The 'All-Holder - Best Price' Rule: Executive Compensation Agreements and Their Place in Tender Offers

John Mueller

Follow this and additional works at: https://via.library.depaul.edu/bclj

Recommended Citation
Available at: https://via.library.depaul.edu/bclj/vol1/iss2/6

This Comment is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Business and Commercial Law Journal by an authorized editor of Via Sapientiae. For more information, please contact wsulliv6@depaul.edu, c.mcclure@depaul.edu.
The ‘All-Holder—Best Price’ Rule: Executive Compensation Agreements and Their Place in Tender Offers

John Mueller¹

I. INTRODUCTION

Should one’s position, or lack thereof, within a target company affect the level of compensation received in the event of a tender offer? This question has spawned countless arguments within the legal and business communities. Both the courts and legislature of the United States have undertaken efforts to provide a solution.² However, it is the inconsistent application of these regulations through a myriad of judicial tests that requires examination.

Included in the 1968 amendments to the Securities Exchange Act of 1934 (the “Exchange Act”),³ the “all-holder—best price rule” (the “AHBPR”)⁴ and its application in business litigation have created ex-

¹. J.D. from DePaul University College of Law expected May 2003; Vanderbilt University, B.A., 2000.
⁴. The AHBPR is regarded as one rule, but actually combines the requirements of both § 14(d)(7) and § 14(d)(10) of the Exchange Act:
Under Rule 14d-10, 17 C.F.R. § 240.14d-10, also known as the ‘all-holder—best price’ rule:
(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.
Section 14(d)(7) prohibits a tender offeror from offering different consideration to different shareholders for the same shares and provides, in pertinent part, as follows:
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 for 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.
Katt, 133 F. Supp. 2d at 638 (quoting 17 C.F.R. § 240.14d-7).
tensive controversy and variance within the courts. Originally adopted as a mechanism to insure equal treatment of all shareholders in the event of a tender offer, courts have interpreted the AHBPR’s current purpose and application in vastly different manners. The courts have used essentially three distinct tests in their analysis of actions brought under the AHBPR; each test interprets the AHBPR to have a particular reach in its control of tender offers.

The recent decision in Katt v. Titan Acquisitions marks a unique development in the AHBPR’s interpretation. Rather than following one of the already developed tests, the Katt court chose to adopt a test that combined aspects of the other tests. The decision has caused a great amount of uncertainty within the business community and, in particular, with those companies who engage, or wish to engage, in any form of merger or acquisition within which a tender offer may be involved.

This paper will analyze the conflicting interpretations of the AHBPR within the context of tender offers and propose a solution that will ensure identical application of the rules throughout the country and at every level of the judicial system. Part II provides a thorough statutory and judicial history of the AHBPR’s application in several landmark cases, including Katt. Part III examines the varying effects of the different tests and the manner in which they control court rulings. Part IV proposes a new approach for the courts, namely adoption of the Bright Line Test, and discusses the reasons for its adoption—consistency and certainty in business decisions, without having to worry about which district one is in.

7. Seeinfra Parts II.B, II.C, II.D.
10. The Court in Katt chose to adopt both the ‘integral part of the tender offer’ and ‘functional’ tests of the Second and Ninth Circuits. Katt, 133 F. Supp. 2d at 644.
11. “Executive compensation arrangements negotiated in contemplation of a corporate transaction are a common occurrence in the mergers and acquisitions arena. But a recent federal case out of the middle district of Tennessee (Katt) has the potential to scare away many of those who would otherwise test these waters.” 8/27/02 L.A. Bus. J. at 49.
13. Seeinfra Part III.
14. Seeinfra Part IV.
II. BACKGROUND

In order to best understand the importance of the AHBPR, it is essential that one be knowledgeable of its history and its treatment within the American judicial system. Part A discusses the AHBPR’s origin, statutory development, and eventual adoption by the SEC. Part B examines the Second Circuit’s decision in Field v. Trump and introduces the Functional Test. Part C examines the Ninth Circuit’s decision in Epstein v. MCA and introduces the Integral Part Test. Part D examines the Seventh Circuit’s decision in Lerro v. Quaker Oats Co. and introduces the Bright Line Test. Part E examines the decision in Katt v. Titan Acquisitions, Ltd. and introduces the Combined Test, which incorporates elements of both the Integral Part and Functional Tests.

A. Williams Act and the Tender Offer

In 1968, the United States Congress enacted the Williams Act, which served as an amendment to the Exchange Act. By the time Senator Harrison Williams reintroduced the Act in 1967, virtually all of the major stock exchanges supported its passage. This consensus was made possible only through a series of extensive revisions in the drafting of the Act, because when first introduced in 1965 the legislation was avidly pro-management. However, in 1967 the Exchange Act reflected a much more neutral approach; Senator Williams even noted Congress’s efforts to maintain a balance of power between

15. See infra Part II.A.
17. See infra Part II.B.
18. 50 F.3d 644 (C.D. Cal. 1995).
19. See infra Part II.C.
20. 84 F.3d 239 (N.D. Ill. 1996).
21. See infra Part II.D.
23. See infra Part II.E.
27. The original piece of legislation (Senate Bill 2731) was often characterized as the “Incumbent Management Protection Act.” See Moylan, Exploring the Tender Offer Provisions of the Federal Securities Laws, 43 Geo. Wash. L. Rev. 551, 553 (1975).
management and those engaging in takeover practices. In accordance with the recommendations of the Securities and Exchange Commission (SEC), the Williams Act, as revised, imposed restrictions on the behavior of target management, particularly those opposing the tender offer, and reduced restrictions on the conduct of the acquiring business entity.

As enacted in 1968, the Williams Act was designed to serve two interrelated objectives: protection of investors through the disclosure of information and preservation of the tender offer process through neutral regulations. The Williams Act included provisions designed to promote a balance of power between the acquiring business and the affiliates of the target company. This balance of power was to be accomplished by ensuring that ample information was provided and adequate time given for shareholders to consider the offer.

This article will focus on tender offers and the provisions contained within § 14(d) of the Exchange Act, which provide in pertinent part:

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.

Commonly referred to as the AHBPR, it requires a company that is making a tender offer to pay all tendering shareholders the same price for their shares.

In its adoption of the AHBPR, the SEC included two additional substantive requirements intended to prevent acquiring businesses

---

28. “We have taken extreme care to avoid tipping the scales in favor of management or in favor of the person making the takeover bids.” Id. at 252. Senator Williams went on further to state, “S.510 is designed solely to require full and fair disclosure for the benefit of investors. The bill will at the same time provide the offeror and management equal opportunity to present their case.” JESSE H. CHOPER ET AL., CASES AND MATERIALS ON CORPORATIONS 919, n.18 (2000).

29. Id. at 251. The SEC submitted several comments to Senator Williams, as well as a revised version of the bill, id. at 250, n.50.

30. Id. at 252.

31. Id. at 244. The major provisions regulating tender offers are Section 14(d) regulating third-party tender offers, section 14(e) is the general antifraud/antimanipulation provision for all tender offers, and 13(e) governs a company’s purchase of its own securities, including by way of tender offer, id. at 254.


33. The AHBPR, as codified by 15 U.S.C.A. § 78n(d)(7) and 17 C.F.R. § 240.14d-10.

from discriminating among target shareholders. The first addition holds that a tender offer must be open to all target shareholders owning the particular class, or classes, of securities that the acquiring company is seeking. The SEC's second addition requires that all target shareholders must be paid the highest consideration paid to any other shareholder during the tender offer.

The major policy that motivated passage of the Exchange Act, in particular the AHBPR, and its eventual adoption by the SEC, was the notion of fair and equal treatment among all target shareholders. This is evident in the various provisions throughout the Exchange Act that serve to provide target shareholders with adequate time to consider the communications from both the tender offeror and target management in deciding whether to tender, sell into the market, or retain all or part of their securities.

B. Field v. Trump & The Functional Tender Offer Test

Following the SEC's adoption of the AHBPR in 1986, Field v. Trump, litigated in the Second Circuit Court of Appeals, presented one of the first tests for the application of the rules pertaining to tender offers. The court in Field held that the payment of additional consideration to certain shareholders, in an effort to gain their approval of a tender offer, violated the AHBPR because it resulted in the payment of different prices to target shareholders for the tendering of their common shares of stock.

35. Tyson, supra note 3, at 259. The additional requirements are contained in rule 14d-10, codified as 17 C.F.R. § 240.14d-10.

36. 17 C.F.R. § 240.14d-10(a)(1) (1990). The all-holders requirement does not prevent a tender offeror from excluding all shareholders in a state where the offeror is prohibited from making the tender offer by government regulation pursuant to state statute, provided the offeror has made a good faith effort to comply with the statute. Id. § 240.14d-10(b)(2).

37. Id. § 240.14d-10(a)(2). The best-price provision does not prohibit more than one type of consideration as long as shareholders are permitted to elect among each type and the highest consideration of each type paid to any shareholder is paid to any other shareholder receiving that type of consideration. Id. § 240.14d-10(c). The best-price provision's design prevents a tender offeror from paying a higher consideration to employee-shareholders than to non-employee-shareholders. Tyson, supra note 3, at 260 n.88.

38. Tyson, supra note 3, at 260.

39. Field, 850 F.2d 938.


41. Id. at 945.
The dispute began in January 1984 when defendant Pay'n Save Corporation acquired Schuck's Auto Supply, Inc. The transaction left the defendants, Samuel N. Stroum, Stuart M. Sloan, and members of their families (collectively the "Stroum Group"), with possession of a substantial portion of Pay'n Save's outstanding common stock. The Stroum Group was strongly opposed to the management of Pay'n Save at the time. As a result, Pay'n Save's management obtained a standstill agreement on March 30, 1984, in which the Stroum Group agreed not to sell or otherwise dispose of their shares, or to offer to purchase Pay'n Save. However, relations between Pay'n Save's management and the Stroum Group did not improve.

At that time defendant Calvin Hendricks, Pay'n Save's Chief Financial Officer and Vice-Chairman of its board, initiated discussions to acquire Pay'n Save with defendant Eddie Trump, President of the Trump Group, Ltd., an acquisition company (the "Trumps"). After reaching an agreement on August 31, 1984, the Trumps proposed to Pay'n Save's board a cash tender offer at $22.00 per share for two-thirds of the company's shares, with a cash-out merger at the same price to follow. Approximately one week later, at a late-night Pay'n Save board meeting, the Trumps raised the tender offer to $22.50 per share, but warned that the offer would be withdrawn if it were not approved. Although a majority of the board approved the offer, board members Samuel Stroum and Stuart Sloan did not.

Over the course of the next few days, the Trumps engaged in various efforts to obtain the approval of Stroum and Sloan. Following a meeting on September 12, 1984, the Trumps announced to the Pay'n Save board that they were withdrawing their tender offer in order to engage in further negotiations with the Stroum Group.

42. Field, 850 F.2d at 941.
43. The Stroum Group possessed 18.4% of Pay'n Save's outstanding common stock. Id.
44. In return for their involvement, Samuel Stroum and Stuart Sloan received seats on the Pay'n Save's board Id.
45. Id.
46. The cash-out merger would allow the Trumps to purchase whatever outstanding shares of common stock had not been acquired in the initial tender offer; the holders of Pay'n Save common stock would be required to tender their shares as a result of the cash-out merger, if they had not already done so. The Trumps also required that Pay'n Save management agree to participate in the equity of the resulting entity, before it would consider an acquisition of the company. Id.
47. The Stroum Group refused to approve the offer despite that fact that Merrill Lynch, who had been retained by Pay'n Save management, opined that the $22.50 offer was a fair price. Field, 850 F.2d at 941.
48. In a statement released the next morning, September 7, 1984, the Stroum Group referred to the Trump offer as "skimpy" and accused management of acting in "unseemly haste". Id.
49. The Trumps issued a press release that announced both the withdrawal of their tender offer and the ongoing negotiations with the Stroum Group. Id.
same night, the parties reached an agreement under which the Trumps would pay the Stroum Group $3,300,000 for an option to purchase their shares of Pay'n Save stock at $23.50 per share.\textsuperscript{50} The agreement also included the payment of $900,000 to the Stroum Group for "fees and expenses."\textsuperscript{51} The Pay'n Save board approved the agreement between the Trumps and the Stroum Group as an amendment to the new tender offer, which provided a tender price of $23.50 per share for common stock.\textsuperscript{52}

In response to the higher price received by the Stroum Group for their shares, Bertram Field, a Pay'n Save shareholder, brought an action against the Trumps, their firms, Pay'n Save and its officers and directors.\textsuperscript{53} Count I alleged that the $4,200,000 payment to the Stroum Group constituted additional consideration of $1.50 per share above what the other shareholders received, in violation of the AHBPR.\textsuperscript{54}

The parties disputed whether the $4,200,000 payment was made during the tender offer, a determination upon which the entire case rested.\textsuperscript{55} The District Court dismissed Count I of the complaint and the Court of Appeals for the Second Circuit disagreed with their interpretation.\textsuperscript{56}

The court noted that since the Exchange Act did not define "tender offer," application of a functional test was appropriate for its analysis; a test that would scrutinize such agreements in the context of various salient characteristics of tender offers and would also take into consideration the Exchange Act's stated legislative purpose.\textsuperscript{57} The court rejected the parties' use of labels that one tender offer was 'withdrawn' and a 'new' offer made.\textsuperscript{58} In its analysis of Rule 14d-2(b), the court

\begin{flushleft}
\begin{footnotesize}
\textsuperscript{50} \textit{Id.} at 941-942.
\textsuperscript{51} The total payment of $4,200,000 to the Stroum Group, when added to the $23.50 paid per share made it so that the members of the Stroum Group were receiving $25.00 per share. \textit{Id.} at 942.
\textsuperscript{52} \textit{Field}, 850 F.2d at 942.
\textsuperscript{53} The suit was brought as a putative class action against Pay'n Save, its officers, its pro-management directors, the Stroum Group, and the Trumps and their affiliated entities. \textit{Id.}
\textsuperscript{54} \textit{Id.} The plaintiffs claimed that the $1.50 premium was intended to induce the Stroum Group's acceptance of the tender offer. \textit{Id.} at 943.
\textsuperscript{55} \textit{Field}, 850 F.2d at 943.
\textsuperscript{56} The District Court summarized their opinion by citing \textit{Hanson Trust PLC v. SCM Corp.}, "Neither the [Williams] Act nor any SEC rule promulgated thereunder prohibits a former tender offeror from purchasing stock of a target through privately negotiated transactions immediately after a tender offer has been terminated." 774 F.2d 47, 60 (2d Cir. 1985). The District Court also reasoned that no tender offer was in place at the time of the Settlement Agreement, so as a matter of law, there was no violation of the AHBPR. 661 F.Supp. 529, at 532.
\textsuperscript{57} \textit{Field}, 850 F.2d at 943-944.
\textsuperscript{58} \textit{Id.} at 944.
\end{footnotesize}
\end{flushleft}
ruled that "purchases of shares by an offeror after a purported withdrawal of a tender offer may constitute a continuation of the original tender offer." It ruled that for purposes of the AHBPR, withdrawal of a tender offer is only effective when the offeror genuinely intends to abandon the goal of the original offer. In its application of the Functional Test, the court used a series of factors to determine that the Trumps had not abandoned the goal of the original offer. It treated the two tender offers as a single continuing offer for the purposes of the AHBPR, thus the agreement with the Stroum Group was deemed a violation of the AHBPR.

C. Epstein v. MCA & The Integral Part Test

The Ninth Circuit Court of Appeals' 1995 decision in Epstein v. MCA marked the adoption of a new test for analysis under the AHBPR. Epstein involved a collection of actions from shareholders of a target corporation, both individually and on behalf of all target shareholders, against allegedly favored target corporation shareholders and the acquiring corporation. The Epstein court held that the payment of additional consideration to a shareholder because of his status as an officer-shareholder violated the AHBPR.

The dispute began when Matsushita Electrical Co. Ltd. ("Matsushita") acquired MCA, Inc. (MCA) for $6.1 billion in 1990. Matsushita made the acquisition through a tender offer of $71 per share for MCA common stock. The tender offer price consisted of $66 in cash and $5 worth of stock in a subsidiary company of MCA.

59. Id. The court held that the language § 14(d)(7) explicitly recognizes material changes to the terms of a tender offer, such as an increase in price, as a continuation of the original offer rather than a new tender offer. Id.

60. Field, 850 F.2d at 945.

61. See Katt, 133 F. Supp. 2d at 640 (citing the decision in Field and noting the basic characteristics of the Functional Test).

62. The factors included: (1) are the offers part of a single plan of acquisition; (2) do the offers involve the purchase of the same class of security; and (3) are the offers made at or about the same time. Field, 850 F.2d at 945.

63. Id.

64. Epstein v. MCA, 50 F.3d 644 (C.D.Cal. 1995).


66. Epstein, 50 F.3d at 648, n.4.

67. The court noted that the agreement had specifically violated § 14d-10(c)(1) of the Exchange Act. Id. at 657.

68. Id. at 647.

69. Epstein, 50 F.3d at 647.

70. The tender offer included $66.00 in cash and $5.00 worth of stock in WWOR-TV, a television station spun-off from MCA, because there were legal restrictions against foreign ownership of domestic broadcast stations. Id at 647 n.1.
Shareholders of MCA common stock argued that two individuals, Lew Wasserman, MCA's chairman and chief executive officer, and Sidney Sheinberg, MCA's chief operating officer, had received additional payments in return for the tender of their shares.\(^1\) Wasserman owned 4,953,927 shares of MCA common stock, worth $351,728,817 at the tender offer price of $71.00 per share.\(^2\) Wasserman did not tender his shares, but rather, entered into a separate agreement with Matsushita (the "Wasserman Transaction") in which Wasserman exchanged his shares of MCA common stock for preferred stock in a wholly owned Matsushita subsidiary called MEA Holdings ("MEA").\(^3\) The thrust of the agreement was that Matsushita would fund MEA by contributing 106% of the tender price, multiplied by the number of MCA shares Wasserman exchanged.\(^4\) Sheinberg's agreement differed in the respect that he received additional consideration of $83,754,085 above the tender offer price of $71 per share and also received $21 million in cash two days after Matsushita had accepted all tendered shares.\(^5\)

A class of former MCA shareholders, who had tendered their shares at $71 (the "Plaintiffs"), argued that Matsushita's treatment of Wasserman and Sheinberg violated the AHBPR.\(^6\) The District Court granted summary judgment on this claim to Matsushita.\(^7\) However, the Ninth Circuit Court of Appeals reversed the decision, with instructions to grant the Plaintiffs' motion for partial summary judgment.\(^8\)

In its analysis of the Wasserman Transaction, the court focused on whether the transaction was an integral part of the acquiring company's tender offer. If it was, the offeror violated the AHBPR because it paid to him, pursuant to the tender offer, different consideration than it had offered to the other shareholders.\(^9\) The court noted four areas in which the Wasserman Transaction appeared

---

\(^1\) Id. at 647-648.
\(^2\) Id. at 647.
\(^3\) The Wasserman agreement was known as the 'Capital Contribution and Loan Agreement.' Epstein, 50 F.3d at 647-648.
\(^4\) In addition the preferred stock that Wasserman received paid a dividend of 8.75% annually, was secured by letters of credit, and was redeemable upon the death of either Wasserman or his wife. Id. at 648.
\(^5\) The $21 million was allegedly exchanged for unexercised stock options. Id.
\(^6\) Epstein, 50 F.3d at 648.
\(^7\) Id.
\(^8\) With respect to the $21 million paid to Sheinberg, the Court vacated the ruling and remanded for further proceedings to determine if it was in fact a premium paid to encourage Sheinberg to tender his shares. Id.
\(^9\) Epstein, 50 F.3d at 655-656. The preferred stock that Wasserman received may have had a value greater than $326,959,182, the value of his 4,953,927 shares at the cash tender price of $66 per share. Id. at 657.
to be conditioned on the success of the tender offer: (1) neither party was obligated to perform if the conditions of the tender offer were not satisfied; (2) timing of performance was tied to the tender offer's completion; (3) the amount of cash Matsushita was required to contribute to MEA was dependent upon the tender offer price; and (4) the redemption value of Wasserman's preferred stock was set as the tender price.  

From these facts the court concluded that the Wasserman Transaction was an integral part of the tender offer, thus subject to the requirements of the AHBPR.  

The court based its Integral Part Test on the fact that the redemption value of Wasserman's preferred stock incorporated the tender offer price by reference and the Wasserman Transaction was conditioned solely on the success of the tender offer. Accordingly, the court held that Matsushita's payment of additional consideration to Wasserman violated the AHBPR because they had failed to offer equal consideration to the other shareholders.

D. *Lerro v. Quaker Oats Co.* & The Bright Line Test

The Seventh Circuit Court of Appeals' 1996 decision in *Lerro v. Quaker Oats Co.*, signified one of the strictest interpretations of the AHBPR. The court used a Bright Line Test to hold that a distribution agreement made between Quaker Oats and Selective Beverages Inc. did not violate the AHBPR.

The case arose when Quaker Oats acquired Snapple Beverage Corp. in 1994 for $1.7 billion. On November 1, 1994, a merger agreement was signed between the two companies and a tender offer to the public was announced on November 4. In both the tender offer and merger agreement Quaker Oats offered to pay $14 in cash for each share of Snapple stock. Despite the ability of shareholders

---

80. If Matsushita increased the tender price at any point it would have been required to increase both the funding of MEA and the amount paid upon the redemption of Wasserman's preferred stock. *Id.* at 653.

81. Epstein, 50 F.3d at 656.

82. *Id.*

83. *Id.* at 657. The court rejected Matsushita's argument that the plaintiffs were unable to prove that they suffered injury as a result of the Wasserman Transaction. *Id.*

84. 84 F.3d 239 (N.D.Ill. 1996).

85. The court based its decision on the timing of the tender offer and payments, "so far as the Williams Act and Rule 14d-10(a)(2) are concerned, Quaker Oats could have bought Lee's shares at $20 (or $50) apiece the day before commencing the tender offer, without objection from other investors." *Id.* at 242-243.

86. *Lerro*, 84 F.3d at 240.

87. *Id.*

88. Included in the agreements was the provision that investors, who viewed $14 per share as inadequate, could refuse to tender, vote against the merger, and demand appraisal under § 262 of the Delaware Corporation Law. *Lerro*, 84 F.3d at 240.
to oppose the agreements, the transaction was assured through the support of defendant Thomas H. Lee, who controlled approximately 40% of Snapple’s shares. When the offer was eventually closed, 96.5% of Snapple’s stock had been tendered and Snapple Beverage Corporation became a wholly owned subsidiary of Quaker Oats.

The dispute surrounded a distribution agreement ("Distributor Agreement") that was made between Quaker Oats and Select Beverages Inc. Joseph Lerro and John Duty, two investors in the transaction (the "Plaintiffs") claimed that the anticipated profits under the Distributor Agreement constituted additional consideration to Mr. Lee that should be paid to all shareholders pursuant to the AHBPR. The Distributor Agreement granted exclusive distribution rights for a certain geographic area to Select Beverages Inc., a company in which Lee and his affiliates held a majority of the common stock. Of particular contention was a statement in the tender offer documents, "the [Distribution] Agreement commences upon consummation of the Offer." Rather than addressing many of the contentious issues, the District Court dismissed the suit for failure to state a claim and the Seventh Circuit Court of Appeals affirmed.

The Appellate Court chose to apply the Bright Line Test in its analysis of the Distributor Agreement’s role within the tender offer. The court held that the language of the securities statutes and regulations was controlling, "[b]efore the offer is not ‘during’ the offer." In particular, the court held that the very purpose of SEC Rules 10b-13 and 14d-10 was to mark the periods during which the restrictions of the Williams Act should apply. The court supported this contention with a policy-based argument in favor of free market transactions near

---

89. Shareholders who regarded $14 per share as too low could refuse to tender, vote against the merger, and demand appraisal under § 262 of the Delaware Corporation Law. Id. The exact percentage owned by Mr. Lee is uncertain; the plaintiff’s claim “at least 35 percent”, while the tender offer documents place the figure at 47 percent. Id.

90. Quaker Oats effected a short-form merger, under Delaware law, between Snapple and LOOP Acquisition Corporation, which had been created solely for this purpose. LOOP later changed its name to Snapple Beverage Corporation. Id.

91. Id. at 240-241.

92. The ‘area’ included parts of Indiana, Illinois (including Chicago), and Wisconsin. Id. at 240.

93. Lerro, 84 F.3d at 240.


95. Id. at 246.

96. The court went on to state that, “The difference between ‘during’ and ‘before’ (or ‘after’) is not just linguistic.” Id. at 243.

97. Lerro, 84 F.3d at 243.
the time of a tender offer, as well as immediately before and after.\footnote{The court opined that treating the Distributor Agreement as a premium for each of Lee's shares was the same as a higher cash price in advance. \textit{Id.}} In applying the Bright Line Test, the court stated that the Distributor Agreement was signed on November 1, 1994, while the tender offer did not commence until November 4, thus placing the Distributor Agreement outside the reach of the AHBPR.\footnote{\textit{Id.}}

E. \textit{Katt v. Titan Acquisitions, Ltd. & The Combined Test}

The District Court for the Middle District of Tennessee's ruling in \textit{Katt v. Titan Acquisitions Ltd.},\footnote{\textit{Katt v. Titan Acquisitions, Ltd., 133 F.Supp.2d 632 (M.D.Tenn. 2000).}} decided in the fall of 2000, has resulted in a great level of uncertainty for litigation under the AHBPR. Similar to \textit{Epstein},\footnote{\textit{Epstein, 50 F.3d 644.}} \textit{Katt} arose from a target shareholder suit, International Comfort Products ("ICP"), against the acquiring companies, Titan Acquisitions, Ltd. ("Titan") and United Technologies Corporation ("UTC"), as well as various other individuals.\footnote{The suit was filed by Lowell Katt, an investor, as a class on behalf of himself and similarly situated investors against Titan, UTC, William Trachsel, a UTC corporate officer, and Ari Bousbib, Titan's president. \textit{Id.} at 634.} The court in \textit{Katt} held that a series of executive compensation agreements provided to officers of the target company violated the AHBPR because a jury could likely rule that Titan induced the agreements as a part of its tender offer for ICP and not as contracts solely between ICP and its officers.\footnote{\textit{Id.} at 645-646. The court recognized the common role of executive compensation agreements, but distinguished the agreements between Titan and ICP, "[A]s a general rule, incentive contracts between a company and its key officers and executives are not subject to Section 14(d)(7) [AHBPR], but these agreements with ICP officers were executed solely in the context of the Titan's tender offer agreement between Titan and ICP." \textit{Id.} at 645.}

Titan made a tender offer for all outstanding shares of ICP for $11.75 per share with the provision that Titan, upon consummation of the offer, would honor various agreements that it had made with ICP and several of its officers, who were also shareholders.\footnote{\textit{Katt, 133 F. Supp. 2d at 634.}} In one of the agreements certain ICP officers were given accelerated awards under the company's preexisting 'Annual and Long Term Incentive Plan'.\footnote{Referred to as the "accelerated incentive award agreement," this agreement became effective on January 1, 1999. The Plan, however, was brought up for shareholder vote at the company's annual meeting on May 19, 1999. \textit{Id.} at 636.} Another, the "performance unit award agreement," based payments to ICP officers and others on the number of years that the
individual had been in the company's "performance cycle." In addition to these payments, UTC offered "sign on" bonuses of $100,000 to three ICP officers and also provided the officers with the ability to convert certain severance benefits and stock awards if the officers accepted employment with UTC following the takeover. Titan also offered to pay certain ICP officers a Retention Bonus that was contingent on their continued employment with ICP.

Lowell Katt, a stockholder in ICP, filed a class action suit on his own behalf and those similarly situated investors (the "Plaintiffs"), arguing that the side agreements were part of the tender offer because they induced ICP officers to tender their shares and to recommend that all shareholders tender. The Plaintiffs argued that such inducements violated the AHBPR. In its analysis, the court acknowledged the split among the circuits as to which was the appropriate test to apply. The court noted the Seventh Circuit's use of the Bright Line Test in Lerro, the Ninth Circuit's use of the Integral Part Test in Epstein, and the Second Circuit's use of the Functional Test in Field. The Katt court chose to adopt a test that blended aspects of both the Integral Part and Functional Tests (the "Combined Test"). Although the court declined to adopt any part of the Bright Line Test, it acknowledged the merit of that test.

Through its adoption of the Combined Test, the court opined that the controlling issue was whether these types of financial incentive

106. The Plaintiffs contend that the award was as much as $2.5 million for each year in the cycle. Katt, 133 F. Supp. 2d at 637.
107. Id. at 636.
108. Titan promised to pay the retention bonuses within 60 to 90 days after the consummation of the tender offer. Id.
110. Id. at 640.
111. See supra note 56. See also Walker v. Shield Acquisition Corp., 145 F. Supp. 2d 1260 (N.D. Ga. 2001) (finding the defendant's reliance on Lerro as persuasive in its decision to grant the defendant's motion to dismiss).
113. Field, 850 F.2d 938. The Katt court recognized the variance of the decisions within the Circuits, yet chose to adopt a test that did not follow any of the prior rulings. Katt, 133 F.Supp.2d at 640.
114. The Court held that both tests served the purpose behind both the congressional adoption of Section 14(d) and the SEC's drafting of Rule 14d-10. Id. at 644.
115. This decision was interesting because the Katt court acknowledged the ability of the 'bright line' test to provide certainty in the marketplace, but chose not to rely on the issue of timing in reaching its own decision. Id.
agreements with any shareholder of the acquired company are integrally tied to the successful completion of the tender offer. The court concluded that the incentive agreements between the acquiring companies and the ICP officers were an integral part of Titan’s tender offer and constituted additional consideration that was offered to select shareholders, while denied from other shareholders, in violation of the AHBPR. The court articulated that, as a general rule, incentive contracts between a company and its key officers will not be subject to the AHBPR, but the agreements in Katt were executed solely in the context of Titan’s tender offer. The court relied on the fact that a jury could find that Titan induced the agreements as a part of their tender offer, so they were subject to the AHBPR. Accordingly, the Katt court denied Titan’s motion to dismiss.

III. Analysis

The variance in decisions among the circuits has led to a great level of uncertainty for those wishing to engage in any form of business transaction that may involve a tender offer. Executive compensation arrangements have long been a part of virtually all business transactions, however, their legality is under dispute because of the differing views and tests that the courts have adopted. Part A goes through each of the existing tests acknowledging the strengths and weaknesses of each. Part A.1. addresses the faults of the AHBPR as drafted in the Williams Act and as adopted by the SEC. Part A.2. points out the vagueness of the Functional Test in its reliance on individual court interpretation for application. Part A.3. denounces the Integral Part Test as being little more than a judicial title for what is essentially a case-by-case approach. Part A.4. addresses the strengths of the Bright Line Test—the certainty that it provides for those wishing to engage in a tender offer. Part A.5. criticizes the Katt court’s decision to adopt a Combined Test that includes aspects of both the Functional Test and Integral Part Tests. Part B lays out some of the possible solutions for consistent application of the AHBPR. Part B.1. suggest a series of alternatives for structuring a business deal, so as to eliminate the risk of violating the AHBPR. Part B.2. addresses the business commu-

116. Katt, 133 F. Supp. 2d at 644. The term, 'combined test', has been created for use within this article to refer to the test adopted by the United States District Court for the Middle District of Tennessee in Katt.
117. Id.
118. Katt, 133 F.Supp.2d at 645.
119. Id. at 646.
120. Katt, 133 F. Supp. 2d at 640-641.
nity's hope that the courts, SEC, or Congress will, in the foreseeable future, provide long term solutions for the practice of tender offers.

The court's decision in *Katt* created a significant level of uncertainty for companies wishing to engage in tender offers, but much of the confusion already existed. The various circuits have adopted their own tests that, depending on the one chosen, can result in decisions that are completely at odds with one another. The current problem is that companies engaging in tender offers have no guidelines to determine what behavior is admissible and what behavior is not. It depends solely on the Circuit in which the suit is filed as to what test might be applied. Each of the tests that the courts have adopted is flawed in some respect, whether it is too narrow or too broad in its application.

The solution rests in the hands of Congress, SEC, and the Supreme Court. None of the circuits addressing the issue is going to ignore its own precedent and adopt another test. The only remedy that can provide the appropriate guidance needed in today's marketplace is that of a universal test. The appropriate test is one that adopts a narrow time-based interpretation of the rules to eliminate any chance for discrepancies. Rather than examining the details of the payments made in each case, it would be wiser to establish a clear regulatory time frame in which additional consideration to tendering shareholders, regardless of its form, is strictly prohibited. In order to succeed in today's international business community, companies must be able to merge and engage in acquisition transactions freely and without fear of statutory violation.

### A. Critique of Existing Tests

The following sections address each of the tests that the courts have adopted, acknowledging both their strengths and weaknesses. Part III.A.1. examines the AHBPR, as drafted in the Williams Act and adopted by the SEC. Part III.A.2. addresses the Functional Test, as relied upon in *Field*. Part III.A.3. examines the Integral Part Test,

---

122. Compare *Field v. Trump*, 850 F.2d 938, 943-944 (1988) (citing the “salient characteristics of tender offers” to determine that the defendants had not violated the AHBPR), with *Katt v. Titan Acquisitions Ltd.*, 133 F. Supp. 2d 632, 645 (2000) (ruling that agreements had violated the AHBPR because they were “executed solely in the context” of the tender offer).

123. See *Field v. Trump*, 850 F.2d 938, 943-944. The court fails to ever fully define the “salient characteristics of a tender offer,” but uses the term as the basis for its decision to dismiss the plaintiff's complaint. *Id.*

124. See *Lerro v. Quaker Oats Co.*, 84 F.3d 239, 246 (defining the tender offer strictly on the date of commencement of the offer).

125. *Field*, 850 F.2d at 943-945.
as applied in Epstein.\textsuperscript{126} Part III.A.4. addresses the Bright Line Test, as followed in Lerro.\textsuperscript{127} Part III.A.5. examines the Combined Test, as formulated in Katt.\textsuperscript{128}

1. The Williams Act & SEC Adoption

Congress enacted the Williams Act in 1968 to protect tendering shareholders from discrimination, but it failed to adequately outline the rules that had to be followed. The SEC tried to create a more expansive rule when it adopted the provision in 1986,\textsuperscript{129} and then created the AHBPR.\textsuperscript{130} Unfortunately, this rule also failed to provide the guidelines necessary for the regulation of tender offers because it lacked specificity with respect to what particular actions were prohibited. The ever-changing face of modern business has created countless forms of tender offers that cannot be effectively regulated under the current rules.

2. The Functional Test

The Functional Test, as the Second Circuit used in Field,\textsuperscript{131} is logical in appearance, but is too vague in its application. The primary weakness with the test is that it relies on the court’s interpretation of what it regards as “salient characteristics of tender offers.”\textsuperscript{132} The test is also flawed in its reliance on legislative purpose;\textsuperscript{133} a concept that is often unclear, even after extensive study of the legislative record. Although the test lays out a series of factors that are clear and can be easily answered, there is one factor that is fatally inconclusive.\textsuperscript{134} The factor asks whether the various offers were part of a single plan of acquisition. The problem with this factor is that the court neglected to accurately define ‘plan of acquisition’.\textsuperscript{135} One might regard any offers

\textsuperscript{126} Epstein, 50 F.3d at 655-657.
\textsuperscript{127} Lerro, 84 F.3d at 245-246.
\textsuperscript{128} Katt, 133 F. Supp. 2d at 644-646.
\textsuperscript{129} See supra notes 34-36 and accompanying text.
\textsuperscript{130} 17 CFR § 240.14d-10. The Rule provides that no bidder may make a tender offer unless the offer is open to all security holders of the class of securities subject to the tender offer, and that the consideration paid to any security holder pursuant to the tender offer is the highest consideration made to any other security holder during such tender offer. 100 A.L.R. Fed. 444 (1990).
\textsuperscript{131} Field, 850 F.2d 938.
\textsuperscript{132} See infra note 31.
\textsuperscript{133} Field, 850 F.2d at 946 (citing Piper v. Chris-Craft Indus., 430 U.S. 1 (1977)).
\textsuperscript{134} Field, 850 F.2d at 945. The court cites the SEC’s identification of relevant factors for analyzing tender offers and also raising additional factors for defining the extent of “integration.” Id.
\textsuperscript{135} The court does note that were the goal has not been abandoned a new offer must be treated as a single continuing offer. Field, 850 F.2d at 945.
relating to the same acquiring and target companies as being a single plan of acquisition, while another person may rely on the specific numbers and terms in defining what constitutes a plan of acquisition.

The Functional Test represents a strong effort at solving the tender offer puzzle, but still an inadequate one. The factors included in the test fail to provide the clear guidelines necessary for today’s companies. As long as a court’s test allows for different interpretations of its meaning, companies will be uncertain in their transactions and shareholders will be more likely to file suit. The Functional Test creates judgments that depend solely on which side makes the better argument and uses the right language.

3. The Integral Part Test

Similar to the Functional Test, the Integral Part Test lacks the specificity needed for effective control of tender offers. As the Ninth Circuit applied it in Epstein, the Integral Part Test asked only if the financial arrangements at issue were entered into “in furtherance of the tender offer.” The Integral Part Test does have an advantage in that it compels the court to examine the nature of the arrangements in question. The test requires the court to form a better understanding of the tender offer and the reasons for its adoption. However, the test is completely void of structure and, thus, fails to establish any discernible guidelines for future tender offers. The Integral Part Test is essentially a fancy name for a ‘case-by-case’ approach. Rather than providing answers, the Integral Part Test merely provides the hope that the court will look favorably at the case. In all of the cases

136. “Analogous factors may thus point to ‘integration’ in the context of formally separate tender offers: (1) are the offers part of the single plan of acquisition; (2) do the offers involve the purchase of the same class of security; and (3) are the offers made at or about the same time?” Field, 850 F.2d at 945.

137. Epstein, 50 F.3d 644.

138. Stephen I. Glover, Applying the Best Price Rule to Employee Retention Bonuses, 4 No. 11 M & A Law. 19 (April 2001). The integral part test is generally regarded as the opposite of the bright line test because the Bright Line Test is narrow in application and requires that certain decisions be reached, solely on the basis of the tender offer’s commencement and the payment of additional consideration. Id. at 19.

139. The Epstein court held the Wasserman Transaction to integral part of the tender offer because it was, in several material respects, conditioned on the terms of the offer. The court reached this conclusion by examining the details of both the tender offer and the Wasserman Transaction. In particular, the court noted two facts about the Wasserman Transaction, “first, the redemption value of Wasserman’s preferred stock incorporated the tender offer price by reference, and second, the Capital Contribution and Loan Agreement was conditioned on the tender offer’s success.” Epstein, 50 F.3d at 656.

140. “The problem with a [integral part] test is that, while the case establishing such a test may scream for a [integral part] analysis (as is true with Epstein), invariably a borderline case sneaks
examined throughout this article, one could easily argue that the arrangements in question were adopted in furtherance of the tender offer. If it were clear that the arrangements were independent of the tender offer, there would not even be any litigation of the matter.

4. The Bright Line Test

The Seventh Circuit, in its decision in Lerro,\textsuperscript{141} adopted the most logical and simplest approach for determining whether an acquiring company's actions violated any tender offer regulation. In Lerro, the court chose to apply a Bright Line Test that was dependent upon the timing of payment of extra consideration.\textsuperscript{142} The Bright Line Test held that any consideration paid after the commencement of a tender offer and before its closure would be regarded as "pursuant to the tender offer."\textsuperscript{143} An important aspect of the Bright Line Test is that it has its foundation in the statutory language. Rule 14d-2\textsuperscript{144} establishes that a tender offer begins at 12:01 a.m. on the earliest date of one of the following events: (1) the first publication of the long form tender offer filed;\textsuperscript{145} (2) the first publication of a summary advertisement;\textsuperscript{146} or (3) the first public announcement of the tender offer,\textsuperscript{147} unless within five days of the announcement the "bidder"\textsuperscript{148} makes a public statement withdrawing the tender offer or complies with the appropriate disclosure and filing requirements, which all require public presentation of relevant information.\textsuperscript{149}

On a conceptual level, the importance of the Seventh Circuit's use of a Bright Line Test is that it acknowledged the need for stability in tender offer transactions. The court recognized that the approach was through, creating uncertainty for practitioners and companies trying to structure transactions." Lawson, supra note 1, at 49.

141. Lerro, 84 F.3d 239.
142. "[T]he point of Rules 10b-13, 14d-10, and their cousins is to demark clearly the periods during which the special Williams Act rules apply . . . some line is essential, and it had best be a bright one." Id. at 243.
143. The court used this term in accordance with its meaning under Rule 14d-10. Id.
144. 17 C.F.R. § 240.14d-2.
147. See Kahn v. Virginia Retirement System, 13 F.3d 110 (4th Cir. 1993) (joint press release that announced plans for takeover agreement did not commence the tender offer).
148. "The term 'bidder' means any person who makes a tender offer or on whose behalf a tender offer is made [except for a tender offer by the issuer]." 17 C.F.R. § 240.14d-1(b)(1).
149. 17 C.F.R. § 240.14d-3(a) (filing and transmittal of tender offer statements). 17 C.F.R. § 240.14d-6 (disclosure requirements with respect to tender offers). 17 C.F.R. § 240.14d-4 (dissemination of tender offers).
rather mechanical, but held that the critical need for certainty in the regulation of tender offers justified its use.\textsuperscript{150} While the Functional Test and Integral Part Test focus on the content of the financial arrangements in question,\textsuperscript{151} the Bright Line Test relies solely on the timing of the arrangements.\textsuperscript{152} As a result, the \textit{Lerro} court was able to reach a decision much quicker and with a higher level of confidence.\textsuperscript{153} The effect of the Bright Line Test is that it eliminates much of the guesswork and uncertainty associated with all of the other tests. The definition of what constitutes a tender offer is not clearly laid out in either the Williams Act or SEC regulations,\textsuperscript{154} so the courts are forced to analyze individual financial arrangements on a case-by-case basis. It is this lack of clarity that has produced conflicting decisions between the circuits\textsuperscript{155} and left potential tender offerors fearful of litigation.\textsuperscript{156} While companies operating in the regions under Second and Ninth Circuit control can only guess whether their actions will be ruled as violations of the AHBPR,\textsuperscript{157} those in the Seventh Circuit need only pay attention to the timing of their decisions.

\section*{5. The Combined Test}

The Combined Test used in \textit{Katt}\textsuperscript{158} is insufficient because it is essentially a combination of the Ninth Circuit's Functional Test and the Second Circuit's Integral Part Test. The threat of the Combined Test is that it places any arrangement that becomes effective upon completion of the tender offer at risk, because the success of an acquisition often rests primarily on whether target employees decide to remain

\textsuperscript{150} "Plaintiffs remind us that neither the Williams Act nor the SEC's regulations defines 'tender offer'. That term has been frustratingly difficult to encapsulate. True enough, but our case is about 'when' rather than 'what'." \textit{Lerro}, 84 F.3d at 246.

\textsuperscript{151} See supra notes 136, 139 and accompanying text.

\textsuperscript{152} The \textit{Lerro} court adopted a narrow approach that held extra consideration to be 'pursuant' to a tender offer only if it was paid after the tender offer's commencement. If a payment was made either before a tender offer or after it had closed, it would not violate the Bright Line Test adopted by the Seventh Circuit in \textit{Lerro}. Glover, \textit{supra} note 138, at 19.

\textsuperscript{153} Once the \textit{Lerro} court found that the offer had commenced at 12:01 A.M. on November 4, 1994, it held that there were no other "facts to find or inferences to draw". \textit{Id}.

\textsuperscript{154} Particularly those Rules that are known as the AHBPR, Sections 14(d)(7) and 14(d)(10) of the Securities Exchange Act.

\textsuperscript{155} See infra Parts II.B-E.

\textsuperscript{156} "[A] recent federal case out of the middle district of Tennessee has the potential to scare away many of those who would otherwise test these waters." \textit{Lawson}, see supra note 1, at 49 (referring to the use of executive compensation arrangements in contemplation of corporate transactions).

\textsuperscript{157} Sections 14(d)(7) and 14(d)(10) of the Securities Exchange Act.

\textsuperscript{158} 133 F. Supp. 2d 632.
with the company or seek other options. The test’s broad application of the AHBPR serves to encourage litigation because it allows potential plaintiffs to bring to court what are otherwise weak cases. There is little that can be done to discount a plaintiff’s argument that an arrangement was an integral part of a tender offer, other than raising counterarguments through litigation.

The Combined Test’s most dramatic flaw is that it ignores the historical nature of acquisition transactions. Since the inception of the tender offer, companies have included employment retention bonuses and other similar financial arrangements as part of their offer. In any tender offer there is a legitimate concern regarding employment infrastructure. The effect of the Combined Test is that it tries to control the acquiring company’s ability to enter into retention agreements. Bidders will be able to retain target employees who do not own stock, but cannot retain those who do own stock because the retention payments to employee-stockholders will automatically be deemed as “pursuant” to the tender offer. This runs counter to all notions of effective business management because it forces companies to reject those individuals who take a financial interest in their employer through stock ownership, while encouraging the retention of those who do not. In addition, the Combined Test makes the outcome of a case dependent upon whether the acquiring company structured the transaction as a statutory merger or as a tender offer.

The Combined Test is not even a test, but is simply a judiciary loophole for those companies who wish to avoid litigation in the event of a tender offer. Rather than providing a company with answers as to how it should structure a tender offer, the Combined Test merely gives alternatives to the traditional tender offer. Some scholars

159. Glover, 4 No. 11 M & A Law. at 19. “Plaintiffs will almost always be able to argue that these arrangements [compensation arrangements that benefit target employee-stockholders] are an integral part of the tender offer.” Id.

160. See infra note 159 and accompanying text.


162. Glover, 4 No. 11 M & A Law. 19. It is often in the best interests of the acquiring company to retain as many of the target company’s employees as possible. Id.

163. Id. at 19. The author regards this difference in treatment among target employees as “an anomaly that is not easy to justify.” Id.

164. See infra note 163 and accompanying text.

165. Glover, 4 No. 11 M & A Law. 19. If the deal is structured as a statutory merger, the AHBPR will not even apply. Id.

166. In light of the Katt decision, a bidder’s freedom to enter into any form of retention agreements depends solely on the structure of the deal. For example, a deal that is structured as a statutory merger will not trigger the AHBPR. Id. See infra Part II.B.1.
have even predicted that the *Katt* decision will ultimately be overturned as an "aberration," but to date this has not occurred.\textsuperscript{167} It has also been said that, as a direct result of *Katt*\textsuperscript{168} and the split between the circuits, the Supreme Court or the SEC will be forced to address the issue in the near future.\textsuperscript{169}

### B. Possible Solutions

In light of the decision in *Katt*,\textsuperscript{170} it is important that potential tender offerors be able to perform acquisitions. There are two sets of options that must be examined. Part III.B.1. addresses a series of solutions that avoid the risk of AHBPR violations and adhere to the decision in *Katt*. Part III.B.2. proposes that the best solution, in order to guarantee universal application throughout the country, would be for the Supreme Court, SEC, or Congress to adopt a Bright Line Test.

1. Available Alternatives Under Current Law and *Katt*

Despite the unreasonableness of the court’s decision in *Katt*, potential bidders must still be able to initiate tender offers if they chose to do so. Companies cannot rest their decisions on speculation that the Supreme Court will reach a favorable decision or that the SEC will provide guidance because the potential risks for the loss of capital, lengthy litigation, and the departure of highly valued target employees are far too great.\textsuperscript{171} As a result, an interested company has three general alternatives for structuring their business arrangements:\textsuperscript{172}

1. The bidder should structure its deal so as to avoid implicating the rules that govern tender offers. The simplest method is for the bidder and target companies to agree to a statutory merger, rather than structuring it as a tender offer with a back-
end merger.\textsuperscript{173} If structured as a statutory merger, the AHBPR does not apply and the bidder would be free to engage in special financial arrangements with target employee-stockholders.\textsuperscript{174} The main problem with this approach, particularly for companies wishing to engage in quick-moving transactions, is that statutory mergers require a significant amount of time.\textsuperscript{175} The only exception is the rare case in which a small group of stockholders within the target company owns a sufficient amount of a certain class of stock to insure a potential bidder with control.\textsuperscript{176} Under these particular circumstances the bidder is able to legally acquire the stock in a series of privately negotiated agreements that will not trigger the rules governing tender offers.\textsuperscript{177}

(2) The bidding company can structure its acquisition so that it includes a tender offer, but does not provide for separate agreements with target employees. The fault with this structure is that it fails to reduce the risk of employee attrition.\textsuperscript{178} Unfortunately, this is generally not the case with most acquisitions, particularly when the target company is large in size. In order to ensure that the merger goes smoothly, it is crucial that employees of the target company are treated appropriately and in most cases, adequately compensated.\textsuperscript{179}

\begin{itemize}
  \item A back-end merger is the practice of cashing out those remaining shareholders who did not tender their shares in response to the initial offer. The use of an initial tender offer followed by a back-end merger can be seen as advantageous to the acquiring company:

  In a two-tier, front-end loaded takeover bid, the bidder makes a first step cash tender offer for approximately 50\% of the target’s shares and then ‘squeezes out’ the remaining shareholders in a lower priced ‘back-end’ merger. Two-tier bids can be highly coercive since the two-tier aspect of the bid stampedes shareholders into tendering (in the first step) out of fear of receiving only the lower back-end consideration in the second step merger.


  \item The only restriction on any special financial arrangements would be that of existing state law constraints on the practice.

  \item The complexity of statutory mergers results from the fact that are controlled by the laws of the respective states of incorporation for the companies involved, as well as the charter and by-laws of each company. Alan C. Myers et al., \textit{Introduction to Mergers and Acquisitions}, 637 PLI/Corp 155, 168 (April 1, 1989).

  \item Glover, 4 No. 11 M & A Law 19.

  \item The AHBPR would not apply to this transaction, so the bidder would be able to engage in unique arrangements with respect to the individual shareholders. \textit{Id}.

  \item Glover, 4 No. 11 M & A Law 19.

  \item Edward D. Herlihy et al., \textit{Materials Submitted by Craig M. Wassereman}, 1232 PLI/Corp 397, 432 (February 2001). A common practice of modern-day mergers is the inclusion of retention programs, particularly in those transactions where employees are regarded as a principal asset. For example, those occasions where there may be cultural differences between the target and acquiring companies. \textit{Id}.
\end{itemize}
(3) A bidding company can decide to structure a deal so that it includes a tender offer and retention bonuses, or other financial incentives, to target employee stockholders, but it must do so in a manner that minimizes the risk that the payments will be viewed as tender offer consideration. When confronted with a court that is applying the Katt decision, a bidder's only option is to take into account a series of factors that the court will use to assess the financial arrangements that have been entered into:

(a) Is there a real risk of employee attrition? If the companies are able to prove that employee attrition is a true concern, the court is more likely to regard any special financial arrangements as justified. This is one of the easier factors to prove because employee attrition is a legitimate concern in virtually any acquisition.

(b) Which party, bidder or target, initiates and leads the discussions concerning retention bonuses? There is a direct correlation between the bidder's level of involvement in the discussion of special financial arrangements and the court's finding that the payments are an integral part of the tender offer. As a result, it is in the bidder's best interest to refrain from initiating discussions of retention payments. The bidder's safest alternative is to indirectly influence the target company by requiring that a condition to closing be the retention of specific employees.

(c) Is the success of the deal contingent upon the tendering of shares by the target employees? Contrary to the decision in Katt, it is likely that a court would regard the number of shares that employees hold as relevant to whether the payments are made in connection with the tender offer. It is a strong advantage if the bidder can prove that it would have

---

180. 4 No. 11 GLMALAW 19. Both the target and bidder companies in designing the transaction should consider the factors.

181. The significance of employees attrition in the acquisition context is recognized by virtually all companies that engage in the practice, "Occasionally, parties will condition a deal on retention of a required list of key employees or a required percentage of employees. Sometimes, this is coupled with a package of inducements to promote the retention of these employees." Charles M. Nathan et al., Providing Certainty in the Uncertain World of Telecom Deal Making, 1263 PLI/Corp 173, 180 (September 20, 2001).

182. Epstein, 50 F. 3d at 653. The court described the fact that a representative of Matsushita contacted MCA, in advance of the transaction, and expressed their desire to retain Wasserman and Sheinberg as employees after the deal was complete. Id.


184. Glover, 4 No. 11 M & A Law. 19. If an acquiring company were able to gain control of the target company without the acquisition of employee-shareholders’ stock, then the tender offer would not even be necessary for the success of the transaction. Id.
gained control of the target company with or without the tendering of employees' shares, because the success of the transaction would not be contingent upon the success of the tender offer.

(d) Are the special financial arrangements conditioned on the success of the tender offer? Similar to the factor of bidder involvement in payment discussions, the risk of violation increases if the payments are conditioned on the offer's success. The best option is for the target company to provide bonus payments to certain employees, if they are willing to provide extra services during the acquisition process, regardless of the transaction's eventual success or failure.\textsuperscript{185} However, a significant weakness of this approach is its lack of appeal to target companies. Since the payments are made during the transaction, it is possible that the target company, having already provided certain bonuses, will be stuck with the costs of the extra payments if the transaction is to fail at any point during the negotiations.

(e) Are the negotiations for the special financial arrangements separate from those relating to the merger agreement? Are they to occur after the agreement has been signed? It is in the best interests of the bidder to have the discussions occur after the signing of the agreement because the company will then be obligated to go through with the transaction regardless of any agreements with target employee shareholders. If this is the case, it puts the bidder in a better position to argue that the payments are only incentives designed to retain target employees, rather than payments associated with the tender offer.

(f) Are agreements to tender included in the special financial arrangements? Any arrangements that include a requirement that the shareholder submit to the tender offer leave little doubt that there is a direct relationship between the arrangements and the tender offer—a situation that would result in an AHBPR violation regardless of the test that is used. In order to avoid this risk a bidder should never form agreements that call for both special payments and the tendering of shares.

Since none of these factors assures protection against tender offer violations, the only clear answer for potential bidder companies is to

\textsuperscript{185} Extra services was defined as, “service above and beyond the ordinary call of duty during the acquisition process.” \textit{Id.}
either avoid the use of a tender offer or abandon special financial arrangements altogether.

2. Possible Future Solutions

The previous set of solutions are premised on the current state of tender offer law in the United States, but, ideally, the Supreme Court, SEC, or Congress will soon address the issue. The hope for the future is that the Supreme Court will recognize the existing conflict between the Circuits and will in turn decide on a controlling test or set of factors.

The wisest decision would be that of either adopting a Bright Line Test, similar to that used in *Lerro*, or, at the least, restricting the reach of the Integral Part and Functional Tests. The adoption of a Bright Line Test throughout the nation would provide those interested in tender offers with the stability that is so desperately needed. The adoption of a Bright Line Test, codified as SEC Rule 14d-2, would remove the interference of a court's subjective analysis from the practice of business acquisition transactions. It is contrary to basic notions of common sense that companies in certain areas of the country are able to freely engage in tender offers, while those in another region are forced to act with extreme caution and uncertainty.

In the face of today's international economy, all companies must be allowed to engage in acquisition transactions without the fear of statutory violation. A Bright Line Test controlling tender offers would enable this ideal to become a reality and eliminate any guesswork as to whether special financial arrangements with target employee-shareholders are permissible or not.

186. SEC Rule 14d-2, codified as 17 C.F.R. § 240.14d-2, states in pertinent part:
   Commencement of a tender offer.
   (a) 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. For purposes of this section, the means to tender includes the transmittal form or a statement regarding how the transmittal form may be obtained.

187. From a comparative law perspective, the U.S. is one of the only developed nations in the world that fails to provide minority shareholders with a right to share in the same control premiums as controlling shareholders. However, many economists agree that it is more efficient to allow, "privately negotiated transfers at premiums not offered to minority shareholders." John C. Coffee, Jr., *Transfers of Control and the Quest for Efficiency: Can Delaware Law Encourage Efficient Transactions While Chilling Inefficient Ones?*, 21 Del. J. Corp. L. 359, 360-361 (1996).
IV. Conclusion

The policy behind the creation of the AHBPR—the protection of all shareholders in the event of a tender offer—is just as important today as it was back in 1968. Although there are opportunities for acquiring companies to structure their transactions in a particular manner, so as to avoid the confusion associated with application of the AHBPR, it is contrary to the free market system that businesses should be compelled to do so. The purpose of the Exchange Act and subsequent securities laws was to provide a level playing field throughout all types of business transactions. The modern economy, which is truly a global one in form, is highly competitive and ever changing. In order for companies to have the ability to succeed, it is imperative that they be able to freely engage in growth through business acquisition transactions, whether they involve tender offers or not. It is a widely proven fact that the success of many such transactions rests heavily upon the support of those who control the target companies, which is generally acquired through the use of executive compensation agreements. As a result of the lack of clarity in the statutory language, the courts have adopted a series of different and often conflicting judicial tests for determining AHBPR violations. It is the duty of the Supreme Court, SEC, and Congress to provide clarity when the laws, as drafted, fail to do so. Other alternatives may exist, but in light of the modern business world, the adoption of a Bright Line Test, establishing clear and concise guidelines for the lawful execution of tender offers, is necessary for the continued success of both the U.S. and international economies.