential bidders, with five companies submitting preliminary bids for the target company.¹⁹⁰ The defendant, UTC, offered the highest price per share,¹⁹¹ which suggests that its offer was relatively reasonable and fair for all shareholders. Such a process would ensure that shareholders remain reasonably informed about the potential premium they should expect.

The safe harbor provision could also apply when managers disclose reasonable counterarguments and opposition to an attempted takeover. The original purpose of the Williams Act was to protect investors by informing them about the specifics of the tender offer.¹⁹² Additionally, Senator Williams recognized that "full disclosure is not an impediment, but an aid, to legitimate business transactions."¹⁹³ However, thus far, Congress has only required disclosures from the bidding company.¹⁹⁴ Applying the safe harbor provision when management voices reasonable opposition to the tender offer will give shareholders a better description of the full effects of the tender offer, thereby helping them to make an informed decision.

Furthermore, the safe harbor provision could apply when the bidder discloses to the target investors the substance of all agreements it negotiated with target executives. Many of these bonus agreements are made to persuade target management to support the tender offer so that they will in turn solicit investors' support. However, the safe harbor would diminish the coerciveness of these agreements because shareholders might be more skeptical about agreeing with the executives if they know that the executives have been paid to support the acquisition.

¹⁹⁰ *Katt v. Titan Acquisitions, Inc.*, 244 F. Supp. 2d 841, 847-48 (M.D. Tenn. 2003).

¹⁹¹ *Id.* at 848.

¹⁹² *See supra* text accompanying notes 17-19.

¹⁹³ 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams).

¹⁹⁴ *See* 17 C.F.R. § 240.14d-3 (2005).

Finally, the safe harbor provision could protect certain types of agreements. For instance, it could exempt agreements enacted independently of the bidder. Golden parachute agreements are frequently the subject of best-price litigation.¹⁹⁵ However, there are legitimate and important business reasons for having golden parachutes, namely obtaining and retaining quality management.¹⁹⁶ As such, Congress should encourage corporations to enact these agreements by reducing liability in tender offers. Moreover, the Williams act was not meant to cover these agreements; they are not a form of additional compensation for shares that Senator Williams intended to remedy. The senator's concern was to prevent coercive two-tiered tender offers which would pressure "shareholders to make hasty deposits."¹⁹⁷ Essentially, he intended to ensure that all who tendered would receive the same compensation. Golden parachute agreements, on the other hand, are a form of executive compensation for work performed, not for shares tendered. As a result, by exempting these contracts, Congress would help reduce best-price litigation and remove "undue obstacles in the way of honest and fairly conducted transactions."¹⁹⁸

Another type of agreement that the safe harbor provision could exempt is an unconditional agreement to pay target management for work performed around the time of a tender offer. Although one would wonder why a bidder would "contemplate making payments to a target's executives...unless the bidder succeeded in acquiring the company,"¹⁹⁹ a bidder's irrevocable promise to pay would signal good faith on its part rather than an attempt to capture target executives. If the bidder were really paying the executives for assisting in the tender offer, then the payment made should not be conditioned upon the tender offer's success because the executives performed the work that they contracted to do. However, there are issues of double payment because executives had a pre-existing duty and were paid to work for their company. A bidder's bonus payment is thus meaningless in this context. The safe harbor provision might limit the frequency of these payments by signaling to bidders that conditional agreements will be scrutinized.

¹⁹⁵ See text accompanying note 98.

¹⁹⁶ See text accompanying notes 97-104.

¹⁹⁷ 113 CONG. REC. 854, 856 (1967) (statement of Sen. Williams).

¹⁹⁸ *Id.*

¹⁹⁹ *Katt*, 244 F. Supp. 2d at 858 n.11.

VI. CONCLUSION

Clarity is essential to maintaining an efficient market. With so much at stake, uncertainty impedes even the legitimate acquirors' actions. The Williams Act, in promoting the dual and dichotomous goals of investor protection and clarity, is difficult to interpret. Focusing on one purpose of the Act necessarily compromises the other to some extent. When interpreted under the broad policy of neutrality (that is, maintaining the importance of both purposes equally), cases become almost impossible to decide without hurting one class of litigants. This is why courts like the Ninth Circuit devise tests that are entirely fact dependent. However, these tests have caused more confusion than they have alleviated. As a result, many well-advised companies are shying away from tender offers in favor of other mechanisms for acquiring companies. Alternatively, some companies have used tender offers to facilitate a subsequent merger by structuring a two-tier offer that concludes with a short-form merger. Whether this trend is beneficial to shareholders and companies in the long run is unknown. However, research suggests that target shareholders gain in both tender offers and mergers,²⁰⁰ whereas shareholders of a bidding firm only gain value when their firm conducts a tender offer.²⁰¹ Ultimately, however, Congress or the SEC will need to address this ambiguity and the market's reaction.

²⁰⁰ See Jensen & Ruback, *supra* note 90, at 10-13.

²⁰¹ See *id.* at 16.