Authority: 49 U.S.C. 106(g), 40113, 44701.

§ 39.13 [Amended]

■ 2. The FAA amends § 39.13 by adding the following new AD:

2006–23–04 Diamond Aircraft Industries GmbH: Amendment 39–14816; Docket No. FAA–2006–26165; Directorate Identifier 2006–CE–57–AD.

Effective Date

(a) This airworthiness directive (AD) becomes effective November 28, 2006.

Affected ADs

(b) None.

Applicability

(c) This AD applies to Model DA 40 airplanes equipped with Garmin G1000 supplemental type certificate (STC) SA01254WI, serial numbers 40.448 through 40.673, excluding 40.538, 40.590, 40.641, 40.642, 40.644, 40.651, 40.654, 40.655, and 40.699, certificated in any category.

Reason

(d) The mandatory continuing airworthiness information (MCAI) states that the aircraft manufacturer has identified that during production installation of the Garmin G1000 STC some parts of the installed fuel system indicating system were contaminated with particles from the manufacturing process. If not corrected, this may lead to improper engine operation, power loss or in-flight engine failure. The MCAI requires you to do a one time special inspection and recertification for the effected airplanes.

Actions and Compliance

(e) Prior to further flight, unless already done, inspect engine fuel system for possible contamination of fuel per Diamond Aircraft Industries GmbH Mandatory Service Bulletin No. MSB 40–048/2, Revision 2, dated September 26, 2006; and Work Instruction WI–MSB–40.048/2, Revision 2, dated September 26, 2006.

FAA AD Differences

Note: This AD differs from the MCAI and/or service information as follows: No differences.

Other FAA AD Provisions

(f) The following provisions also apply to this AD:

(1) *Alternative Methods of Compliance (AMOCs):* The Manager, Standards Staff, FAA, ATTN: Sarjapur Nagarajan, Aerospace Safety Engineer, FAA, Small Airplane Directorate, 901 Locust, Room 301, Kansas City, Missouri 64106; telephone: (816) 329–4145; fax: (816) 329–4090, has the authority to approve AMOCs for this AD, if requested using the procedures found in 14 CFR 39.19.

(2) *Airworthy Product:* For any requirement in this AD to obtain corrective actions from a manufacturer or other source, use these actions if they are FAA-approved. Corrective actions are considered FAA-approved if they are approved by the State of Design Authority (or their delegated agent). You are required to assure the product is airworthy before it is returned to service.

(3) *Reporting Requirements:* For any reporting requirement in this AD, under the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*), the Office of Management and Budget (OMB) has approved the information collection requirements and has assigned OMB Control Number 2120–0056.

Related Information

(g) Refer to European Aviation Safety Agency (EASA) Emergency Airworthiness Directive No.: 2006–0295–E, dated September 26, 2006; Diamond Aircraft Industries GmbH Mandatory Service Bulletin No. MSB–40–048/2, Revision 2, dated September 26, 2006; and Diamond Aircraft Industries GmbH Work Instruction WI–MSB–40.048/2, Revision 2, dated September 26, 2006, for related information.

Material Incorporated by Reference

(h) You must use Diamond Aircraft Industries GmbH Mandatory Service Bulletin No. MSB–40–048/2, Revision 2, dated September 26, 2006; and Diamond Aircraft Industries GmbH Work instruction WI–MSB–40.048/2, Revision 2, dated September 26, 2006, to do the actions required by this AD, unless the AD specifies otherwise.

(1) The Director of the Federal Register approved the incorporation by reference of this service information under 5 U.S.C. 552(a) and 1 CFR part 51.

(2) For service information identified in this AD, contact Diamond Aircraft Industries GmbH, N.A. Otto-Straβe 2, A–2700 Wiener Neustadt, Germany; telephone +43 2622 26700; fax +43 2622 26780.

(3) You may review copies at the FAA, Central Region, Office of the Regional Counsel, 901 Locust, Kansas City, Missouri 64106; or at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to: *http://www.archives.gov/federal-register/cfr/ibr-locations.html.*

Issued in Kansas City, Missouri on October 30, 2006.

Kim Smith,

Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. E6–18732 Filed 11–7–06; 8:45 am]

BILLING CODE 4910–13–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200 and 240

[Release Nos. 34–54684; IC–27542; File No. S7–11–05]

RIN 3235–AJ50

Amendments to the Tender Offer Best-Price Rules

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the language of the third-party and issuer tender offer best-price rules to clarify that the provisions apply only with respect to the consideration offered and paid for securities tendered in a tender offer. We also are amending the third-party and issuer tender offer best-price rules to provide that any consideration that is offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company that meet certain requirements will not be prohibited by the rules. Finally, we are amending the third-party and issuer tender offer best-price rules to provide a safe harbor provision so that arrangements that are approved by certain independent directors of either the subject company's or the bidder's board of directors, as applicable, will not be prohibited by the rules. These amendments are intended to make it clear that the best-price rule was not intended to capture employment compensation, severance or other employee benefit arrangements. We are also making a technical amendment to correct a cross-reference in the rules that govern the ability to delegate authority for purposes of granting exemptions under the best-price rule.

DATES: *Effective Date:* December 8, 2006.

FOR FURTHER INFORMATION CONTACT: Brian V. Breheny, Chief, or Mara L. Ransom, Special Counsel, Office of Mergers and Acquisitions, Division of Corporation Finance, at (202) 551–3440.

SUPPLEMENTARY INFORMATION: We are adopting amendments to Rule 13e–4 [1] and Rule 14d–10 [2] under the Securities Exchange Act of 1934 [3] and making certain technical changes to a delegated authority rule that is affected by the amendments to the best-price rule.[4]

I. Background

A. Introduction and Summary

On December 16, 2005, we proposed changes to the issuer and third-party tender offer best-price rules [5] to make it clear that the best-price rule generally was not intended to apply to compensatory arrangements.[6] We believed that these amendments were necessary to alleviate the uncertainty

[1] 17 CFR 240.13e–4.

[2] 17 CFR 240.14d–10.

[3] 15 U.S.C. 78a *et seq.*

[4] 17 CFR 200.30–1.

[5] For purposes of this release, unless otherwise indicated, our references to the ''tender offer best-price rule'' or the ''best-price rule'' are intended to refer to both Exchange Act Rule 13e–4(f)(8)(ii) (17 CFR 240.13e–4(f)(8)(ii)) and Exchange Act Rule 14d–10(a)(2) (17 CFR 240.14d–10(a)(2)).

[6] Amendments to the Tender Offer Best-Price Rule, Release No. 34–52968 (Dec. 22, 2005) [70 FR 76116] (the ''Proposing Release'').

that the various interpretations of the best-price rule by courts have produced. We also intended that the amendments would reduce a regulatory disincentive to structuring an acquisition of securities as a tender offer, as compared to a statutory merger, to which the best-price rule does not apply.[7] We received 11 comment letters on the proposed amendments.[8] In general, commenters supported our proposed changes to the tender offer best-price rule and believed that the proposed changes, if adopted, would meet our objectives. We did, however, receive a number of comments with regard to specific aspects of the proposed changes. The changes we adopt today are, in most respects, consistent with those proposed on December 16, 2005, but include certain revisions made in response to concerns raised by commenters.

The amendments to the best-price rule will change the language of the rule to clarify that the provisions of the rule apply only with respect to the consideration offered and paid for securities tendered in a tender offer. The amendments are premised on our view that the best-price rule was never intended to apply to consideration paid pursuant to arrangements, including employment compensation, severance or other employee benefit arrangements, entered into with security holders of the subject company, so long as the consideration paid pursuant to such arrangements was not to acquire their securities.[9] Accordingly, the amendments provide that consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company of a tender offer, where the arrangements meet certain requirements, are not prohibited by the best-price rule.

The amendments also provide for a non-exclusive safe harbor, which states that arrangements, and any consideration offered and paid according to such arrangements, that are approved by either a compensation committee of the subject company's board of directors or a committee performing similar functions, regardless of whether the subject company is a party to the arrangement, are not prohibited by the best-price rules. Alternatively, if the bidder is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the bidder's board of directors.[10] In order to satisfy the safe harbor, we have provided certain alternatives for bidders or subject companies, as applicable, that do not have a compensation committee or that are foreign private issuers.[11]

The principal changes from the proposals, as discussed in detail below, are:

- For purposes of the exemption and the safe harbor, the persons who may enter into an employment compensation, severance or other employee benefit arrangement have been expanded to include all security holders of the subject company, as opposed to only employees and directors of the subject company;
- The requirements of the exemption have been modified;
- The approval of the directors of the subject company will satisfy the safe harbor requirements, regardless of whether the subject company is a party to the arrangement;
- A special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement may approve the arrangement and satisfy the safe harbor requirements if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of those committees is independent;
- The approving directors do not need to determine that the arrangements meet the additional requirements of the compensation arrangement exemption to qualify for the safe harbor;
- The safe harbor provides certain accommodations for foreign private issuers;
- A new instruction provides that a determination by the board of directors that the board members approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the independence requirements of the safe harbor; and
- The exemption and safe harbor are included as part of the issuer, as well as third–party, best-price rule.

B. History of the Best-Price Rule and the Reasons for Today's Amendments

Section 14(d)(7) of the Exchange Act[12] requires equal treatment of security holders.[13] Based on the objectives of the Williams Act[14] and the protections afforded by Section 14(d)(7), the Commission adopted Rules 13e–4(f)(8) and 14d–10 in 1986.[15] These rules codified the positions that both an issuer tender offer and a third-party tender offer must be open to all holders of the class of securities subject to the tender offer (commonly referred to as the ''all-holders rule'') and that all security holders must be paid the highest consideration paid to any security holder (commonly referred to as the ''best-price rule'').[16] The rules provided that no one may ''make a tender offer unless: (1) [T]he tender offer is open to all security holders of the class of securities subject to the tender offer; and (2) [t]he 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.'' [17]

Since the adoption of these rules, the best-price rule has been the basis for litigation brought in connection with tender offers in which it is claimed that the rule was violated as a result of the bidder entering into new agreements or arrangements, or adopting the subject company's pre-existing agreements or arrangements, with security holders of the subject company.[18] When ruling on these best-price rule claims, courts generally have employed either an ''integral-part test'' or a ''bright-line

[7] Statutory mergers are also known as ''long-form'' or unitary mergers, the requirements of which are governed generally by applicable State law.

[8] The public comments we received are available for inspection in our Public Reference Room at 100 F Street, NE., Washington DC 20549 in File No. S7–11–05, or may be viewed at *http://www.sec.gov/rules/proposed/s71105.shtml*.

[9] *See* the definition of ''subject company'' at Exchange Act Rule 14d–1(g)(7) (17 CFR 240.14d–1(g)(7)).

[10] *See* the definition of ''bidder'' at Exchange Act Rule 14d–1(g)(2) (17 CFR 240.14d–1(g)(2)).

[11] *See* the definition of ''foreign private issuer'' at Rule 405 of the Securities Act of 1933 (17 CFR 230.405).

[12] 15 U.S.C. 78n(d)(7).

[13] The statute and rules governing third-party tender offers apply to tender offers for more than 5 per cent of any class of any equity security registered pursuant to Section 12 of the Exchange Act, or any equity security of an insurance company that would have been required to be registered but for the exemption contained in Section 12(g)(2)(G) of the Exchange Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940. *See* Section 14(d)(1) of the Exchange Act.

[14] Pub. L. No. 90–439, 82 Stat. 454 (1968).

[15] *See* Amendments to Tender Offer Rules: All-Holders and Best-Price, Release No. 34–23421 (July 17, 1986) [51 FR 25873].

[16] *Id.*

[17] Exchange Act Rules 13e–4(f)(8) (17 CFR 240.13e–4(f)(8)) and 14d–10(a) (17 CFR 240.14d–10(a)).

[18] *See, e.g., Epstein* v. *MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995), *rev'd on other grounds sub nom.*; *Matsushita Elec. Indus. Co.* v. *Epstein*, 516 U.S. 367 (1996); *Lerro* v. *Quaker Oats Co.*, 84 F.3d 239 (7th Cir. 1996); *Walker* v. *Shield Acquisition Corp.*, 145 F. Supp.2d 1360 (N.D. Ga. 2001).

test'' to determine whether the arrangement violates the best-price rule.

The integral-part test states that the best-price rule applies to all integral elements of a tender offer, including employment compensation, severance and other employee benefit arrangements or commercial arrangements that are deemed to be part of the tender offer, regardless of whether the arrangements are executed and performed outside of the time that the tender offer formally commences and expires.[19] Courts following the integral-part test have ruled that agreements or arrangements made with security holders that constituted an ''integral part'' of the tender offer violate the best-price rule.[20]

The bright-line test, on the other hand, States that the best-price rule applies only to arrangements executed and performed between the time a tender offer formally commences [21] and expires.[22] Jurisdictions following the bright-line test have held that agreements or arrangements with security holders of the subject company do not violate the best-price rule if they are not executed and performed ''during the tender offer.'' [23]

These differing interpretations of the best-price rule have made using a tender offer acquisition structure unattractive because of the potential liability of bidders for claims alleging that compensation payments violate the best-price rule.[24] This potential liability is heightened by the possibility that claimants can choose to bring a claim in a jurisdiction that recognizes an interpretation of the best-price rule that suits the claimant's case. These differing interpretations do not best serve the interests of security holders and have resulted in a regulatory disincentive to structuring an acquisition of securities as a tender offer, as compared to a statutory merger, to which the best-price rule does not apply. We believe that the interests of security holders are better served when all acquisition structures are viable options.[25] We intend for the amendments we are adopting today to alleviate this regulatory disincentive.

C. Overview of the Proposed Amendments

As we discussed in the Proposing Release, we do not believe that the best-price rule should be subject to a strict temporal test because such a test lends itself to abuse. However, we also do not believe that all payments that are conditioned on or otherwise somehow related to a tender offer, including payments under compensatory or commercial arrangements that are made to persons who happen to be security holders, whether made before, during or after the tender offer period, should be subject to the best-price rule. Accordingly, we proposed amendments to the best-price rule that did not follow the approach of either the integral-part or the bright-line test. Instead, we proposed to change the language of the best-price rule so that only consideration paid to security holders for securities tendered into a tender offer will be evaluated when determining the highest consideration paid to any other security holder for securities tendered into the tender offer.

Our proposed amendments to the third-party tender offer best-price rule also acknowledged that critical personnel decisions often are required to be made concurrently with decisions regarding whether to pursue a transaction with the subject company in a tender offer. We believed, and continue to believe, that these decisions generally are made independently from the consideration paid for securities tendered in the tender offer. We therefore proposed a specific exemption from the third-party tender offer best-price rule for consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with employees and directors of the subject company of a tender offer where the amounts payable under the arrangements meet certain requirements. We also proposed a safe harbor to the exemption from the third-party tender offer best-price rule for consideration offered and paid according to certain employment compensation, severance or other employee benefit arrangements that were approved by either the compensation committee or a committee performing similar functions as the compensation committee of the board of directors of either the subject company or bidder, depending on which entity was a party to the arrangement.

II. Amendments to the Best-Price Rule

A. Amendments to the Basic Standard in Exchange Act Rules 13e–4(f)(8)(ii) and 14d–10(a)(2)

1. Discussion

We proposed amendments to the issuer and third-party best-price rule to address the uncertainty that the various court interpretations have produced while ensuring that the intent of the best-price rule—equal treatment of security holders—is satisfied. The amendments revise the best-price rule to state that no one may make a tender offer unless ''[t]he consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer.'' The clause ''for securities tendered in the tender offer'' would replace the clauses ''pursuant to the tender offer'' and ''during such tender offer,'' as the rule previously read, to clarify the intent of the best-price rule. Today, we adopt these changes as proposed.

2. Comments Regarding the Proposed Amendments to the Basic Standard in Exchange Act Rules 13e–4(f)(8)(ii) and 14d–10(a)(2)

Although commenters generally favored the proposals, certain commenters expressed some concerns

[19] *See Epstein*, 50 F.3d 644; *Perera* v. *Chiron Corp.*, 1996 U.S. Dist. LEXIS 22503 (N.D. Cal. 1996); *Padilla* v. *MedPartners, Inc.*, 1998 U.S. Dist. LEXIS 22839 (C.D. Cal. 1998); *Millionerrors Inv. Club* v. *General Elec. Co.*, 2000 U.S. Dist. LEXIS 4778 (W.D. Pa. 2000); *Maxick* v. *Cadence Design Sys., Inc.*, 2000 U.S. Dist. LEXIS 14099 (N.D. Cal. 2000); *McMichael* v. *United States Filter Corp.*, 2001 U.S. Dist. LEXIS 3918 (C.D. Cal. 2001); *Karlin* v. *Alcatel, S.A.*, 2001 U.S. Dist. LEXIS 12349 (C.D. Cal. 2001); *Harris* v. *Intel Corp.*, 2002 U.S. Dist. LEXIS 13796 (N.D. Cal. 2002); *Cummings* v. *Koninklijke Philips Elec., N.V.*, 2002 U.S. Dist. LEXIS 23383 (N.D. Cal. 2002); *In re: Luxottica Group S.p.A.*, 293 F. Supp.2d 224 (E.D. N.Y. 2003).

[20] *Id.*

[21] *See* Exchange Act Rule 13e–4(a)(4) (17 CFR 240.13e–4(a)(4)) and Exchange Act Rule 14d–2 (17 CFR 240.14d–2) (relating to procedures for formal commencement of tender offers).

[22] *See Lerro*, 84 F.3d 239; *Gerber* v. *Computer Assoc. Int'l, Inc.*, 303 F.3d 126 (2d Cir. 2002); *In re: Digital Island Securities Litig.*, 357 F.3d 322 (3d Cir. 2004); *Walker* v. *Shield Acquisition Corp.*, 145 F. Supp.2d 1360 (N.D. Ga. 2001); *Susquehanna Capital Group* v. *Rite Aid Corp.*, 2002 U.S. Dist. LEXIS 18290 (E.D. Pa. 2002); *Katt* v. *Titan Acquisitions, Inc.*, 244 F. Supp.2d 841 (M.D. Tenn. 2003).

[23] *Id.*

[24] Commenters cited the judicial interpretations as one reason for the decline in the use of tender offers and some indicated that they do not recommend the use of tender offers if other acquisition structures are available. *See, e.g.*, the letters from the American Bar Association, Business Law Section, Committee on Federal Regulation of Securities (''ABA''); Cravath, Swaine & Moore LLP, Davis Polk & Wardwell, Latham & Watkins LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen & Katz (''Law Firm Group''); and Association of the Bar of the City of New York, Special Committee on Mergers, Acquisitions and Corporate Control Contests (''NYCBA'').

[25] As we indicated in the Proposing Release, at the time we adopted Regulation M–A (17 CFR 229.1000–229.1016) we stated that ''[o]ur goals in proposing and adopting these changes are to * * * harmonize inconsistent disclosure requirements and alleviate unnecessary burdens associated with the compliance process * * *'').

regarding the proposed amendments.[26] These commenters were of the view that the proposed changes likely would alter the bright-line precedent that has been established by courts. Specifically, one commenter indicated that the removal of the phrase ''during the tender offer'' would be used to argue that payments made at any time are for ''securities tendered in'' the tender offer, which would expand the application and, therefore, the potential claims that could be made under the best-price rule.[27] We believe that the amendments we are adopting today, as discussed in more detail below, will provide sufficient certainty in assuring that payments made with respect to compensatory arrangements will not be captured by the best-price rule such that any temporal certainty that may previously have been present under the ''bright-line test'' will no longer be necessary. As stated above, we also do not believe that the best-price rule should be subject to a strict temporal test, which could provide opportunities for evasion of the rule.

As we articulated in the Proposing Release, the flexible concept of a tender offer is consistent with the purpose of the best-price rule, in that it prevents bidders from impermissibly circumventing the rule by limiting the application of the rule to stated dates.[28] The best-price rule was not intended to apply to all payments made to persons who happen to be security holders of a subject company, whether made before, during or after the formal tender offer period. Further, the amendments that we are adopting today will remove the potentially expansive concept of consideration paid ''pursuant to'' the tender offer in order to focus the analysis as to whether the consideration to which the best-price rule would apply was paid ''for securities tendered in'' the tender offer.

In response to questions that we posed about whether employees and directors who enter into arrangements with the bidder or subject company and do not tender their securities into a tender offer will avoid the strictures of the best-price rule as proposed, commenters generally agreed that no violation of the best-price rule should occur under these circumstances.[29] Commenters believed that this outcome was appropriate. We agree, because the best-price rule would not be applicable in these instances.

B. Exemption for Consideration Offered and Paid Pursuant to Compensatory Arrangements

1. Discussion

We are adopting an amendment to the issuer and third-party best-price rules so that consideration offered and paid pursuant to employment compensation, severance or other employee benefit arrangements that are entered into with security holders of the subject company and that meet certain substantive requirements are not prohibited by the best-price rules.[30] We believe that amounts paid pursuant to arrangements meeting the requirements of this provision should not be considered when calculating the price paid for tendered securities.

We have revised the proposed exemption for compensatory arrangements that meet specified substantive requirements to address a number of the comments received. We have expanded the persons who may enter into an employment compensation, severance or other employee benefit arrangement to include all security holders of the subject company, as opposed to only employees and directors of the subject company. We are also extending this exemption to issuer tender offers.[31] Finally, we have modified the requirements of the exemption so that the amounts to be paid pursuant to an arrangement will have to be ''paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto)'' and may ''not [be] calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.''

2. Comments Regarding the Compensatory Arrangement Exemption

a. Parties to the Arrangement

As proposed, the exemption would have applied to employment compensation, severance or other employee benefit arrangements entered into with employees or directors of the subject company. We solicited comment regarding whether the exemption should be restricted to such persons. Commenters believed that the exemption should be expanded and suggested expansion of the exemption to encompass consultants,[32] independent contractors,[33] employees or directors of the bidder,[34] and/or any security holder of the subject company.[35] Commenters were of the view that it would be appropriate to expand the class of persons because arrangements entered into with the expanded class of persons are, like those entered into with employees and directors, intended to cover compensation for past services or incentives for future services and not tied to the number of shares to be tendered.[36] We agree and have expanded the exemption to apply to any security holder of the subject company. While, as a practical matter, the challenges to the best-price rule to date have focused primarily on employment compensation, severance and other employee benefit arrangements with employees or directors of the subject company, we believe that the role of the person who is a party to the arrangement is irrelevant.

b. Types of Arrangements Covered by the Exemption

In the Proposing Release, we asked whether we should expand the exemption to include commercial arrangements, in addition to employment compensation, severance or other employee benefit arrangements. Several commenters favored extending the exemption to commercial arrangements.[37] In doing so,

[26] *See, e.g.*, letters from ABA; Dechert LLP (''Dechert''); and Law Firm Group.

[27] Letter from Law Firm Group.

[28] *See* note 21 above.

[29] *See, e.g.*, letters from ABA; Jason A. Gonzalez (''Gonzalez''); and Law Firm Group.

[30] The exemption and safe harbor were proposed as amendments to Rule 14d–10(c) of the third-party tender offer rules. The exemption and the safe harbor are adopted as new Rules 14d–10(d)(1) and 14d–10(d)(2), respectively, and Rules 13e–4(f)(12)(i) and 13e–4(f)(12)(ii), respectively. Because we are inserting the exemption and safe harbor into an existing subparagraph (and redesignating old subparagraph (d) as (e), etc.), we are also making a technical change to reflect this redesignation in the rules that govern the ability to delegate authority for purposes of granting exemptions under the best-price rule.

[31] The term ''issuer tender offer,'' as defined in Rule 13e–4(a)(2) (17 CFR 240.13e–4(a)(2)), refers to a tender offer for, or a request or invitation for tenders of, any class of equity security, made by the issuer or an affiliate of such issuer of the class of such equity security. For purposes of this release, all references to ''subject company,'' as defined for purposes of the third-party tender offer rules are intended to refer to ''issuer,'' for purposes of the issuer tender offer rules. Similarly, all references to ''bidder,'' as defined for purposes of the third–party tender offer rules are intended to refer to an ''issuer'' and ''affiliate,'' for purposes of the issuer tender offer rules.

[32] *See, e.g.*, letters from Law Firm Group and Shearman & Sterling LLP (''Shearman'').

[33] Letter from New York State Bar Association, Business Law Section, Committee on Securities Regulation (''NYSBA'').

[34] *See, e.g.*, letters from Gonzalez and Society of Corporate Secretaries & Governance Professionals, Securities Law Committee (''SCSGP'').

[35] *See, e.g.*, letters from ABA and Dechert.

[36] *See, e.g.*, letter from SCSGP.

[37] *See, e.g.*, letters from ABA; Dechert; Intel Corporation (''Intel''); NYCBA; NYSBA; SCSGP; and Securities Industry Association, Capital Markets Committee (''SIA'').

commenters generally argued that it is not uncommon for security holders of the subject company of a tender offer to enter into commercial arrangements with the bidder and, absent a specific exemption, such arrangements could be (and have been) challenged under the best-price rule.[38] Other commenters suggested that providing an express exemption for employment compensation, severance or other employee benefit arrangements but not providing a similar exemption for commercial arrangements may undermine our objectives in adopting these amendments.[39]

We do not believe that it is appropriate to provide a separate exemption for commercial arrangements. As is reflected in an instruction to the exemption, which is adopted as proposed,[40] the fact that the exemption extends to employment compensation, severance or other employee benefit arrangements does not mean that an arrangement of any other nature, including a commercial arrangement, with a security holder should be treated as consideration paid for securities tendered in a tender offer. This instruction should alleviate the concerns raised by commenters about whether the perceived exclusivity of the exemption will create an unintended inference.[41] Also, because of the wide variety of potential commercial arrangements that could be negotiated at the time of a tender offer we are presently unable to craft a specific exemption for commercial arrangements—unlike the language of the compensation arrangement exemption—that could be tailored to be functional while assuring security holders of the intended benefits of the best-price rule.

In the Proposing Release, we also asked whether we should consider adopting a *de minimis* exception to the best-price rule whereby holders of a certain percentage of securities of the subject company would be exempt from the application of the best-price rule. Some commenters were in favor of a *de minimis* exception, although the commenters had differing views as to the percentage to be applied to the exception, to whom the exception would apply and what types of arrangements should be available under the exception.[42] We determined that it would not be appropriate to implement a *de minimis* exception because it could undermine the protections of the best-price rule.

In the Proposing Release, we also asked whether the proposed exemption should provide a definition or provide examples of what we mean when we refer to ''employment compensation, severance or other employee benefit arrangements.'' Commenters were mixed in their preference as to whether or not defining the phrase or offering examples would be helpful, although most did not believe it would be necessary.[43] Some commenters expressed the view that if the phrase was defined and an employment compensation, severance or other employee benefit arrangement did not fall squarely within the definition or list of examples, potential bidders might opt to use a transaction structure other than a tender offer.[44] Others stated that the phrase ''employment compensation, severance or other employee benefit arrangement'' uses terms that are generally understood and an attempt to define the phrase or provide examples would raise questions of interpretation.[45] We agree and generally believe that providing a definition or a list of examples is not necessary and would invite confusion.

c. Additional Requirements of the Exemption

We proposed that, for purposes of satisfying the exemption, the amounts to be paid pursuant to an arrangement would have to relate ''solely to past services performed or future services to be performed or refrained from performing, by the employee or director (and matters incidental thereto)'' and could ''not [be] based on the number of securities the employee or director owns or tenders.'' As we explained in the Proposing Release, we included these requirements so that the amounts paid pursuant to employment compensation, severance or other employee benefit arrangements were based on legitimate compensatory reasons.[46] We also believed that it was not appropriate to permit the exemption of any payments to be made that were proportional to or otherwise based on the number of securities held by the security holder because such a relationship between the payment and the securities tendered presented the type of situation the best-price rule was adopted to guard against.

Most of the commenters believed that excluding employment compensation, severance or other employee benefit arrangements from the application of the best-price rule would provide certainty and address the issues raised by the current legal precedent.[47] A number of commenters suggested, however, that we remove the requirements of the exemption.[48] These commenters generally were concerned that the courts would scrutinize whether the requirements were satisfied, resulting in the substitution of one set of disputed facts for another.[49] Commenters also were concerned that it might be difficult to determine whether or not the requirements have been met, given that it would require the ability to discern the intent of the parties at the time the arrangement was made.[50] At least one commenter also expressed the concern that the requirements might unnecessarily circumscribe the availability of the exemption.[51]

We have considered these comments and determined to retain the requirements with certain modifications. While we recognize that it may be difficult to determine in all instances whether or not the requirements have been satisfied, we believe making the exemption available without the requirements might subject the exemption to abuse. These requirements are designed to prevent the compensation being paid or granted under an arrangement from being for securities tendered in the tender offer.[52]

[38] *See, e.g.*, letters from Dechert, Intel and NYCBA.

[39] *See, e.g.*, letter from NYSBA.

[40] As noted in Section II.C.2.d., the instruction now applies to both the exemption and the safe harbor.

[41] Further, the best-price rule does not apply if a security holder refrains from tendering into a tender offer. *See* Section II.A.2. above.

[42] Letters from ABA; Law Firm Group; NYCBA; NYSBA; SCSGP; and SIA.

[43] *See, e.g.*, letters from ABA; Intel; Law Firm Group; and SCSGP.

[44] *See, e.g.*, letter from Intel.

[45] *See, e.g.*, letters from ABA and SCSGP.

[46] Proposing Release at Section II.B.1.

[47] *See, e.g.*, letters from Dechert; Law Firm Group; and NYCBA.

[48] *See, e.g.*, letters from ABA; Dechert; Law Firm Group; NYCBA; and SIA.

[49] *See, e.g.*, letters from ABA; Dechert; Law Firm Group; and SIA.

[50] *See, e.g.*, letter from Dechert.

[51] *See, e.g.*, letter from Shearman.

[52] Some commenters asked us to confirm whether any compensatory arrangement that is conditioned upon the security holder, who is a party to the arrangement, tendering securities into the tender offer would render the arrangement less likely to be one that should fall within the exemption or whether it is objectionable for the compensatory arrangement to be conditioned upon consummation of the tender offer. We believe that conditioning an arrangement on a security holder tendering securities into the tender offer would most likely violate one or both of the requirements of the exemption. We do not believe that conditioning an arrangement on the completion or consummation of the tender offer, without any requirements as to the security holder who is a party to the arrangement tendering shares in the tender offer, is relevant to a determination as to whether the exemption is available.

i. Requirement That the Amount Payable Under the Compensatory Arrangement Is Being Paid or Granted as Compensation

With respect to the first requirement, some commenters asked that we remove the reference to ''solely'' in order to avoid language that might unnecessarily circumscribe the availability of the exemption.[53] We agree and have substituted the first clause that read ''relate solely to'' with ''is being paid or granted as compensation for'' to clarify that it was our intent to provide an exemption only for employment compensation, severance or other employee benefit arrangements for which there is a legitimate compensatory purpose.

One commenter also asked that we consider using a term other than ''services'' to avoid the possibility that certain forms of consideration, which may be paid or granted pursuant to the arrangements, would not meet the requirements of the exemption.[54] The commenter was concerned that the use of the term ''services'' might exclude those arrangements that called for compensation to be paid that was unconventional, such as the purchase of assets owned or used by an employee or director. We considered this concern and note that this requirement is intended only to require that the consideration paid is for services performed or to be performed or to be refrained from being performed—not to restrict the forms of consideration to be paid under an arrangement. We believe that the inclusion of the phrase ''and matters incidental thereto'' also should provide flexibility to cover other service-related compensation.

ii. Requirement That the Amount Payable Under the Compensatory Arrangement Is Not Calculated Based on the Number of Securities Tendered

With respect to the second requirement, several commenters expressed concern as to whether we intended for employment compensation, severance or other employee benefit arrangements that are in the form of equity-based awards to be captured by this requirement.[55] Because equity-based awards are almost always based on the number of securities ''owned or tendered,'' commenters argued that the grant of equity-based awards or the modification of previously granted equity-based awards generally would fall outside of the compensation arrangement exemption to the best-price rule by virtue of failing to meet this second requirement. They suggested that we clarify the intent of the requirement. For similar reasons, commenters also suggested that we remove the reference to securities ''owned'' and refocus the provisions of this requirement on securities ''tendered.'' [56] We believe that we have addressed these concerns by adding the word ''calculated'' before ''based'' and replacing ''owns or tenders'' with ''tendered or to be tendered'' so that the exemption now requires that the arrangement ''not [be] calculated based on the number of securities tendered or to be tendered * * *'' We believe these changes address the concerns raised by commenters and clarify that we did not intend for equity-based employment compensation, severance or other employee benefit arrangements that are premised on legitimate compensatory reasons to fall outside this exemption from the best-price rule.

C. Arrangements Approved by Independent Directors

1. Discussion

We proposed a safe harbor from the third-party tender offer best-price rule for consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with employees and directors of the subject company that are approved by certain committees of the subject company's or bidder's board of directors. As we stated in the Proposing Release, we believe that the fiduciary duty requirements of board members, coupled with significant advances in the independence requirements for compensation committee members and recent advances in corporate governance, provide safeguards to allow employment compensation, severance or other employee benefit arrangements that are approved by independent compensation committee members and groups of independent board members to be exempt from the best-price rule.[57] As proposed, this provision would have operated as a safe harbor within the broader proposed exemption that included the two requirements discussed above. As we noted in the Proposing Release, we believed that providing such a safe harbor would provide increased certainty to bidders and subject companies in connection with the application of the best-price rule. We also believed that the proposed safe harbor struck the proper balance between the need for certainty in planning and structuring proposed acquisitions and the statutory purposes of the best-price rule. Most of the commenters agreed that providing the safe harbor was a good idea, although some commenters suggested certain changes to the provisions of the safe harbor to address issues on which we requested comment or that commenters identified.[58]

We are adopting the safe harbor provision with certain modifications. First, we added the safe harbor to both the issuer and third-party tender offer best-price rules. Next, we amended the language of the safe harbor so that arrangements can be approved by either a compensation committee or a committee performing similar functions of the subject company's board of directors, regardless of whether the subject company is a party to the arrangement. Alternatively, if the bidder is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the board of directors of the bidder. In the case of issuer tender offers, arrangements must be approved by either a compensation committee of the issuer's board of directors or a committee performing similar functions, regardless of whether the issuer is a party to the arrangement. Alternatively, if an affiliate is a party to the arrangement, the arrangement may be approved by either a compensation committee or a committee performing similar functions of the board of directors of the affiliate. We are also amending the safe harbor to allow a special committee of the approving entity formed to consider and approve the arrangement to approve the arrangement and meet the requirements of the safe harbor if the approving entity does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if all the members of either of those committees are not independent. All of the members of the committee used to approve an arrangement must be independent, as defined.[59] We have

[53] *See, e.g.*, letters from SCSGP and Shearman.

[54] Letter from NYCBA.

[55] *See, e.g.*, letters from ABA; NYCBA; and SIA.

[56] *See, e.g.*, letter from ABA.

[57] *See, e.g.*, New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. Order Approving Proposed Rule Changes, Release No. 34–48745 (Nov. 4, 2003) [68 FR 64154] and Section 303A.05 of the New York Stock Exchange's Listed Company Manual (requiring the compensation committee to be comprised solely of independent directors).

[58] *See* the discussion at Section II.C.2. below.

[59] Therefore, it is not necessary for the entire compensation committee of the bidder or subject company to approve the arrangement and, in fact, a subcommittee of this committee may approve the arrangement, so long as the subcommittee is comprised entirely of members that are

made certain accommodations to these requirements for foreign private issuers, as discussed below.

Most of the commenters believed that providing the safe harbor would create certainty in an otherwise uncertain environment caused by the legal precedent that has evolved in this area.[60] In this regard, commenters were of the view that the safe harbor should provide as much certainty as possible, while still retaining a certain amount of flexibility so as to allow parties to be able to take advantage of it.[61] Commenters provided significant specific guidance regarding the operation of the proposed safe harbor and offered suggestions regarding the most effective means of accomplishing its purpose. The safe harbor we are adopting today has been revised from the proposal to address the following concerns, as discussed in further detail below:

- The approval of the directors of the subject company will satisfy the safe harbor requirements, regardless of whether the subject company is a party to the arrangement; [62]
- A special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement may approve the arrangement and satisfy the safe harbor requirements if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of such committees is independent;
- Foreign private issuers may have the arrangement approved by any members of the board of directors or any committee of the board of directors authorized to approve the arrangement under the laws or regulations of their home country, and the members of the board or committee need not be independent in accordance with the U.S. listing standards but must be independent in accordance with the laws, regulations, codes or standards of their home country;
- The approving directors do not need to determine that the arrangements meet the additional requirements of the compensation arrangement exemption;
- A new instruction provides that a determination by the board of directors that the board members approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the independence requirements of the safe harbor; and
- We have expanded the safe harbor to apply to issuer, in addition to third-party, tender offers.

2. Comments Regarding the Safe Harbor

a. The Committee Approval Required

i. Approving Party

As proposed, for purposes of satisfying the safe harbor, an arrangement would have needed to be approved by the applicable committee of the board of directors of either the subject company or the bidder, depending on whether the subject company or bidder is a party to the arrangement. We requested comment on whether the safe harbor could be modified to work better with State law protections. Several commenters advocated that the safe harbor provide that the arrangement may be approved by the applicable committee of the subject company, regardless of whether the subject company is a party to the arrangement.[63] We agree with these comments and have followed this approach in the amendments we are adopting. We believe the duties owed by the subject company's board members to the security holders subject to a tender offer provide certain protections of security holder interests regardless of whether the subject company is a party to the arrangement because the subject company's directors have a duty to act in the best interests of the security holders of the subject company. Also, this provides additional flexibility to parties wanting to take advantage of the safe harbor; bidders that, for whatever reason, do not have a compensation committee with independent directors will be able to rely upon the safe harbor by allowing the subject company to approve the compensation arrangement whether or not the bidder is a party to the arrangement. The safe harbor adopted today also allows approval by the applicable committee of the bidder's board of directors only if the bidder is a party to the arrangement. The amendments to the issuer tender offer rules follow a similar approach with respect to the approval required by the directors of the issuer or an affiliate of the issuer.

ii. Approving Body

The proposed safe harbor would have allowed a compensation committee or a committee performing similar functions comprised solely of independent members of the board of directors to approve the arrangement. The safe harbor adopted today includes this provision. In the Proposing Release, we sought comment as to whether certain entities (*e.g.*, small business issuers, foreign private issuers) may not have established compensation committees or committees performing similar functions such that the safe harbor may not be available to them. Commenters suggested we expand the approving body to include, among others, the entire board of directors or another duly authorized committee of the board.[64]

In response to these comments, the safe harbor adopted today has been expanded in two respects. First, the safe harbor allows a special committee of the board of directors of the subject company or the bidder, as applicable, comprised solely of independent members and formed to consider and approve the arrangement, to approve the arrangement and satisfy the safe harbor if the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee that performs functions similar to a compensation committee or does have one of these committees but none of its members is independent. The safe harbor adopted today also has been expanded to allow foreign private issuers to obtain the approval by any or all members of the board of directors or any committee of the board of directors authorized to approve the arrangement under the laws or regulations of the home country of the approving party.

We believe that expanding the safe harbor to include approvals by a special committee comprised of independent directors and the accommodation for foreign private issuers is appropriate for purposes of the best-price rule. Allowing a special committee, in lieu of a compensation or similar committee, to approve the compensatory arrangement provides additional flexibility to parties who want to rely on the safe harbor. Further, because the members of the special committee would have to be independent, we believe the approval by a special committee should not compromise investor protection.[65]

---

independent in accordance with the requirements of the listing standards. *See* the related discussion at Section II.C.2.b. and note 72 below.

[60] *See, e.g.*, letters from ABA, Dechert and NYCBA.

[61] *See, e.g.*, letters from Law Firm Group and NYCBA.

[62] Alternatively, as adopted, the safe harbor is available where the arrangement is approved by the bidder's board of directors, but only if the bidder is a party to the arrangement.

[63] *See*, *e.g.*, letters from ABA; Dechert; Law Firm Group; NYCBA; and SIA.

[64] *See*, *e.g.*, letters from ABA; Dechert; Law Firm Group; NYCBA; NYSBA; and SIA.

[65] State law also creates an incentive for board members to be disinterested from the transaction.

Continued

The accommodation for foreign private issuers is appropriate because those issuers may not have compensation or similar committees. Deferring to the laws and regulations of the home country of foreign private issuers makes it more likely that they will avail themselves of the safe harbor and, consequently, conduct tender offers that will include U.S. security holders.

b. Determining Independence

In the Proposing Release, we solicited comment regarding the appropriateness of relying on the independence standards for compensation committee members as defined in the listing standards. One commenter suggested that we rely upon State law duties of directors because the approving body is already relying upon State law standards of fiduciary duties in approving the arrangement.[66] Other commenters suggested that codifying an independence definition similar to other definitions provided in some Exchange Act rules—as opposed to relying upon a definition that is determined by reference to the listing standards, as we have in other Exchange Act rules—would be a better approach because this would provide a consistent definition.[67] We disagree and are adopting the provisions related to the independence standards as proposed, with an accommodation for foreign private issuers. We believe this approach is appropriate because the definitions under the listing standards have previously been approved by us and are consistent with the approach we have followed in the past.[68] In addition, the amendments, as adopted, clarify that a director of a registered closed-end investment company is considered to be independent if the director is not an ''interested person'' of the investment company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.[69] This clarification is necessary because compensation committee listing standards typically do not apply to registered investment companies.[70]

The amendments do not require that the approving body of a foreign private issuer be comprised of members that are independent as defined in the listing standards. While foreign private issuers may rely on the listing standards when determining independence for purposes of the new rule, those issuers will have the alternative of determining the independence of the members of the board or committee approving a compensatory arrangement for purposes of the safe harbor in accordance with home country laws, regulations, codes and standards. We believe this accommodation is appropriate because foreign private issuers may not be subject to the listing standard's independence provisions as they relate to compensation committees and should be provided with the flexibility to rely on home country laws, regulations, codes and standards in adhering to independence standards. We recognize that foreign private issuers may be subject to regulatory schemes and structures that differ from those that apply to U.S. issuers and that some of these schemes and structures may have a definition that is not consistent with the definition of independence contained in U.S. listing standards. Nevertheless, we are comfortable with this approach and believe that it balances the premise of the safe harbor—approval of arrangements by independent board members—against the potential that local independence standards differ drastically from the listing standard's definitions.

We also received comments regarding the possibility that a member of an existing compensation committee or a committee that performs functions similar to a compensation committee may not be independent for purposes of a particular tender offer.[71] Recusal by a member of the approving body from considering and approving the arrangement under those circumstances in accordance with State or local law or the listing standards would not eliminate the availability of the safe harbor.[72]

In the Proposing Release, we requested comment regarding whether the language of the proposed amendments provided sufficient certainty and clarity. Some commenters stated that the safe harbor should be clarified to state that a conclusion by the board of directors that each member of the approving committee is independent should be sufficient to determine conclusively that such committee members meet the applicable independence requirements.[73] We have added an instruction to the safe harbor that a determination by the bidder's or the subject company's board of directors, as applicable, that the members of the committee approving an arrangement are independent in accordance with the provisions of the safe harbor will satisfy the requirements of the safe harbor. We believe that clarifying this point is consistent with the provisions of the safe harbor and the intent of the best-price rule.

c. Procedural Aspects of the Approval of Arrangements

We proposed that, for purposes of satisfying the safe harbor, an arrangement needed to be approved by the applicable committee as meeting the additional requirements of the proposed compensation arrangement exemption—specifically, that the amount to be paid pursuant to a compensatory arrangement must ''relate[] solely to past services performed or future services to be performed or refrained from performing, by the employee or director (and matters incidental thereto) and [may not be] based on the number of securities the employee or director owns or tenders.'' We solicited comment on the appropriateness of these requirements. Commenters believed that requiring the committee to consider these additional factors was unnecessary and could potentially lead to confusion regarding the application of the safe harbor.[74] We agree with these comments, and the safe harbor adopted today does not require that the approving committee consider these requirements. The language of the safe harbor adopted today does require that the independent directors approve the arrangement as an employment compensation, severance or other employee benefit arrangement. We believe this procedural requirement is necessary so directors understand that by approving an arrangement and thereby satisfying the requirements of

See, e.g., 8 Del. C. section 144 and *Weinberger* v. *UOP, Inc.*, 457 A.2d 701 (Del. 1983).

[66] *See* letter from Dechert.

[67] *See, e.g.*, letter from Shearman, which refers to Rule 16b–3(d), but we presume that the commenter is referring to the definition of ''Non-Employee Director'' provided in Exchange Act Rule 16b–3(b)(3) (17 CFR 240.16b–3(b)(3)).

[68] *See, e.g.*, Item 407 of Regulations S–B and S–K (17 CFR 228.407 and 17 CFR 229.407) as adopted in Executive Compensation and Related Person Disclosure, Release No. 33–8732A (Aug. 29, 2006) [71 FR 53158] and Self-Regulatory Organizations; New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. Order Approving Proposed Rule Changes, Release No. 34–48745 (Nov. 4, 2003) [68 FR 64154].

[69] 15 U.S.C. 80a–2(a)(19).

[70] *See, e.g.*, Section 801 of the American Stock Exchange Company Guide; NASDAQ Rule 4350(a)(2); and, Section 303A.00 of the New York Stock Exchange's Listed Company Manual.

[71] *See, e.g.*, letter from SCSGP.

[72] A bidder or subject company's standing compensation committee may include multiple board members, each of whom has qualified as independent in accordance with the requirements of the applicable listing standards. The safe harbor does not require that each of the members of a company's standing compensation committee participate in the consideration and approval of an arrangement.

[73] *See, e.g.*, letters from Law Firm Group and NYCBA.

[74] *See* the discussion at Section II.B.2.c. above.

the safe harbor, they are determining that the arrangement is compensatory.[75]

In response to our request for comment, many commenters expressed the view that committee approval of specific arrangements, as compared to approval of plans or programs, with security holders of a subject company should not be required by the proposed safe harbor.[76] We have not made changes in response to these comments, as we believe they are inconsistent with a basic premise of the safe harbor, which is that individuals vested with the fiduciary responsibility for approving compensation arrangements will consider and approve arrangements with security holders of the subject company of a tender offer and, therefore, the best-price rule need not apply. Based on this premise, directors would need to have knowledge of the specific arrangements with security holders and the related tender offer when the approval is given. Of course, the corporate procedures for obtaining and documenting such approval remain matters of State law and the requirements of the safe harbor do not limit the ability of the independent directors to approve multiple specific arrangements or stock grants generally.

Many commenters requested that the timing of the required approval of arrangements by the committee and the ability of committees to reapprove or ratify arrangements originally approved before the consideration of a specific transaction or the effectiveness of these rule changes be clarified. We have not proposed changes to the safe harbor to address these comments, as we do not believe it is necessary to address such procedural issues in the rule itself. We do note, however, that the revised best-price rule states that ''[t]he consideration paid to any security holder for securities tendered in the tender offer [shall be] the highest consideration paid to any other security holder for securities tendered in the tender offer'' and, as such, approval pursuant to the provisions of the safe harbor would need to be received before the consideration is paid in the tender offer. We also note that the requirements of the safe harbor do not prohibit ratification of arrangements provided that the tender offer consideration has not been paid yet.

d. Challenges to the Applicability of the Safe Harbor

Commenters requested clarification of the proposed safe harbor to provide that any finding of a violation of fiduciary duties by the board would not nullify the application of the safe harbor.[77] We have not adopted changes to the safe harbor to address these comments. A violation of State law fiduciary duties would not have any impact on the availability of the safe harbor, as remedies are generally available for such allegations under State law.

We have also expanded the application of the proposed instruction that no inference should be drawn that consideration paid pursuant to arrangements other than compensation arrangements, such as commercial arrangements, constitutes consideration paid for securities tendered in the tender offer. The adopted instruction now relates to both the exemption and the safe harbor. The fact that directors approve an arrangement as an employment compensation, severance or other employee benefit arrangement in order to meet the requirements of the safe harbor should not raise an inference that consideration paid or to be paid pursuant to other arrangements that may be entered into with security holders of the subject company constitutes consideration paid for securities tendered in a tender offer.

We also received comments about whether the language of the safe harbor was potentially ambiguous and whether the safe harbor was self-operating.[78] In order to address these comments, we adopted the exemption and the safe harbor as new sections of the third-party and issuer best-price rules.[79] We also amended the language of the safe harbor so that it is clear that the negotiation, execution and amendment of, and any payments made or to be made or benefits granted or to be granted according to, arrangements approved pursuant to the safe harbor are not prohibited by the best-price rule.

e. Application of the Safe Harbor to the Issuer Best-Price Rule

In the Proposing Release, we proposed to add the safe harbor to the third-party best-price rule but did not propose an analogous safe harbor to the issuer best-price rule. To date it does not appear that claims of a violation of the best-price rule have been made under the issuer tender offer rules. Commenters, however, were unanimous in their request that we extend the safe harbor to the issuer best-price rule.[80] They reasoned that the need to enter into employment compensation, severance or other employee benefit arrangements also arises during issuer tender offers because similar issues of severance and retention often are present, especially in restructuring and recapitalization transactions.[81] Commenters also believed that there appeared to be no compelling reason to distinguish between the issuer and third-party best-price rules, especially because doing so might have unintended consequences.[82] We agree and the amendments we are adopting today add the safe harbor to the issuer best-price rule at Rule 13e–4(f)(12).

III. Paperwork Reduction Act

We have not prepared a submission to the Office of Management and Budget under the Paperwork Reduction Act of 1995 because the proposals do not impose any new recordkeeping or information collection requirements, or other collections of information requiring the approval of the Office of Management and Budget.

IV. Cost-Benefit Analysis

A. Background

On December 16, 2005, we proposed amendments to the best-price rule to clarify that the best-price rule applies only with respect to the consideration offered and paid for securities tendered in a tender offer. We also proposed that the rule exclude employment compensation, severance and other employee benefit arrangements between subject company employees or directors and the subject company or bidder from the application of the best-price rule, as long as the compensatory arrangements meet certain requirements. Finally, we proposed an accompanying safe harbor to the exemption for those compensatory arrangements that were approved by a compensation committee (or a committee performing similar functions) of either the bidder or the subject company, depending upon who was a party to the arrangement.

We are adopting the amendments substantially as proposed. First, we are adopting the amendment to the language of the best-price rule that clarifies that the provisions of the rule apply only with respect to the consideration offered and paid for securities tendered in a tender offer. We also are amending the third-party and

[75] This procedural requirement is not intended to affect the State law or listing standard approval or documentation requirements for matters considered by the board of directors or committees of the board of directors.

[76] *See, e.g.*, letters from ABA; Intel; Law Firm Group; NYCBA; SCSGP; and Shearman.

[77] *See, e.g.*, letters from Intel and SIA.

[78] *See, e.g.*, letter from Dechert.

[79] *See* note 30 above.

[80] *See, e.g.*, letters from ABA; Dechert; Gonzalez; Intel; Law Firm Group; NYCBA; NYSBA; Perkins Coie LLP (''Perkins''); SCSGP; Shearman; and SIA.

[81] *See, e.g.*, letters from ABA; Intel; and SCSGP.

[82] *See, e.g.*, Law Firm Group; SCSGP; and SIA.

issuer tender offer best-price rules to provide that any consideration that is offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company that meet certain requirements will not be prohibited by the rules. Finally, we are amending the third-party and issuer tender offer best-price rules to provide a safe harbor provision so that arrangements that are approved by the independent directors of either the subject company's or the bidder's board of directors, as applicable, will not be prohibited by the rules.

We expect that these amendments will make it clear that the best-price rule was not intended to capture compensatory arrangements. The amendments also are intended to alleviate the reluctance bidders and subject companies have expressed in planning and structuring transactions as tender offers due to differing judicial interpretations of the best-price rule that have been rendered by courts to date. We also want to diminish a regulatory disincentive against structuring transactions as tender offers, as compared to statutory mergers, to which the best-price rule does not apply. We recognize that the amendments may create costs and benefits to parties engaging in tender offers and to the economy as a whole. We have identified those costs and benefits below.

B. Benefits

The amendments to the rule will benefit investors most directly through their intended effect of lowering the costs of tender offer transactions that arise from the risk of litigation under the current case law. Bidders and subject companies are expected to respond with increased tender offer activity as a result of choosing to structure an acquisition as a tender offer, rather than a statutory merger. Some benefits from lower litigation-related costs are expected to arise in each instance, depending on the cost of the litigation risk that would be borne otherwise. This cost would likely continue to persist as a regulatory obstacle in the absence of the amendment; such cost would deter the use of tender offers relative to statutory mergers and the conduct of acquisitions as tender offers that would not occur otherwise. The magnitude of the benefit from the amendment will thus partly depend on the magnitude of the substitution into tender offers and any tender offer-related increase in acquisition activity generally. In the Proposing Release, we requested comment on the magnitude of these and other potential benefits of the proposed amendments. We received no direct response to this request. Commenters also did not indicate that the judicial interpretations of the best-price rule were preventing potential acquisitions from proceeding in any form. Commenters did indicate that the judicial interpretations of the best-price rule were causing transactions to proceed as statutory mergers, as opposed to tender offers. Accordingly, we do not expect the amended best-price rule to materially impact the number of transactions that occur overall, but rather the form in which the transaction takes place.[83]

The comments that we received on the proposed amendments are consistent with the view that benefits would occur through a reduction in the litigation-related cost of conducting tender offers, leading to an increased incentive to undertake tender offers. As to the regulatory incentives to conduct statutory mergers as compared to tender offers, one commenter indicated that the economic efficiencies of using tender offers, as compared to mergers, have been lost because of the potential liability associated with conducting a tender offer that may be subject to a lawsuit where a compensatory arrangement is involved.[84] This commenter endorsed the objectives of the amendments to the best-price rule. Several commenters also indicated generally that the amendments would meet the objectives of the best-price rule.[85] Others expressed their support by indicating that the amendments would provide clarity and certainty to participants in tender offers, particularly regarding the perceived litigation risk that has been present in the best-price rule.[86] Almost all of the commenters suggested additional changes to the amendments, particularly with respect to the exemption and safe harbor from the best-price rule.

The litigation-related costs that the amendment would eliminate stem from diverging court interpretations of the best-price rule that have emerged in the past decade. The best-price rule has been interpreted as requiring, in some courts, that the amounts paid pursuant to compensation arrangements be included as part of the consideration paid to security holders in the tender offer either because the compensation was offered or paid during a tender offer and, in other courts, because the compensatory arrangement constituted an ''integral part'' of the tender offer. These interpretations have made parties reluctant to structure acquisitions as tender offers for fear of exposure to potential liability. We believe it is appropriate to amend the best-price rule to clarify this point now, rather than to wait and see how the courts might interpret the rule in the future. These amendments are thus intended to eliminate a regulatory obstacle to the use of tender offers as a viable alternative to statutory mergers for parties who wish to conduct an acquisition. We believe that the interests of security holders are better served when all acquisition structures are viable options.[87]

We recognize that the application of our exemption and safe harbor is limited to compensatory arrangements. Parties who wish to enter into arrangements that are not compensatory in nature may continue to be reluctant to engage in tender offers. In these situations, parties may choose to engage in a statutory merger, as opposed to a tender offer, to accomplish an acquisition because the litigation risk continues to be too great. While we do not intend for arrangements entered into with security holders that are not compensatory to be presumed to be in violation of the best-price rule,[88] we also believe that it is appropriate to limit our exemption and safe harbor to arrangements that are compensatory in nature.

[83] Under the assumption that the amendments do not have a material impact on the number of overall acquisitions conducted annually, an estimate of the potential increase in tender offers can be obtained from an estimate of the potential decline in statutory mergers, expressed as a fraction of the total. For example, if 5% of the transactions that would otherwise be conducted as statutory mergers will now be conducted as tender offers, an estimated 35.7% increase in the number of tender offers might result annually (based upon the number of statutory mergers and tender offers that have taken place over the last 10 years).

[84] *See, e.g.,* letter from Law Firm Group (citing the benefit of the relatively shorter amount of time that it takes to conduct a tender offer (30 days) as compared to mergers (90–120 days)). Similar support for the fact that tender offers, as compared to mergers, provide the benefit of time can be found in the letters from ABA, Dechert and SIA. Other benefits of tender offers include the fact that management support is not necessary for the bidder to acquire the target company (*i.e.*, individuals make their own investment decision) and control by a bidder may be obtained without necessarily purchasing all of the outstanding securities of the target company. *See* Eleanor M. Fox and Byron E. Fox, *Corporate Acquisitions and Mergers* (2006 ed.) at 5E–6.

[85] *See, e.g.,* letters from ABA and NYCBA.

[86] *See, e.g.*, letters from Dechert; SCSGP; and Shearman.

[87] A disincentive against structuring transactions as tender offers has potential negative consequences to acquirors and security holders. *See* prior note 84 for a discussion of some of the benefits of tender offers.

[88] The rule, as adopted, includes the proposed instruction to this effect.

Depending upon the jurisdiction in which a best-price rule claim has been brought, the potential costs to bidders as a result of certain of the judicial interpretations of the best-price rule have been substantial. An intended benefit of our amendments will be to assist parties in reducing their exposure to potential costs arising from allegations of best-price rule violations. These potential costs include, among others, the cost of litigation to defend against alleged violations of the best-price rule.[89] We believe bidders will be less likely to be subject to a claim because our amendments provide an exception to the best-price rule for compensatory arrangements without the loss of the basic protections that the rule is designed to provide to security holders.

C. Costs

The best-price rule prohibits certain conduct in connection with a tender offer. In this regard, the amendments to the best-price rule do not add any new requirements. Rather, the amendments clarify that certain conduct is not prohibited by the rule and add means by which parties can comply, via an exemption or a safe harbor provision, with the rule. Continued compliance with the best-price rule can be achieved in the same manner and by the same persons responsible for compliance under the rule in effect before our amendments today. Reliance upon the exemption or the safe harbor, however, may entail additional costs. We discuss these additional costs below. We do not believe these costs are substantial.

The amendments seek to modify the language of the existing best-price rule to remove the reference to ''during.'' Some commenters have indicated that the effect of this change would be to expand the potential timeframe in which litigants could argue that a best-price rule violation has occurred.[90] If the commenter's concerns were realized, it is possible claims that the best-price rule has been violated might continue to be brought, only under a different, potentially more expansive, theory. We do not believe that a temporal limitation in the best-price rule is appropriate because such a strict timeframe might lend itself to abuse. Further, we believe that the amendments providing for the exemption and the safe harbor to the best-price rule provide sufficient certainty to parties desiring to engage in a tender offer such that any concern regarding continued litigation under the best-price rule as a result of the removal of ''during'' is reduced.

The exemption and the safe harbor adopted today provide that, presuming certain requirements are met, consideration paid pursuant to certain arrangements will not be prohibited by the best-price rules. Parties may be able to challenge whether the provisions of the exemption or the safe harbor have been met. Complying with the conditions of the exemption and safe harbor, therefore, may be a cost of complying with the best-price rule.

To the extent parties choose to rely upon the safe harbor, bidders and/or subject companies, in the case of third-party tender offers, or issuers and/or affiliates, in the case of issuer tender offers, may need to take extra steps—such as obtaining approval of the compensatory arrangement by directors—to comply with the safe harbor. However, most bidders, issuers, affiliates and subject companies are already required to have a compensation committee or a committee performing similar functions, so the cost of forming, organizing and convening a committee should be a cost that already is being incurred by most bidders, issuers, affiliates or subject companies. Companies without such a committee will incur a cost, most likely in the form of legal fees.

Further, bidders, issuers, affiliates or subject companies may already have their compensation committee or a committee performing similar functions approve specific employment compensation, severance or other employee benefit arrangements in the ordinary course of performing its duties. These bidders, issuers, affiliates or subject companies would not incur additional costs to comply with the amended best-price rule and, even if they are not already engaging their committees to perform this function, the costs should be limited to the time and expense associated with reviewing the specific arrangement and holding a meeting of the committee. With respect to subject company approval, it is possible that subject company directors may already be reviewing arrangements executed in connection with negotiated acquisitions [91] in order to meet their State law fiduciary duties when considering and determining whether to recommend the transaction to the security holders of the subject company.[92]

To the extent parties choose to rely upon the exemption, we recognize there may be similar costs associated with adhering to the exemption. While we have not dictated the manner or method by which we expect the parties to meet the requirements of the exemption, we expect that, at the very least, it will take the parties time to make a determination as to whether the compensatory arrangement meets the requirements of the exemption. The time it takes for the parties to make this determination is a cost but we believe that the cost should be minimal.

Under the amendments, some compensatory arrangements may qualify for the safe harbor provision with approval by a committee of the bidder's board. Since the bidder's board does not typically owe a fiduciary duty to security holders of the subject company, the amendments could impose costs on security holders of the subject company by making it possible for transactions to occur without safeguards associated with directors' fiduciary duties. However, such costs are likely to be limited because they would be dependent upon the ability of security holders of the subject company to anticipate such transactions and contract in advance of the transaction with management, employees, or other security holders of the subject company. In addition, such costs may be limited to the extent that other rights of action, such as litigation in State courts, exist for security holders in the subject company.

Finally, the rule may introduce costs associated with new litigation risks. It is possible that the amended best-price rule will simply shift the litigation to State law; security holders may claim that directors have breached their fiduciary duties in approving the compensatory arrangement.[93] In

[89] In sixteen published judicial opinions over the last ten years, approximately half were decided in favor of the plaintiff with the other half being decided in favor of the defendant. Extrapolating from these opinions, we assume an average of three claims per year are brought, that one claim is settled per year, that the costs of defending all three actions would total no more than $10 million per year (based on the staff's estimate of attorney's fees), and that the costs associated with settling one such action would be $15 million (based on historical data). *See, e.g., Technology Briefing Software: Computer Associates Ordered to Pay $11 Million*, The N.Y. Times, Sept. 6, 2002 at C6 and *$18.25 Million Settlement Approved in Litigation Resulting From Take-Over*, Securities Class Action Reporter, March 15, 2006 at 17. Based on these assumptions, the annual cost savings would be approximately $25 million.

[90] *See, e.g.*, letters from ABA; Dechert; and Law Firm Group.

[91] *See, e.g.*, Item 1012(a) of Regulation M–A (17 CFR 229.1012(a)), which requires a statement as to whether the subject company is advising security holders in a third-party tender offer to accept or reject the tender offer or to take other action.

[92] *See, e.g.*, letters from ABA and SIA.

[93] We requested comment about whether this potential outcome should impact the structure of the amendments to the best-price rule. Certain commenters noted that the fiduciary duties owed by the bidder's directors to the bidder's security holders would guide their actions and, therefore,

Continued

addition, or alternatively, they may claim that the provisions of the exemption or safe harbor were not satisfied. Whether a successful claim can be made against members of the board of directors for breach of their fiduciary duties or for failure to satisfy the provisions of the exemption or safe harbor is uncertain. As a result, the potential costs associated with identifying the alleged illegal behavior and bringing a claim of liability could be imposed on potential plaintiffs. We note that commenters, when asked about shifting litigation to State law issues, did not object, so long as no remedy would be available under the best-price rule.[94]

D. Small Business Issuers

Although the amended rules apply to small business issuers, we do not anticipate any disproportionate impact on small business issuers. Like other issuers, small business issuers should incur relatively minor compliance costs, and should find it unnecessary to hire extra personnel. It is possible that the safe harbor, for the reasons mentioned above, will cause small business issuers in particular to incur some cost due to the establishment of an appropriate approving body and the time and expense of reviewing the compensatory arrangement and convening a meeting. This is because small business issuers are less likely to have the pre-existing infrastructure in place. But we do not believe that these costs are unreasonable in order to ensure that the purpose of the best-price rule is met. Further, the exemption and safe harbor available under the amended rules are non-exclusive methods of complying with the best-price rule so any additional costs incurred are voluntary.

The issues of equal treatment among security holders in the context of tender offers affect small business issuers as much as they affect larger issuers. Thus, we do not believe that applying the amendments to small business issuers would be inconsistent with the policies underlying the small business issuer disclosure system.

V. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 3(f) of the Exchange Act[95] and Section 2(c) of the Investment Company Act[96] require the Commission, whenever it engages in rulemaking, to consider or determine if an action is necessary or appropriate in the public interest and to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.[97] Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The amendments to the best-price rule are intended to improve market efficiency by providing greater clarity to bidders, subject companies and security holders as to the situations in which compliance with the best-price rule has been met. Courts rendering decisions arising from allegations of a violation of the best-price rule have differed in their approach to resolving these claims and the resulting uncertainty has left parties who want to engage in a tender offer unsure about how to proceed. The amendments are intended to clarify the application of the best-price rule where employment compensation, severance or other employee benefit arrangements have been or are expected to be entered into in contemplation of an acquisition of securities that is structured as a tender offer. Specifically, the amendments provide for an exemption and a safe harbor provision from the best-price rule for certain arrangements that either meet certain requirements or that are approved by independent directors. The resulting clarity should make the determination as to whether to engage in a tender offer a more viable one for bidders, issuers, affiliates and subject companies, resulting in a positive effect upon market efficiency.

As to the impact on competition, the amendments to the best-price rule are intended to have a positive impact on competition among the alternative mechanisms for completing acquisitions. Bidders desiring to acquire another entity by conducting a tender offer would have the benefit of the amendments to the best-price rule that delineate the instances in which the negotiation or execution of employment compensation, severance or other employee benefit arrangements would not run afoul of the requirements of the best-price rule. Previously, the existence of compensatory arrangements might have caused parties to hesitate before engaging in a tender offer in order to weigh the potential benefits of the acquisition carefully against the potential for liability for a best-price rule violation. Ultimately, the parties may have declined to pursue a tender offer as an alternative to a statutory merger in completing the transaction. The amendments, however, are designed to alleviate the need to hesitate and, therefore, increase competition between these alternative acquisition mechanisms. Having more acquisition structures available to parties contemplating an acquisition is a positive effect of the rule upon competition.

We acknowledge the possibility that, because bidders, issuers, affiliates and subject companies may desire to take advantage of the safe harbor to the best-price rule where arrangements approved by an appropriate approving body of directors meet the requirements of the safe harbor and therefore consideration paid pursuant to such arrangement are not prohibited by the rule, those bidders, issuers, affiliates and subject companies may need to reevaluate whether they have an approving body and adequate policies and procedures in place to take advantage of the safe harbor. Such an evaluation could place a limitation on the ability of the parties to move quickly and efficiently in pursuing an acquisition, which could diminish the beneficial effect on market efficiency and competition. We believe, however, that the approval of directors is an important step in the availability of the safe harbor and, therefore, any increased efforts or costs that need to be expended to comply with the safe harbor are appropriate to provide equal treatment of security holders. Further, we believe that we have provided sufficient flexibility in the operation of the safe harbor to ease this potential impact. We also have provided an exemption that does not require director approval.

The amendments should promote capital formation, as they are intended to significantly reduce the uncertainty caused by the varying judicial interpretations of the best-price rule. The clarifications to the best-price rule are expected to have the effect of alleviating regulatory disincentives to structuring an acquisition of securities as a tender offer, as compared to a statutory merger, where the best-price rule is inapplicable. It is difficult to estimate the magnitude of these effects, if or when they would occur, and the extent to which they will be offset by the costs of the amendments, nor have we received comments on their likely magnitude.

provide some level of protection. *See, e.g.*, the ABA letter.

[94] *See, e.g.*, letters from Law Firm Group and NYCBA.

[95] 15 U.S.C. 78c(f).

[96] 15 U.S.C. 80a–2(c).

[97] 15 U.S.C. 78w(a)(2).

We requested comment on these matters in the Proposing Release. We received no comments in response to these specific requests, but some comments touched on these issues. Commenters generally expressed support for the proposal to amend the best-price rule, given the structural impediments to the use of tender offers as a result of the case law that has developed.[98] They generally believed that the amendments would provide clarity and greater certainty to the tender offer process.[99]

VI. Final Regulatory Flexibility Act Analysis

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with the Regulatory Flexibility Act. This analysis relates to proposed revisions to the tender offer best-price rule under the Exchange Act to clarify that the rule applies only with respect to the consideration offered and paid for securities tendered in an issuer or third-party tender offer and should not apply to consideration offered and paid according to employment compensation, severance or other employee benefit arrangements entered into with security holders of the subject company. The amendments provide an exemption and safe harbor from the strictures of the best-price rule for arrangements that meet certain criteria or that are approved by independent directors, respectively.

A. Reasons for the Proposed Amendments

The best-price rule was adopted originally to provide fair and equal treatment of all security holders of the class of securities that are the subject of a tender offer by requiring that the consideration paid to any security holder is the highest paid to any other security holder in the tender offer. We proposed amendments to the best-price rule on December 16, 2005. The amendments we adopt today are, in most respects, consistent with the proposed amendments but include certain revisions made in response to concerns raised by commenters. The objectives of the changes are as follows:

First, we want to make it clear that compensatory arrangements between security holders and the subject company or bidder are not captured by the application of the best-price rule. We believe that amounts paid pursuant to employment compensation, severance or other employee benefit arrangements should not be included in the consideration paid for tendered securities. These payments are made for a different purpose, to provide compensation in exchange for services rendered or in connection with severance or similar events.

Second, since the adoption of the best-price rule, it has been the basis for litigation brought in connection with tender offers in which it is claimed that the best-price rule was violated as a result of the bidder in a tender offer entering into new, or adopting the subject company's pre-existing, employment compensation, severance or other employee benefit arrangements with security holders of the subject company. In the process of resolving these claims, courts have interpreted the best-price rule in different ways. We are adopting changes to the rule to alleviate the uncertainty that the various interpretations of the best-price rule by courts have produced.

Finally, we want to reduce the regulatory disincentive to structure acquisitions of securities in the form of tender offers, as compared to statutory mergers, to which the best-price rule does not apply. We understand that the prospect of the uncertain application of the best-price rule that has arisen as a result of the case law has made parties averse to the use of tender offers as a means to accomplish extraordinary transactions, and we believe the amendments to the rule will reduce this aversion to the use of tender offers.

B. Significant Issues Raised by Public Comment

An Initial Regulatory Flexibility Analysis was prepared in accordance with the Regulatory Flexibility Act in connection with the Proposing Release, and we solicited comments on any impact the proposed changes might have on any aspect of our IRFA. We did not receive any public comments that responded directly to the IRFA or that dealt directly with the proposal's impact on small business issuers.

C. Small Entities Subject to the Proposed Rules

The changes to the best-price rule will affect issuers that are small businesses. Exchange Act Rule 0–10(a) [100] defines an issuer, other than an investment company, to be a ''small business'' or ''small organization'' for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year. An investment company is considered to be a ''small business'' or ''small organization'' if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[101] These are the types of entities that we refer to as small entities in this discussion. We estimate that there are approximately 2,500 public issuers, other than investment companies, that may be considered small businesses. We estimate that there are approximately 230 investment companies that may be considered small businesses. Of these 230 investment companies that may be considered small businesses, we estimate that 94 are closed-end investment companies, including closed-end investment companies electing to be treated as business development companies, as defined in Section 2(a)(48) of the Investment Company Act,[102] that may be affected by the proposed amendments.

The Commission received a total of 412 issuer and 141 third-party tender offer schedules in its 2006 fiscal year. We estimate that half of the 14 issuer tender offer schedules were filed by subject companies that were small business issuers and the other half were filed by investment companies that are small businesses as that term is defined for purposes of the Regulatory Flexibility Act.[103] We further estimate that 18 of the third-party tender offer schedules received by the Commission in its 2006 fiscal year were tender offers where the target companies were small business issuers.[104] We note that our use of small business issuers is a broader category of issuers than small entities. Therefore, we believe that the amendments are likely to affect a limited number of small business issuers and, for the same reason, an even smaller number of small entities that are reporting companies.

We requested comment on the number of small entities that would be impacted by our proposals, including any available empirical data. We received no responses to our request.

D. Reporting, Recordkeeping and Other Compliance Requirements

The amendments to the best-price rule are expected to result in relatively small costs to all bidders and subject companies, large or small. Even before

[98] *See, e.g.,* letter from Law Firm Group.

[99] *See, e.g.,* letters from ABA and NYCBA.

[100] 17 CFR 240.0–10(a).

[101] 17 CFR 270.0–10.

[102] 15 U.S.C. 80a–2(a)(48).

[103] A small business issuer is defined as a company that, among other things, has revenues of less than $25,000,000. *See* Securities Act Rule 405 (17 CFR 230.405).

[104] No investment company that is a small business, as that term is defined for purposes of the Regulatory Flexibility Act, conducted a third-part tender offer in the 2006 fiscal year of the Commission.

our proposed amendments, the best-price rule required bidders to pay any security holder pursuant to the tender offer the highest consideration paid to any other security holder for securities tendered in the tender offer. Therefore, the changes to the best-price rule should not impose significant additional costs, if any, and should not require any specialized professional skills. The task of complying with the changes could be performed by the same person or group of persons responsible for compliance under the rules that were in effect before today's amendments at a minimal incremental cost.

We understand that the exemption and safe harbor from the best-price rule may impose extra steps on the bidder and/or subject company to comply with the exemption and safe harbor, and such compliance could entail new costs. For example, with respect to the safe harbor for compensatory arrangements that are approved by the directors of the bidder or subject company, most bidders and subject companies already are required to have a compensation committee or a committee performing similar functions, so the cost of forming and organizing a committee should be a cost that already is being incurred by the bidder or subject company. This is particularly the case where the bidder or subject company either has a class of securities listed on a registered national securities exchange or on an automated inter-dealer quotation system of a national securities association because the listing standards of each generally impose certain requirements regarding the formation and composition of the members of the board of directors and its committees.

Small entities or organizations may be less likely to have a class of securities listed on a registered national securities exchange or on an automated inter-dealer quotation system of a national securities association. As a result, it is possible that small entities or organizations will be less likely to have the pre-existing infrastructure in place for a compensation committee or a committee performing similar functions to approve employment compensation, severance or other employee benefit arrangements. Such small entities or organizations likely will incur additional costs to take advantage of this safe harbor. The cost, however, should be limited to the expense of organizing a committee, reviewing the specific arrangement and holding a meeting of the committee. We believe these costs are appropriate to promote equal treatment of security holders in the application of the best-price rule.

With respect to the exemption for compensatory arrangements that meet certain requirements, all bidders or subject companies that choose to avail themselves of this exemption will need to make a determination as to whether the arrangement at issue meets the requirements. This determination likely will entail additional costs, even if only in the form of the additional time it will take to make this determination. However, the amendments do not mandate any particular method or procedure that a bidder or subject company must follow in making this determination.

Both the exemption and the safe harbor, however, are optional provisions and serve as non-exclusive methods to ensure compliance with the best-price rule. This means that bidders and subject companies that are small entities or organizations will not be required to take advantage of the provision, so any additional expenses that may be incurred, if any, would be optional on the part of the small entity or organization. We acknowledge, however, that the cost of foregoing the application of the exemption or safe harbor might be significant if there is a risk of potential liability where a compensatory arrangement is found to violate the best-price rule and the cost of that violation is expected to be greater than the cost of complying with the exemption or safe harbor. In that circumstance, entities would be likely to structure transactions as statutory mergers.

E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives while minimizing any significant adverse impact on small entities or organizations. In connection with the proposals, we considered the following alternatives:

1. Establishing different compliance or reporting requirements or timetables that take into account the resources of small entities;

2. The clarification, consolidation, or simplification of the compliance or reporting requirements for small entities;

3. The use of performance rather than design standards; and

4. An exemption for small entities from coverage of the best-price rule, or any part thereof, for small entities.

We have considered a variety of reforms to achieve our regulatory objectives. However, we believe that the original intent of the best-price rule, to require equal treatment of security holders, would not be served by a best-price rule that applied only to bidders and subject companies of a certain size. Further, we believe that uniform rules applicable to all bidders and subject companies, regardless of size, are necessary to alleviate the uncertainty that the parties to tender offers face. Therefore, the establishment of different requirements for small entities would not be practicable, nor would it be in the public interest. For similar reasons, the clarification, consolidation or simplification of the compliance and reporting requirements for small entities also would not be practicable.

Although the best-price rule generally employs performance standards rather than design standards, the amendments to the rule would implement certain design standards in order to clarify that the rule should not apply where employment compensation, severance or other employee benefit arrangements are made or will be made or have been granted or will be granted, as long as they have been approved by the directors of an appropriate approving body of either the bidder or the subject company. We intend for the implementation of design standards, in this case, to be more useful to bidders and subject companies because the circumstances in which the best-price rule would likely be inapplicable will be delineated clearly. This should provide greater certainty in the application of the rule and the enforcement of the application of the rule. Therefore, implementing design rather than performance standards in the application of the rule appears to be more effective in promoting compliance with the rule, as amended.

As discussed above, most bidders and subject companies that engage in tender offers and are subject to the best-price rule are not small entities or organizations, as defined for purposes of the Regulatory Flexibility Act. Further, where small entities are bidders and/or subject companies in the tender offer, the proposed changes to the best-price rule, in general, and the invocation of the exemption or safe harbor, in particular, impose minimal additional costs or burdens. Therefore, exempting small entities from the best-price rule altogether would not be justified in this context.

VII. Statutory Basis

The amendments to the best-price rule are adopted pursuant to Sections 3(b), 13, 14, 23(a) and 36 of the Exchange Act, as amended, and Section 23(c) of the Investment Company Act, as amended. The amendments to the Rules of Practice are adopted pursuant to

Section 19 of the Securities Act, as amended and Sections 4A, 19 and 23 of the Exchange Act, as amended.

VIII. Text of the Rules and Amendments

List of Subjects

17 CFR Part 200

Administrative practice and procedure; Authority delegations (Government Agencies).

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

■ In accordance with the foregoing, the Securities and Exchange Commission amends Title 17, chapter II of the Code of Federal Regulations as follows:

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

■ 1. The general authority citation for part 200, subpart A is revised to read as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d–1, 78d–2, 78w, 78*ll*(d), 78mm, 80a–37, 80b–11, and 7202, unless otherwise noted.

* * * * *

■ 2. Amend § 200.30–1 (e)(11) by removing the phrase ''pursuant to Rule 14d–10(e) (§ 240.14d–10(e) of this chapter)'' and by adding the phrase ''pursuant to Rule 14d–10(f) (§ 240.14d–10(f) of this chapter)'' in its place.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 3. The general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

■ 4. Amend § 240.13e–4 by revising paragraph (f)(8)(ii), redesignating paragraph (f)(12) as paragraph (f)(13) and adding new paragraph (f)(12) to read as follows:

§ 240.13e–4 Tender offers by issuers.

* * * * *

(f) * * *

(8) * * *

(ii) The consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer.

* * * * *

(12)(i) Paragraph (f)(8)(ii) of this section shall not prohibit the negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement, or payments made or to be made or benefits granted or to be granted according to such an arrangement, with respect to any security holder of the issuer, where the amount payable under the arrangement:

(A) Is being paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto); and

(B) Is not calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.

(ii) The provisions of paragraph (f)(12)(i) of this section shall be satisfied and, therefore, pursuant to this non-exclusive safe harbor, the negotiation, execution or amendment of an arrangement and any payments made or to be made or benefits granted or to be granted according to that arrangement shall not be prohibited by paragraph (f)(8)(ii) of this section, if the arrangement is approved as an employment compensation, severance or other employee benefit arrangement solely by independent directors as follows:

(A) The compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the issuer approves the arrangement, regardless of whether the issuer is a party to the arrangement, or, if an affiliate is a party to the arrangement, the compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the affiliate approves the arrangement; or

(B) If the issuer's or affiliate's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of the issuer's or affiliate's compensation committee or committee that performs functions similar to a compensation committee is independent, a special committee of the board of directors formed to consider and approve the arrangement approves the arrangement; or

(C) If the issuer or affiliate, as applicable, is a foreign private issuer, any or all members of the board of directors or any committee of the board of directors authorized to approve employment compensation, severance or other employee benefit arrangements under the laws or regulations of the home country approves the arrangement.

Instructions to paragraph (f)(12)(ii): For purposes of determining whether the members of the committee approving an arrangement in accordance with the provisions of paragraph (f)(12)(ii) of this section are independent, the following provisions shall apply:

1. If the issuer or affiliate, as applicable, is a listed issuer (as defined in § 240.10A–3 of this chapter) whose securities are listed either on a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or in an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o–3(a)) that has independence requirements for compensation committee members that have been approved by the Commission (as those requirements may be modified or supplemented), apply the issuer's or affiliate's definition of independence that it uses for determining that the members of the compensation committee are independent in compliance with the listing standards applicable to compensation committee members of the listed issuer.

2. If the issuer or affiliate, as applicable, is not a listed issuer (as defined in § 240.10A–3 of this chapter), apply the independence requirements for compensation committee members of a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o–3(a)) that have been approved by the Commission (as those requirements may be modified or supplemented). Whatever definition the issuer or affiliate, as applicable, chooses, it must apply that definition consistently to all members of the committee approving the arrangement.

3. Notwithstanding Instructions 1 and 2 to paragraph (f)(12)(ii), if the issuer or affiliate, as applicable, is a closed-end investment company registered under the Investment Company Act of 1940, a director is considered to be independent if the director is not, other than in his or her capacity as a member of the board of directors or any board committee, an ''interested person'' of the investment company, as defined in section 2(a)(19)

of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(19)).

4. If the issuer or affiliate, as applicable, is a foreign private issuer, apply either the independence standards set forth in Instructions 1 and 2 to paragraph (f)(12)(ii) or the independence requirements of the laws, regulations, codes or standards of the home country of the issuer or affiliate, as applicable, for members of the board of directors or the committee of the board of directors approving the arrangement.

5. A determination by the issuer's or affiliate's board of directors, as applicable, that the members of the board of directors or the committee of the board of directors, as applicable, approving an arrangement in accordance with the provisions of paragraph (f)(12)(ii) are independent in accordance with the provisions of this instruction to paragraph (f)(12)(ii) shall satisfy the independence requirements of paragraph (f)(12)(ii).

Instruction to paragraph (f)(12): The fact that the provisions of paragraph (f)(12) of this section extend only to employment compensation, severance and other employee benefit arrangements and not to other arrangements, such as commercial arrangements, does not raise any inference that a payment under any such other arrangement constitutes consideration paid for securities in a tender offer.

* * * * *

■ 5. Amend § 240.14d–10 by revising paragraph (a)(2), redesignating paragraphs (d) and (e) as paragraphs (e) and (f) and adding new paragraph (d) to read as follows:

§ 240.14d–10 Equal treatment of security holders.

(a) * * *

(2) The consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer.

* * * * *

(d)(1) Paragraph (a)(2) of this section shall not prohibit the negotiation, execution or amendment of an employment compensation, severance or other employee benefit arrangement, or payments made or to be made or benefits granted or to be granted according to such an arrangement, with respect to any security holder of the subject company, where the amount payable under the arrangement:

(i) Is being paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the security holder (and matters incidental thereto); and

(ii) Is not calculated based on the number of securities tendered or to be tendered in the tender offer by the security holder.

(2) The provisions of paragraph (d)(1) of this section shall be satisfied and, therefore, pursuant to this non-exclusive safe harbor, the negotiation, execution or amendment of an arrangement and any payments made or to be made or benefits granted or to be granted according to that arrangement shall not be prohibited by paragraph (a)(2) of this section, if the arrangement is approved as an employment compensation, severance or other employee benefit arrangement solely by independent directors as follows:

(i) The compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the subject company approves the arrangement, regardless of whether the subject company is a party to the arrangement, or, if the bidder is a party to the arrangement, the compensation committee or a committee of the board of directors that performs functions similar to a compensation committee of the bidder approves the arrangement; or

(ii) If the subject company's or bidder's board of directors, as applicable, does not have a compensation committee or a committee of the board of directors that performs functions similar to a compensation committee or if none of the members of the subject company's or bidder's compensation committee or committee that performs functions similar to a compensation committee is independent, a special committee of the board of directors formed to consider and approve the arrangement approves the arrangement; or

(iii) If the subject company or bidder, as applicable, is a foreign private issuer, any or all members of the board of directors or any committee of the board of directors authorized to approve employment compensation, severance or other employee benefit arrangements under the laws or regulations of the home country approves the arrangement.

Instructions to paragraph (d)(2): For purposes of determining whether the members of the committee approving an arrangement in accordance with the provisions of paragraph (d)(2) of this section are independent, the following provisions shall apply:

1. If the bidder or subject company, as applicable, is a listed issuer (as defined in § 240.10A–3 of this chapter) whose securities are listed either on a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or in an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o–3(a)) that has independence requirements for compensation committee members that have been approved by the Commission (as those requirements may be modified or supplemented), apply the bidder's or subject company's definition of independence that it uses for determining that the members of the compensation committee are independent in compliance with the listing standards applicable to compensation committee members of the listed issuer.

2. If the bidder or subject company, as applicable, is not a listed issuer (as defined in § 240.10A–3 of this chapter), apply the independence requirements for compensation committee members of a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or an inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o–3(a)) that have been approved by the Commission (as those requirements may be modified or supplemented). Whatever definition the bidder or subject company, as applicable, chooses, it must apply that definition consistently to all members of the committee approving the arrangement.

3. Notwithstanding Instructions 1 and 2 to paragraph (d)(2), if the bidder or subject company, as applicable, is a closed-end investment company registered under the Investment Company Act of 1940, a director is considered to be independent if the director is not, other than in his or her capacity as a member of the board of directors or any board committee, an ''interested person'' of the investment company, as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(19)).

4. If the bidder or the subject company, as applicable, is a foreign private issuer, apply either the independence standards set forth in Instructions 1 and 2 to paragraph (d)(2) or the independence requirements of the laws, regulations, codes or standards of the home country of the bidder or subject company, as applicable, for members of the board of directors or the

committee of the board of directors approving the arrangement.

5. A determination by the bidder's or the subject company's board of directors, as applicable, that the members of the board of directors or the committee of the board of directors, as applicable, approving an arrangement in accordance with the provisions of paragraph (d)(2) are independent in accordance with the provisions of this instruction to paragraph (d)(2) shall satisfy the independence requirements of paragraph (d)(2).

Instruction to paragraph (d): The fact that the provisions of paragraph (d) of this section extend only to employment compensation, severance and other employee benefit arrangements and not to other arrangements, such as commercial arrangements, does not raise any inference that a payment under any such other arrangement constitutes consideration paid for securities in a tender offer.

* * * * *

Dated: November 1, 2006.

By the Commission.

Nancy M. Morris,

Secretary.

[FR Doc. E6–18815 Filed 11–7–06; 8:45 am]

BILLING CODE 8011–01–P

DEPARTMENT OF THE TREASURY

Alcohol and Tobacco Tax and Trade Bureau

27 CFR Part 9

[T.D. TTB–54; Re: Notice No. 54]

RIN 1513–AA89

Establishment of the Tracy Hills Viticultural Area (2003R–508P)

AGENCY: Alcohol and Tobacco Tax and Trade Bureau, Treasury.

ACTION: Final rule; Treasury decision.

SUMMARY: This Treasury decision establishes the 39,200-acre Tracy Hills viticultural area in San Joaquin and Stanislaus Counties, California, approximately 55 miles east-southeast of San Francisco. We designate viticultural areas to allow vintners to better describe the origin of their wines and to allow consumers to better identify wines they may purchase.

DATES: *Effective Dates:* December 8, 2006.

FOR FURTHER INFORMATION CONTACT: N.A. Sutton, Regulations and Rulings Division, Alcohol and Tobacco Tax and Trade Bureau, 925 Lakeville St., No. 158, Petaluma, CA 94952; phone 415–271–1254.

SUPPLEMENTARY INFORMATION:

Background on Viticultural Areas

TTB Authority

Section 105(e) of the Federal Alcohol Administration Act (the FAA Act, 27 U.S.C. 201 *et seq.*) requires that alcohol beverage labels provide consumers with adequate information regarding product identity and prohibits the use of misleading information on those labels. The FAA Act also authorizes the Secretary of the Treasury to issue regulations to carry out its provisions. The Alcohol and Tobacco Tax and Trade Bureau (TTB) administers these regulations.

Part 4 of the TTB regulations (27 CFR part 4) allows the establishment of definitive viticultural areas and the use of their names as appellations of origin on wine labels and in wine advertisements. Part 9 of the TTB regulations (27 CFR part 9) contains the list of approved viticultural areas.

Definition

Section 4.25(e)(1)(i) of the TTB regulations (27 CFR 4.25(e)(1)(i)) defines a viticultural area for American wine as a delimited grape-growing region distinguishable by geographical features, the boundaries of which have been recognized and defined in part 9 of the regulations. These designations allow vintners and consumers to attribute a given quality, reputation, or other characteristic of a wine made from grapes grown in an area to its geographical origin. The establishment of viticultural areas allows vintners to describe more accurately the origin of their wines to consumers and helps consumers to identify wines they may purchase. Establishment of a viticultural area is neither an approval nor an endorsement by TTB of the wine produced in that area.

Requirements

Section 4.25(e)(2) of the TTB regulations outlines the procedure for proposing an American viticultural area and provides that any interested party may petition TTB to establish a grape-growing region as a viticultural area. Section 9.3(b) of the TTB regulations requires the petition to include—

- Evidence that the proposed viticultural area is locally and/or nationally known by the name specified in the petition;
- Historical or current evidence that supports setting the boundary of the proposed viticultural area as the petition specifies;
- Evidence relating to the geographical features, such as climate, soils, elevation, and physical features, that distinguish the proposed viticultural area from surrounding areas;
- A description of the specific boundary of the proposed viticultural area, based on features found on United States Geological Survey (USGS) maps; and
- A copy of the appropriate USGS map(s) with the proposed viticultural area's boundary prominently marked.

Tracy Hills Petition and Rulemaking

General Background

TTB received a petition from Sara Schorske of Compliance Service of America, Inc., filed on behalf of the Brown family, owners of a vineyard near Tracy, California. The petition proposed the establishment of the 39,200-acre ''Tracy Hills'' viticultural area south and southwest of the city of Tracy, California, in southern San Joaquin and northern Stanislaus Counties. Located approximately 55 miles east-southeast of San Francisco, the proposed Tracy Hills viticultural area currently encompasses 1,005 acres of vineyards. The proposed area is not within, nor does it include, any other proposed or established viticultural area.

Originally, the petitioner submitted the name ''Mt. Oso'' for this proposed viticultural area. However, after an initial review of the petition, TTB concluded and advised the petitioner that the submitted evidence did not demonstrate, as required by § 9.3(b)(1) of the TTB regulations, that the proposed viticultural area is locally or nationally known as Mt. Oso. In response, the petitioner amended the petition to propose use of the name ''Tracy Hills'' for the proposed viticultural area. The petitioner also revised the proposed viticultural area's western boundary and submitted additional evidence to support the amended petition. We summarize below the information submitted in support of the petition.

Name Evidence

The petitioner states that the name ''Tracy,'' which is used to identify the city of Tracy, California, and its surrounding agricultural land, together with the geographical modifier ''Hills,'' accurately describes and identifies the proposed Tracy Hills viticultural area. Stating that the name ''Tracy Hills'' is ''locally and nationally associated with the proposed area,'' the petition discusses the rationale for the Tracy Hills name and offers examples of its