

## SEC Proposes Amendments to Cross-Border Tender Offer, Exchange Offer and Business Combination Rules

*June 23, 2008*

In its release of May 6, 2008 (the "Release"),<sup>1</sup> the U.S. Securities and Exchange Commission (the "SEC") proposed amendments to the rules relating to cross-border tender offers, exchange offers and business combinations and provided interpretive guidance with respect to certain existing rules. This memorandum summarizes the key proposals and interpretive guidance in the Release.

### **BACKGROUND OF THE RELEASE**

In 1999, the SEC adopted a series of exemptions from the substantive and procedural requirements applicable to U.S. tender offers, exchange offers and business combinations to encourage the participation of U.S. investors in cross-border transactions involving securities of foreign private issuers.<sup>2</sup> These rules established a two-tier system of exemptions based on the amount of target securities of the foreign private issuer held by U.S. investors: Where no more than 10% of the subject securities of a foreign private issuer are held by U.S. investors (Tier I), a cross-border transaction is exempt from most U.S. tender offer rules under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and from the registration requirements of Section 5 of the Securities Act of 1933, as amended (the "Securities Act"). Where U.S. investors hold more than 10% but less than 40% of the target's securities (Tier II), the cross-border exemptions provide a more limited relief from some U.S. tender offers rules to avoid conflicts between the U.S. regulatory system and foreign laws.

The proposed revisions are intended to address certain recurring areas of conflict between the U.S. rules and foreign regulations and practice that the SEC has identified since the adoption of the cross-border rules in 1999. With the Release, the SEC clarifies the existing exemptions and provides bidders with more certainty and flexibility in structuring transactions involving non-U.S. target companies. The SEC appears to be inclined to maintain the basic framework of the existing rules, although it has invited comment on limited elements of that framework.

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<sup>1</sup> "Revisions to the Cross-Border Tender Offer, Exchange Offer, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions," Release No. 33-8917 (34-57781) (May 6, 2008).

<sup>2</sup> "Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings," Release No. 33-7759 (34-42054) (October 22, 1999) ("Cross Border Adopting Release"). The Cross Border Adopting Release became effective in January 2000.

## PROPOSED AMENDMENTS OF EXISTING RULES

### Eligibility Standards

The proposed revisions would refine the test for calculating the U.S. beneficial ownership levels of the target for the purpose of determining eligibility to rely on either the Tier I or Tier II exemptions. The existing rules measuring the level of U.S. ownership distinguish between negotiated and non-negotiated (hostile) transactions.

#### *Negotiated Transactions*

In negotiated transactions, in order to determine eligibility to rely on a cross-border exemption, an acquiror must generally calculate the U.S. ownership percentage by reference to the target company's "free float." In its calculation, an acquiror must exclude securities held by persons who hold more than 10% of the target's securities or that are held by the acquiror itself. Importantly, the existing rules require the acquiror to "look through" securities held of record by brokers or other nominees in the United States or the issuer's home jurisdiction to identify those held for the accounts of U.S. persons.<sup>3</sup> The relevant date for determining the level of U.S. ownership is the record date, in the case of a rights offering, or the 30th day before commencement of the offer, in the case of a tender offer, exchange offer or other business combination.

Under the proposed rules, acquirors would be allowed to calculate the level of U.S. beneficial ownership as of any date within 60 days before the public announcement of the transaction.<sup>4</sup> The proposed amendments would provide acquirors with greater flexibility by focusing on a range of dates rather than a specific date. Keying the calculation to the date of announcement rather than commencement would also cause U.S. ownership to be determined before the shareholder base is influenced by the announcement.

The SEC has requested comment on a number of other matters relating to this calculation method, including the issues highlighted below under "Alternative Eligibility Standards."

#### *Non-Negotiated Transactions*

Given the difficulty of measuring the level of U.S. ownership of the target's securities without the target's cooperation in the context of a non-negotiated transaction, the level of U.S. ownership of the target's securities is currently presumed to be less than the applicable threshold percentage unless (1) the aggregate trading volume of the subject class of securities in the United States over a 12-

<sup>3</sup> See Instruction 2 to Rule 14d-1(c) and 14d-1(d), Instruction 2 to Rule 13e-4(h)(8) and 13e-4(i) under the Exchange Act and Rule 800(h)(3) under the Securities Act.

<sup>4</sup> The SEC has not proposed to change the relevant date for the calculation of U.S. ownership in connection with rights offerings.

month period ending 30 days before the commencement of the offer exceeds 10% (or 40%, in the case of the Tier II exemption) of the worldwide aggregate trading volume of the same class of securities over the same period, (2) the target's most recent annual report filed with its home country regulators or the SEC indicates a U.S. ownership level in excess of the applicable threshold percentage or (3) the bidder "knows or has reason to know" that the level of U.S. ownership exceeds the applicable threshold percentage level.<sup>5</sup>

The proposed amendments would clarify the "reason to know" element: All information that is publicly available would be imputed to the bidder. Publicly available information would include information appearing in reports compiled by independent service providers that are generally available to the public or information about beneficial ownership reflected in filings made by third parties with the SEC, such as reports filed on Schedules 13D, 13F or 13G, or similar reports filed by third parties in the target's home country. The SEC also emphasizes that neither the current rules nor the proposed changes require an acquiror to engage an independent service provider at its own expense to research the target's U.S. ownership levels.

Consistent with the proposed amendments for negotiated transactions, the applicable 12-month period for measurement of the aggregate trading volume would end no later than 60 days before the public announcement of the transaction. The proposed changes would also provide that the bidder's actual or imputed knowledge refers to knowledge as of the date of the public announcement of the transaction. A bidder would therefore be allowed to ignore conflicting information that it receives after the date of the announcement.

#### *Alternative Eligibility Standards*

In connection with the proposed rules regarding the determination of the target's U.S. ownership, the SEC has requested comment on, among other issues, whether:

- the requirement to exclude persons holding more than 10% and securities held by the acquiror should be eliminated;
- the applicable threshold percentage of U.S. beneficial ownership for Tier I-eligible transactions should be increased;
- for negotiated transactions, the eligibility standard should be based on the average daily trading volume ("ADTV") over a 12-month period in the United States as compared to the worldwide ADTV over the same period; and whether

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<sup>5</sup> See Instruction 3 to Rules 14d-1(c) and 14d-1(d) under the Exchange Act and Rule 802(c) under the Securities Act.

- the eligibility test should be based on the percentage of target securities held in the form of American Depositary Receipts.

Although it has requested comment on an ADTV test, the SEC expressed concern, based on SEC staff research, that a low ADTV in the United States may not correlate with a low percentage of U.S. ownership and may not provide necessary protection to U.S. holders.

*Proposed Form Amendments*

The SEC proposed a number of amendments to SEC forms. Most significantly, the SEC requested comment on whether an additional box should be added to Schedule TO, Forms S-4, F-4 and Form CB to specify the level of U.S. ownership interest in the foreign private issuer, noting that requiring the filing person to disclose the U.S. beneficial ownership level would help it to monitor the application and effectiveness of the cross-border exemptions.

**Expansion of Cross-Border Exemptions**

*Suspension of "Back-End" Withdrawal Rights While Counting Tendered Securities*

Under the U.S. tender offer rules, tendering security holders may withdraw their securities at any point during the initial offering period<sup>6</sup> and after 60 days following the commencement of the offer until the bidder has accepted and paid for the tendered securities (so-called "back-end" withdrawal rights).<sup>7</sup> Currently, bidders may suspend back-end withdrawal rights in Tier II-eligible third-party tender offers, but only if a subsequent offering period is provided immediately after the announcement of the results of the initial offering period.<sup>8</sup>

The proposed amendments would codify the position that the SEC has previously adopted in connection with Tier II cross-border transactions and would permit suspension of back-end withdrawal rights while tendered securities are being counted, even where no subsequent offering period is provided, if the following conditions are satisfied:

- the bidder has provided an offer period, including withdrawal rights, of at least 20 U.S. business days;
- at the time withdrawal rights are suspended, all offer conditions have been satisfied or waived, except to the extent that the bidder is in the process of determining whether a

<sup>6</sup> See Rules 14d-7(a)(1) and 13e-4(f)(2)(i) under the Exchange Act.

<sup>7</sup> See Section 14(d)(5) of the Exchange Act. For issuer tender offers, Rule 13-4(f)(2)(ii) under the Exchange Act provides for a 40-business-day period.

<sup>8</sup> See Rule 14d-1(d)(2)(v) under the Exchange Act.

minimum acceptance condition included in the terms of the offer has been satisfied by counting tendered securities; and

- withdrawal rights are suspended only during the counting process and are reinstated immediately thereafter, except to the extent that they are terminated through the acceptance of tendered securities.

*Expanding Exemptions during the Subsequent Offering Period*

The SEC also proposes to expand and refine the Tier II exemptions from the rules applicable to subsequent offering periods in tender offers that are subject to Section 14(d) of the Exchange Act. The proposed rules would:

- allow a bidder to include a subsequent offering period in excess of 20 U.S. business days;
- allow a bidder to accept and pay for securities tendered during the subsequent offering period on a “modified rolling basis” by bundling and paying for them within 14 business days after they are tendered;
- remove certain constraints on so-called “mix-and-match” offer structures (in which tendering securityholders can elect different mixes of cash and securities to the extent other holders make offsetting elections, typically up to a ceiling on each form of consideration) by allowing a bidder to include a ceiling on the form of consideration and separate offset and proration pools for the initial offering period and subsequent offering period; and
- permit the payment of interest on securities tendered during a subsequent offering where required under applicable foreign law.

*Codification of Existing Exemptive Orders with respect to the Application of Rule 14e-5*

Under existing rules, Tier I-eligible offers that meet minimum conditions are exempt from Exchange Act Rule 14e-5, which generally prohibits the offeror, its advisors and any of their affiliates from purchasing or arranging to purchase any subject securities of the target or other related target securities outside the tender offer.

The proposed amendments would, if adopted, codify and refine exemptive relief for Tier II-eligible tender offers that the SEC has granted in the past:

- Proposed Rule 14e-5(b)(11) would permit purchases pursuant to a Tier II-eligible non-U.S. tender offer that is made concurrently with the U.S. tender offer pursuant to Exchange Act Rule 14d-1(d)(2)(ii) if, among other conditions, the intention of the offeror to make purchases pursuant to the foreign tender offer is disclosed in the U.S. offering documents. This exception would be limited to purchases pursuant to foreign tender offers and would not

apply to open market purchases, private transactions or other transactions outside the tender offer.

- Proposed Rule 14e-5(b)(12) would permit purchases outside a Tier II-eligible tender offer, including open market and private purchases, by the offeror and its affiliates and an affiliate of a financial advisor so long as, among other things, these activities are permissible under the laws of the target's foreign home jurisdiction, such purchases are not made in the United States and the U.S. offering materials prominently disclose the possibility of such purchases. If any such purchase is made by the offeror and its affiliates, the tender offer price must be increased to match any consideration paid outside the tender offer that is greater than the tender offer price. If any such purchase is made by an affiliate of a financial advisor, then, among other things, the purchase may not be made to facilitate the offer, and the affiliate's officers and employees generally may not overlap with those of the financial advisor who are providing financial advisory or dealer manager services to the offeror.

*Other Proposed Amendments*

In addition, the SEC has proposed the following changes:

- The proposed rules would exempt any Tier I-eligible transaction from the heightened disclosure requirements for "going private" transactions of Exchange Act Rule 13e-3 rather than only specified types of transactions under the current rule.
- Consistent with the SEC's current position, Tier II exemptions would be available for tender offers that are not subject to Regulation 14D or Rule 13e-4 under the Exchange Act, such as offers for unregistered equity securities and debt tender offers.
- Bidders would be allowed to conduct multiple non-U.S. offers in conjunction with a U.S. offer, and the proposed rules would allow the U.S. offer to include all holders of American Depositary Receipts and the foreign offer(s) to include U.S. persons where foreign laws expressly preclude the exclusion of U.S. holders and where the offer materials adequately disclose the risks of participating in the foreign offer(s).
- Bidders in Tier II-eligible offers would be allowed, subject to providing withdrawal rights and certain other conditions, to commence exchange offers that are not subject to Regulation 14D or Rule 13e-4 under the Exchange Act, such as offers for unregistered equity securities or debt securities, on the date of filing of the registration statement rather than on the date the registration statement becomes effective. The SEC also requested comment on whether early commencement should be allowed for all exchange offers, including those for unregistered equity securities of domestic target companies or for debt securities.

### **Beneficial Ownership Reporting by Foreign Institutions**

Subject to exceptions, any person who acquires more than 5% of a class of equity securities registered under Section 12 of the Exchange Act must report the acquisition on Schedule 13D within 10 days. One of the exceptions permits certain investors who acquired the securities in the ordinary course of their business and not with the purpose of influencing control of the issuer to file a short-form statement on Schedule 13G within 45 days after the end of the calendar year if they are an institution of the type listed in Rule 13d-1(b)(1)(ii).<sup>9</sup>

Currently, foreign institutional investors generally do not qualify under Rule 13d-1(b)(1)(ii) and may only be able to rely on another exception in Rule 13d-1(c), which permits passive investors holding less than 20% of the class of securities to file a Schedule 13G within 10 days after the acquisition, so long as they have no disqualifying purpose.

The SEC proposes to amend Rule 13d-1(b)(1)(ii) to include non-U.S. institutions that are functionally equivalent to the U.S. institutions listed under the existing rule, but only if the non-U.S. institution is, and can certify that it is, "subject to a regulatory scheme that is comparable to the regulatory scheme applicable to the equivalent U.S. institution."<sup>10</sup> In addition, the proposed changes to Schedule 13G would require a non-U.S. institution to undertake to furnish to the SEC, upon request, the information it otherwise would be required to report on Schedule 13D, the most significant of which is the statement of its investment purpose.

### **INTERPRETIVE GUIDANCE FOR EXISTING RULES**

#### **Termination of Withdrawal Rights after Reduction or Waiver of a Minimum Acceptance Condition**

U.S. tender offer rules generally provide that a bidder must allow an offer to remain open for a specified period of time after the target security holders have been informed of a material change of the terms of the offer and must provide withdrawal rights during such period. In adopting the original cross-border exemptions, the SEC articulated an interpretive position that a bidder whose offer meets the conditions of the Tier II exemptions may, subject to a number of specified conditions,

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<sup>9</sup> These institutions include, among others: (1) brokers or dealers registered under Section 15(a) of the Exchange Act, (2) banks and insurance companies as defined in Section 3(a) of the Exchange Act, (3) investment companies and investment advisors registered under the Investment Company Act of 1940 or the Investment Advisors Act of 1940, respectively, (4) employee benefit plans or pension funds subject to the Employee Retirement Income Security Act of 1974, and related holding companies and groups.

<sup>10</sup> See Release, Section IX.

waive or reduce the minimum acceptance condition without providing withdrawal rights during the remaining offering period.<sup>11</sup>

The SEC has now further limited its interpretive position. The relief from the extension requirements may not be relied upon unless (1) the bidder undertakes not to waive or reduce the minimum acceptance condition below a majority<sup>12</sup> and (2) there is a requirement of law or practice in the foreign home country justifying a bidder's inability to extend the offer after a waiver or reduction in the minimum offer condition. Furthermore, the interpretive guidance does not apply to mandatory extensions for changes related to the offer consideration, the amount of target securities sought in the offer or a change to the dealer's soliciting fee. Finally, a bidder who seeks to rely on this exemption must fully disclose and discuss all of the implications of the potential waiver or reduction in its offering materials.<sup>13</sup>

#### **Application of "All-Holders" Provisions of the Tender Offer Rules to Foreign Target Securities Holders**

Exchange Act Rules 14d-10 and 13e-4(f) require that tender offers subject to Sections 14(d) or 13(e) of the Exchange Act be open to all holders of the subject class of securities.

In the Release, the SEC re-affirmed its position that the so-called "all-holders" provisions in Exchange Act Rules 14d-10 and 13e-4(f) apply equally to U.S. as well as non-U.S. holders of the subject class of securities and do not allow the exclusion of any foreign holders of the target's securities. In recognition of the potential burden for bidders and issuers to comply with U.S. and foreign rules, the SEC is soliciting comments on whether the "all-holders" provisions should be amended to allow certain target security holders to be excluded from the offer. The SEC has also clarified that the "all-holders" provisions do not require that offering materials be mailed into foreign jurisdictions.

The SEC has noted that certain bidders have required target security holders to certify that tendering their securities complies with local laws or that an exemption applies that allows such tenders

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<sup>11</sup> See Cross-Border Adopting Release, Section II.B.

<sup>12</sup> By a majority, the SEC means more than 50% of the outstanding target securities that are the subject of the tender offer.

<sup>13</sup> In the Release, the SEC has also requested comment on whether and under what circumstances a bidder should be allowed to effect an early termination of the initial offering period or of a voluntary extension of the initial offering period. After considering the responses to its comment request, the SEC will consider whether to codify the conditions under which early termination should be permitted. See Release, Section II.C.6.



without further action by the bidder to register or qualify its offer.<sup>14</sup> The SEC believes it is inappropriate for bidders to shift the burden of assuring compliance with the relevant jurisdiction's laws to target security holders because target security holders may not be in possession of the relevant facts regarding the bidder's action and the provisions of local law in their home jurisdiction necessary to make this determination.

#### **Ability of Bidders to Exclude U.S. Target Security Holders**

In the Release, the SEC has also provided additional guidance on whether and how bidders in cross-border business combinations may avoid the application of U.S. tender offer rules. The application of U.S. tender offer rules depends on whether the bidder uses U.S. jurisdictional means in making the tender offer.

In addition to the interpretive guidance in previous releases,<sup>15</sup> the SEC now reiterates that a legend or disclaimer that the offer is not being made into the United States, or that the offer materials may not be distributed in the United States, is not likely to be sufficient in itself. The Release states that a bidder who wants to support a claim that the offer has no jurisdictional connection to the United States will need to take special precautions to prevent sales or tenders from U.S. holders of target securities, as described in the SEC's previous guidance.

The SEC recognizes that, where bidders require a representation or certification from tendering holders that they are not U.S. holders, target security holders may misrepresent their status to participate in the offer. In such cases, bidders will not be viewed as having targeted U.S. investors in the offer thereby triggering the application of U.S. tender offer rules, but only if and to the extent (1) the bidder has taken adequate measures reasonably designed to prevent purchases from and sales to U.S. holders and (2) there are no indicia that would put the bidder on notice that the tendering holder is a U.S. investor.

The SEC indicated that in the future it will more closely monitor offers that purport to exclude U.S. holders of target securities to determine if actions are necessary to protect U.S. investors.

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<sup>14</sup> The SEC specifically references Rule 14d-10(b)(2) pursuant to which a bidder is not prohibited from making a tender offer excluding all security holders in a state where the bidder is prohibited from making the tender offer by administrative or judicial action pursuant to a state statute after a good faith effort by the bidder to comply with such statute.

<sup>15</sup> See "Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Securities Offshore," Release No. 33-7516 (March 23, 1998) and the Cross-Border Adopting Release, Section II.G.

### **Ability of Bidders to Use the Vendor Placement Procedure for Cross-Border Exchange Offers**

If a bidder intends to make an exchange offer in the United States where the consideration includes securities of the bidder, it must consider two issues: First, the issuance of the bidder securities may be subject to the registration requirements under the Securities Act and, second, if the exchange offer is subject to Section 14(d) of the Exchange Act, the “all-holders” and “best price” requirements of Exchange Act Rule 14d-10 will apply.

Tier I-eligible offers may be exempt from the registration requirements of the Securities Act pursuant to Securities Act Rule 802. In addition, in connection with Tier I-eligible exchange offers, bidders are permitted to offer cash to U.S. holders in lieu of offering securities, so long as the bidder has a reasonable basis for believing that the amount of cash is substantially equivalent to the value of the consideration offered to non-U.S. holders.<sup>16</sup>

In offers that are not eligible for the Tier I exemption, bidders seeking to obviate the need for registration under the Securities Act often establish so-called “vendor placement arrangements” for the benefit of U.S. holders who tender into the offer. In a vendor placement, the bidder generally employs a third party to sell the securities to which tendering U.S. holders would otherwise be entitled. The bidder securities are typically sold outside the United States, and the bidder (or the third party) then remits the proceeds of the offshore transactions to tendering U.S. holders. Vendor placement arrangements are used to convert an exchange offer involving the offer of the bidder’s securities into a cash offer.

The SEC has previously permitted the use of vendor placement arrangements on a case-by-case basis without registration under the Securities Act by analyzing a number of factors. In the Release, the SEC noted that a vendor placement arrangement in cross-border exchange offers is generally subject to the Securities Act registration requirements unless (1) the market for the bidder securities to be issued in the exchange offer and sold pursuant to the vendor placement procedure is highly liquid and robust and (2) the number of bidder securities to be issued in the exchange offer for the benefit of tendering U.S. holders is relatively small compared to the total number of bidder securities outstanding.

In addition, the SEC will also consider the following factors:

- the timeliness of the vendor placement process, i.e., whether sales of bidder securities through the vendor placement process are effected within a few business days of the closing of the offer;
- whether the bidder announces material information, such as earnings results, forecasts or other financial or operating information, before that process is complete; and

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<sup>16</sup> See Rule 14d-1(c)(2)(iii) under the Exchange Act.

- whether the vendor placement involves special selling efforts by brokers or others acting on behalf of the bidder.

If the exchange offer is subject to the tender offer rules of Regulation 14D under the Exchange Act, the “all-holders” and “best price” requirements in Exchange Act Rule 14d-10 generally do not permit the use of vendor placement arrangements because U.S. holders would receive different consideration (cash) than non-U.S. holders (bidder securities). The SEC indicates that for exchange offers that are not Tier I-eligible, bidders must seek specific relief from those rules if they wish to use a vendor placement structure.

In addition, bidders may not structure an exchange offer that is subject to Section 14(d) of the Exchange Act as a private offering in the United States and include only those U.S. holders for whom an exemption from Section 5 of the Securities Act is available to avoid the registration requirements of the Securities Act. The equal treatment provisions and the “all holders” rules prohibit a bidder from offering cash under a vendor placement arrangement to some U.S. holders and bidder securities to others (such as institutions).

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all our partners, as well as memoranda regarding recent corporate reporting and governance developments can be obtained from our website, [www.simpsonthacher.com](http://www.simpsonthacher.com).