Corporate Department

Attorney Advertising

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SEC Proposes to Revise Cross-Border Business Combination Rules

I. Introduction

The SEC recently proposed revisions to its rules for cross-border business combinations. These revisions are intended to address practical difficulties encountered since the cross-border rules were adopted in 1999, in an effort to enhance their usefulness.

Currently, the cross-border rules cover statutory mergers, amalgamations, tender offers and exchange offers where a target company is a foreign private issuer.[1] The cross-border exemptions are structured as a two-tier system based on the level of U.S. interest in a transaction, which is measured by the percentage of a foreign target's securities held by U.S. investors. Where 10% or less of the securities of a foreign private issuer that is the target are held by U.S. investors, a qualifying cross-border transaction will be exempt from most U.S. tender offer rules and from the registration requirements of Section 5 of the Securities Act of 1933. These are the Tier I Rules and Rules 801 and 802. Where more than 10% but no more than 40% of the securities of a foreign private issuer that is the target are held by U.S. investors, the cross-border exemptions provide narrow relief from certain U.S. tender offer rules. These are the Tier II Rules and cover accommodations such as those for prompt payment, extension and notice of extension requirements in Regulation 14E. The Tier II exemptions do not provide relief from the registration requirements of Securities Act Section 5, nor do they include an exemption from the additional disclosure requirements for going private transactions.

II. Summary

The proposed rule changes include:

1. Refining the tests for calculating U.S. ownership of the target company to determine eligibility to rely on the cross-border exemptions in both negotiated and hostile transactions. These refinements include changes to:

    a. use the date of public announcement of the business combination as the reference point for calculating U.S. ownership;

[1] A foreign private issuer is a non-U.S. company that either (a) has 50% or less of its outstanding voting securities held of record by U.S. residents, or (b) has more than 50% of its outstanding voting securities held by U.S. residents and does not have (i) a majority of its officers or directors who are U.S. citizens or residents, or (ii) more than 50% of its assets located in the United States or (iii) its business principally administered in the United States.

   b. permit the offeror to calculate U.S. ownership as of a date within a 60-day range before announcement; and

   c. specify when the offeror has reason to know information about U.S. ownership that may affect its ability to rely on the presumption of eligibility in hostile tender offers.

2. Expanding the relief under Tier I for affiliated transactions subject to Rule 13e-3 (the going private rule) for transaction structures not covered under the current cross-border exemptions, such as schemes of arrangement, cash mergers, or compulsory acquisitions for cash.

3. Extending the specific relief under Tier II to tender offers not subject to Sections 13(e) or 14(d) of the Exchange Act (i.e., for targets that are not filing periodic reports with the SEC under the Securities Exchange Act).

4. Expanding the relief under Tier II to eliminate recurring conflicts between U.S. and foreign law and practice, including:

   a. allowing more than one offer to be made outside the United States in conjunction with a U.S. offer;

   b. permitting bidders to include foreign security holders in the U.S. offer and U.S. holders in the foreign offers;

   c. allowing bidders to suspend back-end withdrawal rights while tendered securities are counted;

   d. allowing subsequent offering periods to extend beyond 20 U.S. business days;

   e. allowing securities tendered during the subsequent offering period to be purchased within 14 business days from the date of tender;

   f. allowing bidders to pay interest on securities tendered during a subsequent offering period; and

   g. allowing separate offset and proration pools for securities tendered during the initial and subsequent offering periods.

5. Codifying existing exemptive orders for the application of Rule 14e-5 for Tier II tender offers.

6. Expanding the availability of early commencement to offers not subject to Section 13(e) or 14(d) of the Exchange Act (i.e., for targets that are not filing periodic reports with the SEC under the Securities Exchange Act).

7. Requiring that all Form CBs and accompanying Form F-Xs be filed electronically.

8. Modifying the cover pages of certain tender offer schedules and registration statements to list the cross-border exemptions being relied upon.

9. Permitting foreign institutions to report on Schedule 13G to the same extent as U.S. institutions, without

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obtaining individual no-action relief.

Additionally, the SEC provided guidance or solicited comments on the following issues:

1. The ability of bidders to terminate an initial offering period or any voluntary extension of that period before a scheduled expiration date.
2. The ability of bidders in tender offers to waive or reduce the minimum tender condition without providing withdrawal rights.
3. The application of the all-holders provisions of the tender offer rules to foreign target security holders.
4. The ability of bidders to exclude U.S. target security holders in cross-border tender offers.
5. The ability of bidders to use the vendor placement procedure for exchange offers subject to Section 13(e) or 14(d) of the Exchange Act.

III. Eligibility Threshold - Calculating U.S. Ownership

A. *Negotiated Transactions*

Currently, eligibility to rely on the cross-border exemptions is determined by the percentage (10% or 40%) of the non-affiliated float of the relevant class of target securities held by U.S. beneficial owners as of the 30th day before commencement of a tender offer or exchange offer. Securities held by holders of more than 10% of the subject class and any securities held by the acquiror in the business combination transaction, are excluded from the calculation of U.S. ownership. Additionally, the acquiror in a negotiated transaction must "look through" securities held of record by bankers, brokers and other nominees in specified jurisdictions to
53 identify those held for the accounts of persons located in the United States. If the acquiror is unable after "reasonable inquiry" to obtain information about the location of the security holders for whom a nominee holds, it may assume that the customers are residents of the jurisdiction in which the nominee has its principal place of business.

The SEC proposed that acquirors be permitted to calculate U.S. ownership in the target company as of any date within a 60-day period before the public announcement (instead of commencement) of the cross-border tender offer or business combination transaction.

Note that issuers will continue to calculate U.S. ownership as of the record date for a rights offering.

B. *Hostile Transactions*

The cross-border exemptions include a presumption for non-negotiated (i.e., "hostile") transactions. Under the "hostile" presumption, a third-party bidder in a non-negotiated tender or exchange offer may assume that U.S. ownership in the target company is no more than 10% or 40%, so long as average daily trading volume in the United States does not exceed 10% or 40% of the average daily trading volume worldwide over a

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twelve-month period ending 30 days before commencement, and the bidder has no reason to know that actual U.S. ownership is inconsistent with that figure (either based on the issuer's informational filings with the SEC or foreign regulators or based on the bidder's actual or imputed knowledge from other sources).

The SEC proposed changes to the hostile presumption for determining eligibility to rely on the cross-border exemptions. First, it proposed to clarify the "reason to know" element of that test by specifying that an acquiror has reason to know information that is publicly available. This includes information appearing in beneficial ownership reports filed by third parties and reports compiled by independent information service providers that generally are available to the public. An acquiror seeking to rely on the hostile presumption would not be required to engage a third-party service at its own expense. Additionally, acquirors may not ignore credible information about target securities held by U.S. persons from non-public sources, e.g., investment bankers or other market participants.

The acquiror's knowledge or "reason to know" refers to knowledge as of the date of announcement, which allows an acquiror to ignore conflicting information received after announcement.

The SEC also proposed to specify that for the average daily trading volume calculation under the "hostile presumption," the calculation should be made over a twelve-calendar month period ending no later than 60 days before announcement.

The SEC solicited comments on raising the threshold for the Tier I exemption to 15% and changing the current requirement to exclude 10% target shareholders.

IV. Proposed Changes to the Tier I Exemption: Expanded Exemption From Rule 13e-3

Rule 13e-3 (the "going private rule") establishes specific filing and disclosure requirements for certain kinds of affiliated transactions that have a "going private" effect.

The current Tier I exemption from Rule 13e-3 does not apply to some common transaction structures such as schemes of arrangement, cash mergers, compulsory acquisitions for cash, and other types of transactions. The proposed rule would cover these common transaction structures (i.e. it would cover any kind of transaction that would otherwise meet the conditions for Tier I or Rule 802).

V. Proposed Changes to Tier II Exemptions

A. *Extend Tier II Relief Where Target Securities are not Subject to Rule 13e-4 or Regulation 14D*

The Tier II exemptions apply to transactions governed by Regulation 14D and Rule 13e-4 under the Exchange Act (i.e., where the target is a reporting company). The SEC proposed to clarify that the Tier II exemptions are available to tender offers not subject to Rule 13e-4 or Regulation 14D.

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B. *Expand Tier II Relief for Dual or Multiple Offers*

1. Bidder May Make More Than One Non-U.S. Offer

The Tier II cross-border exemptions currently permit a bidder conducting a tender offer to separate that offer into two separate offers - one U.S. and one foreign - for the same class of securities. The SEC proposed to permit a bidder to make more than one offer outside the United States in conjunction with a U.S. tender offer.

2. U.S. Offer May Include Non-U.S. Persons and Foreign Offers May Include U.S. Persons

The existing Tier II dual offer exemption provides that the U.S. offer can be open only to security holders resident in the United States. This limitation creates a problem because bidders frequently seek to include all holders of American Depositary Receipts (ADRs), not only U.S. holders, in the U.S. offer. The SEC proposed to change the rules so that bidders can make a U.S. offer to U.S. target holders and all holders of ADRs of the subject securities. The U.S. offer must be made on terms at least as favorable as those offered any other holder of the subject securities.

The SEC also proposed to allow U.S. holders to participate in non-U.S. offers where required under foreign law, i.e., where the laws of the jurisdiction governing such foreign offers expressly preclude the exclusion of U.S. persons from the foreign offer and where the offer materials distributed to U.S. persons fully and adequately disclose the risks of participating in the foreign offers.

3. Proration and the Use of Dual or Multiple Offers

When a bidder makes a partial tender offer subject to Section 13(e) or 14(d) of the Exchange Act, SEC rules currently require tendered securities to be purchased pro rata if the offer is oversubscribed. This is to assure equal treatment of security holders who have tendered their securities. The SEC has clarified that where a bidder makes a partial tender offer for less than all outstanding target securities of a given class, and relies on Tier II for the use of a dual or multiple (as proposed) offer structure, the securities tendered into the U.S. and non-U.S. offers must be pro rated on an aggregate basis using a single proration pool.

C. *Termination of Withdrawal Rights While Tendered Securities are Counted*

Currently, bidders must provide back-end withdrawal rights after a set date, measured from the commencement of a tender offer. Thus, even where a tender offer has technically closed and tenders are no longer being accepted, depending on the length of the tender offer period, back-end withdrawal rights may exist until the offeror accepts tendered shares for payment. The SEC proposed to permit the suspension of back-end withdrawal rights under the Tier II exemptions when tendered securities are being counted.

As proposed, both third-party bidders for securities of a foreign private issuer and foreign private issuers repurchasing their own securities would be permitted to suspend back-end withdrawal rights during the time after the initial offering period, when tendered securities are being counted and before they are accepted for

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payment, even where no subsequent offering period is provided. This relief is subject to the following conditions:

- the Tier II exemption is available;
- the offer includes an offering period, including withdrawal rights, of at least 20 U.S. business days;
- when withdrawal rights are suspended, all offer conditions have been satisfied or waived, except to the extent that the bidder is still counting tendered securities to determine if the minimum acceptance condition has been satisfied; and
- withdrawal rights are suspended only during the necessary centralization and counting process period and are reinstated immediately thereafter, except to the extent that they are terminated by the acceptance of tendered securities.

D. *Expanded Relief for Subsequent Offering Periods*

First, the SEC proposed allowing Tier II cross-border tender offers to include subsequent offering periods longer than 20 U.S. business days.

Second, the SEC proposed to allow bidders to purchase securities tendered during the subsequent offering period on a modified rolling basis under Tier II cross-border tender offers. Instead of requiring daily aggregation of securities tendered during the subsequent offering period, the proposed rule would permit tendered securities to be bundled and paid for within 14 business days from the date of tender.

Third, the SEC proposed to permit the payment of interest for securities tendered during a subsequent offering period in a Tier II cross-border tender offer where required under foreign law.

Last, the SEC proposed to permit cross-border tender offers under Tier II that include a mix and match election feature. In "mix and match" offers the target security holders are offered a set mix of cash and securities of the bidder with the option to elect a different proportion of cash and securities, to the extent that other tendering security holders make opposite elections. The SEC proposed to allow separate offset and proration pools for securities tendered during the initial and the subsequent offering periods. It also proposed to eliminate the prohibition on a "ceiling" for the form of consideration offered in the subsequent offering period, where target security holders are able to elect between two or more different forms of offer consideration.

VI. Additional Guidance for Terminating Withdrawal Rights After Reduction or Waiver of a Minimum Acceptance Condition

Generally, U.S. tender offer rules require that, for tender offers subject to Section 13(e) or 14(d) of the Exchange Act, the bidder must keep the offer open for a set period of time after providing notice of a material

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change, and the bidder must provide withdrawal rights during that period. A reduction or waiver of a minimum acceptance condition is considered a material change.

In adopting the cross-border exemptions, the SEC affirmed its interpretive position that a bidder meeting the conditions of the Tier II exemptions may waive or reduce the minimum acceptance condition without providing withdrawal rights during the time remaining in the tender offer after the waiver or reduction. In this release the SEC limited this interpretive position. The SEC stated this relief may not be relied upon unless the bidder is eligible to rely on the Tier II exemptions and the bidder undertakes not to waive or reduce the minimum acceptance condition below a majority of the outstanding target securities that are the subject of the tender offer. Additionally, this interpretive position is limited to circumstances where there exists a requirement of law or practice in the target's home country justifying a bidder's inability to extend the offer after a waiver or reduction in the minimum offer condition. Furthermore, it does not apply to mandatory extensions for changes related to the offer consideration, the amount of target securities sought in the offer, and a change to the dealer's soliciting fee.

Last, bidders seeking to rely on this guidance, as modified, must fully disclose and discuss all of the implications of the potential waiver or reduction, including at the specific levels contemplated, in its offering materials.

VII. Early Termination of an initial offering period or a voluntary extension of such period

A change in the expiration date of a tender offer (whether from the date set at the outset of the offer or through a voluntary extension)[2] constitutes a material change that requires the offer to remain open for the time periods established by SEC rules.

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[2] The SEC conditioned a bidder's ability to rely on this guidance on the following:

- The bidder must announce that it may reduce or waive the minimum condition at least five business days before it reduces or waives it;
- The bidder must disseminate this announcement through a press release and other methods reasonably designed to inform U.S. security holders, which may include placing an advertisement in a newspaper of national circulation in the United States;
- The press release must state the exact percentage to which the condition may be reduced. The bidder must announce its actual intentions once it is required to do so under the target's home country rules;
- During the five-day period after the announcement of a possible waiver or reduction, security holders who have tendered into the offer must be afforded the right to withdraw tendered securities;
- The announcement must advise security holders to withdraw their tendered securities immediately if their willingness to tender into the offer would be affected by the reduction or waiver of the minimum acceptance condition; The procedure for reducing or waiving the minimum acceptance condition must be described in the offering document; and
- The bidder must hold the offer open for acceptances for at least five business days after the reduction or waiver of the minimum acceptance condition.

When the bidder terminates withdrawal rights pursuant to this interpretive position, all offer conditions must be satisfied or waived so that the offer is wholly unconditional when withdrawal rights terminate. A bidder may not terminate withdrawal rights where an extension is otherwise required under SEC rules because of another material change in the terms of the offer.

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In some foreign jurisdictions, bidders may be required to terminate an offer and withdrawal rights immediately after all offer conditions are satisfied or the offer become wholly unconditional and accept tendered securities and begin the payment process, even if this occurs before the scheduled expiration date of the initial offering period or any voluntary extension of that period. These jurisdictions believe that once the offer is wholly unconditional and is, therefore, certain to be consummated, the initial offering period should close immediately and tendering security holders should receive the offer consideration as soon as possible. Security holders who did not tender before the end of the initial offering period can tender into the subsequent offering.

Bidders have been granted relief by the SEC to permit the early termination of the initial offering period (or any voluntary extension of that period).[3] Bidders in cross-border tender offers have been granted relief to terminate the initial offering period before its scheduled expiration, thereby terminating withdrawal rights, upon the satisfaction of all offer conditions. Also, some bidders have requested relief from the requirement to promptly publish, send or give to target security holders information concerning any material change in the terms of a tender offer. However, early termination of the initial offering period is not permitted, where U.S. rules require mandatory offer extensions for certain changes to the terms of an offer, including those for changes in the offer consideration, the dealer's soliciting fee, or the percentage of target securities for which the offer is made, or other material changes. Thus, bidders making any of these kinds of changes to the terms of a tender offer may not terminate an initial offering period (or any part of that period) before the scheduled expiration of the mandatory extension.

The SEC relief is contingent on several conditions similar to those established for bidders wishing to waive or reduce a minimum acceptance condition.[4] The SEC solicited comments to determine whether to revise its rules to codify the case-by-case relief granted in this area.

VIII. Codification of Rule 14E-5 Cross-Border Exemptions

Rule 14e-5 prohibits purchasing or arranging to purchase any subject securities or any related securities except as part of the tender offer, from the time of the public announcement of the offer until the offer expires. Rule 14e-5 prevents an offeror from extending greater or different consideration to some security holders by offering to purchase their shares outside the offer, while other security holders are limited to the

[3] A voluntary extension is an extension that is not required under U.S. tender offer rules.
[4] Bidders seeking to terminate the initial offering period before its scheduled expiration may do so only if, at the time the initial offering period expires and withdrawal rights terminate:

- The initial offering period has been open for at least 20 U.S. business days and all offer conditions have been satisfied;
- The bidder has adequately discussed the possibility of and the impact of the early termination in the original offer materials;
- The bidder provides a subsequent offering period after early termination of the initial offering period;
- All offer conditions have been satisfied when the initial offering period terminates; and
- The bidder does not terminate the initial offering period during any mandatory extension of the initial offering period required under U.S. tender offer rules.

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offer's terms. The Rule applies to "covered persons" who include the offeror and its affiliates, the offeror's dealer manager and its affiliates, any advisor to the offeror and its affiliates or the offeror's dealer-manager and its affiliates whose compensation is dependent on the completion of the offer, as well as any person acting in concert with the listed persons in connection with any purchase or arrangement to purchase any subject securities or any related securities.

The current rules permit purchases or arrangements to purchase made outside of Tier I tender offers, but do not cover Tier II offers.

The SEC has frequently granted relief for purchases or arrangements to purchase securities of foreign target in Tier II tender offers in three areas: (1) under the non-U.S. tender offer in a cross-border tender offer where there are separate U.S. and non-U.S. offers; (2) by offerors and their affiliates outside of a tender offer; and (3) by financial advisor's affiliates outside of a tender offer.

First, a Tier II tender offer for a foreign target company may be structured as two concurrent but separate tender offers: one made to U.S. security holders and another made to target security holders outside the U.S. If purchases under the foreign offer are made during the Rule 14e-5 prohibited period, those purchases would run afoul of the rule because they technically constitute purchases outside the U.S. tender offer.

The SEC proposed to permit purchases or arrangements to purchase under a foreign tender offer (or in more than one foreign offer) during the Rule 14e-5 prohibited period that are made concurrently with a U.S. offer. To qualify under the proposed rule: (1) the tender offer must qualify as a Tier II tender offer under Rule 14d-1(d) (i.e., the subject company must be a foreign private issuer); (2) U.S. security holders must be treated at least as favorably as non-U.S. tendering security holders; and (3) the offeror's intent to make purchases under a foreign offer must be disclosed in the U.S. offering documents. Any cash consideration paid to U.S. security holders may converted from the currency paid in the foreign offer to U.S. dollars at the exchange rate disclosed in the U.S. offering documents. The proposed rule is limited to purchases in foreign tender offers and does not apply to cover open market transactions, private transactions, or other transactions outside the tender offer.

Second, the SEC proposed to permit purchases or arrangements to purchase outside of a Tier II tender offer by (1) an offeror and its affiliates; and (2) an affiliate of a financial advisor if certain conditions are satisfied.[5]

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[5] The subject company must be a foreign private issuer, and the covered person must reasonably expect that the tender offer qualifies as Tier II. The proposal prohibits any purchases or arrangements to purchase in the U.S. except under the tender offer. The U.S. offering materials must prominently disclose the possibility of or the intention to make purchases or arrangements to purchase outside the tender offer, and the actual amount of U.S. purchases made outside the tender offer must be disclosed to the extent that such information is made public in the home jurisdiction. And, the tender offer price must be raised to equal any higher price paid outside the offer.

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Last, where an affiliate of a financial advisor purchases or arranges to purchase outside of a tender offer, the SEC proposed additional conditions.[6]

IX. Expanded Availability of Early Commencement for Exchange Offers

In 1999, the SEC adopted rules intended to minimize the regulatory disparity between cash tender offers and exchange offers so that they could compete on an equal footing. The SEC permitted exchange offers to commence upon the date of the filing of a registration statement under specified conditions. The SEC also undertook to expedite the review of exchange offers so that bidders could terminate the offer and purchase tendered shares once the registration statement had been declared effective by the SEC.

However, the early commencement option is not available for exchange offers that are not subject to Rule 13e-4 or Regulation 14D. The SEC has now proposed to permit early commencement for all cross-border exchange offers including those not subject to Rule 13e-4 or Regulation 14D under specified conditions. The proposed rules would permit early commencement for exchange offers for unregistered securities only where the bidder provides withdrawal rights in the offer to the same extent as would be required under Regulation 14D or Rule 13e-4. Additionally, the proposed rule would require the same minimum time periods after the occurrence of specified changes as are required for other "early commencement" offers.

X. Proposed Changes to Schedules and Forms

A. *Form CB*

The SEC proposed to require all Form CBs to be filed electronically via EDGAR. Similarly, the SEC proposed to require Form F-X to be filed electronically. Form F-X appoints an agent in the United States for service of process and must be filed by all foreign companies that furnish a Form CB to the SEC.

B. *Proposed Changes to Schedule TO, Form F-4 and Form S-4*

The SEC proposed to add a box on the cover page of the Schedule TO and Forms F-4 and S-4 that a filing person would be required to check to indicate which of the applicable cross-border exemptions it is relying on.

C. *Beneficial Ownership Reporting by Foreign Institutions*

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[6] The financial advisor and affiliate must maintain and enforce information barriers, (i.e., written policies and procedures designed to prevent the flow of information among the financial advisor and the affiliate that might result in a violation of the federal securities laws and regulations). Additionally, the affiliate must have no officers or employees (other than clerical, ministerial, or support personnel) in common with the financial advisor that directly effect or recommend transactions in the subject securities or related securities who also will be involved in providing the offeror or subject company with financial advisory services or dealer-manager services. Further, the financial advisor must have a broker-dealer affiliate registered with the SEC. As the exception is premised on the affiliate of the financial advisor carrying out its normal business activity when purchasing outside a tender offer, it would not permit purchases or arrangements to purchase to be made to facilitate the tender offer. Accordingly, purchasing activity effected in reliance on the proposed exception should be consistent with the affiliate's prior levels of activity. Risk arbitrage is excluded from the exception for the financial advisor's affiliate because it is so closely related to the tender offer that the incentive for abusive behavior is significant.

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Generally, the beneficial ownership reporting provisions require any person who acquires more than 5% of a class of equity securities registered under Section 12 of the Exchange Act to report the acquisition on Schedule 13D within ten days. Persons holding more than 5% of a class of such securities at the end of the calendar year, who are not required to report on Schedule 13D, must file a short-form Schedule 13G within 45 days after December 31. These Schedule 13G filers include broker-dealers, investment advisers and investment companies registered with the SEC; banks and insurance companies regulated in the United States; employee benefit plans or pension funds subject to ERISA; and related holding companies and groups. This list of institutional investors does not include non-U.S. institutions.

The SEC proposed to permit foreign institutions that are substantially comparable to the U.S. institutions listed in the current rule to be eligible to file on Schedule 13G. To do so, the foreign institutions would be required: to determine, and certify on Schedule 13G, that they are subject to a regulatory scheme comparable to the regulatory scheme applicable to their U.S. counterparts; to undertake in their certification on Schedule 13G to furnish to the SEC, upon request, the information they otherwise would be required to provide in a Schedule 13D; and to certify that they acquired and held the relevant equity securities in the ordinary course of business and not with the purpose or effect of influencing or changing control of the issuer.

XI. Interpretive Guidance

A. *Application of the All-Holders Rule to Foreign Target Security Holders*

Rule 14d-10 and Rule 13e-4(f) require all target security holders in a tender offer subject to either of those rules be included in the tender offer and treated equally. These rules require that third-party tender offers subject to Section 14(d) of the Exchange Act, as well as issuer tender offers subject to Section 13(e) of the Exchange Act, be open to all holders of the subject class of securities, U.S. as well as non-U.S. target holders.

The SEC reiterated its position that the all-holders requirement does not allow the exclusion of any foreign or U.S. target holder in tender offers subject to U.S. rules. However, the SEC recognized that the requirement to make an offer available to all foreign target holders, particularly for registered exchange offers, may present a burden for bidders that may need to comply with both foreign and U.S. rules. Consequently the SEC solicited comment on whether any amendments to the U.S. equal treatment provisions are necessary or advisable to allow certain target security holders to be excluded from the offer.

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

Bidders in cross-border business combination transactions frequently seek to avoid the application of U.S. registration and tender offer rules. The SEC's view is that offer structures that exclude U.S. security holders from offers for foreign targets, are inappropriate for U.S. bidders.

Whether U.S tender offer rules apply in the context of a cross-border tender offer depends on whether the bidder triggers U.S. jurisdictional means in making a tender offer.[7] The SEC has provided guidance on measures acquirors may take to avoid triggering U.S. jurisdictional means, and, thereby avoiding application of the U.S. tender offer rules. Bidders who are not U.S. persons may structure a tender offer for target securities of a foreign private issuer and exclude U.S. target security holders if the offer is conducted outside the United States and U.S. jurisdictional means are not implicated. However, a bidder may implicate U.S. jurisdictional means if it fails to take adequate measures to prevent tenders by U.S. target holders while purporting to exclude them. When a bidder permits U.S. target security holders to participate in a tender offer, it must follow U.S. rules unless an exemption applies.

Bidders seeking to avoid the application of U.S. law should take special precautions to assure that their offer is not made in the United States. The most basic measure is to include legends on the offer materials and on any Internet Web site on which they are posted, indicating that the offer is not being made in the United States. The bidder should take special precautions to assure that tenders are not accepted from nor sales of bidder securities made (in the case of exchange offers) to target security holders resident in the United States. These may include, in responding to inquiries and processing letters of transmittal, obtaining adequate information to determine whether the target security holder is a U.S. investor. Additionally, the bidder could require representations by the tendering security holder, or anyone tendering on that person's behalf, that the tendering holder is not a U.S. holder or someone tendering on behalf of a U.S. holder.

Where tenders in exclusionary offers are made through offshore nominees, bidders could require that these nominees certify that tenders are not being made on behalf of U.S. holders. However, this may be problematic where the law of the applicable foreign jurisdiction prevents the nominee from knowing the identity or location of beneficial holders on whose behalf they hold.

The SEC intends to more closely monitor exclusionary offers to determine whether Commission action is necessary to protect U.S. target holders.

C. *Vendor Placements*

In many business combination transactions, the offer consideration may include securities of the bidder. In Tier I tender offers, for purposes of complying with the equal treatment requirement, bidders are permitted to

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[7] The "jurisdictional means" are the means or instrumentalities of interstate commerce or any facility of a national securities exchange.

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offer cash consideration 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. Additionally, most Tier I offers should be eligible for the exemption from Securities Act registration provided by Rule 802. If Rule 802 or another exemption from registration is not available, then the bidder must register the securities being offered under the Securities Act.

In certain cross-border exchange offers, bidders may seek to avoid the registration requirements under the Securities Act by establishing a vendor placement arrangement for the benefit of U.S. target security holders who tender into the offer. In a vendor placement, the bidder employs a third party to sell in offshore transactions the securities to which tendering U.S. security holders are entitled in the offer. The bidder (or the third party) then remits the proceeds of the resale (minus expenses) to those U.S. target security holders that tendered into the offer. In effect, the vendor placement is an effort to convert an exchange offer involving the offer and sale of the bidder's securities (which would require Securities Act registration) into an offer involving solely cash (which does not require registration) for tendering U.S. security holders.

Although tendering holders receive cash in a vendor placement, the amount of cash received is largely dependent on the market value of the underlying security. The protections of the Securities Act are intended to give investors access to information when making an investment decision for the purchase of a security. A vendor placement does not in all circumstances eliminate the requirement for Securities Act registration, because tendering U.S. holders may be effectively making an investment decision for the purchase of a security.

The SEC believes that a vendor placement arrangement in cross-border exchange offers would be subject to Securities Act registration unless the market for the bidder securities to be issued in the exchange offer and sold under the vendor placement procedure is highly liquid and robust and the number of bidder securities to be issued in the exchange offer and for the benefit of tendering U.S. holders is relatively small compared to the total number of bidder securities outstanding. The SEC also considers:

- the timeliness of the vendor placement process; that is, 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
- whether the vendor placement involves special selling efforts by brokers or others acting on behalf of the bidder.

In tender offers subject to Section 14(d) of the Exchange Act, the all-holders and best price requirements in Rule 14d-10 also are implicated by the use of the vendor placement structure because U.S. target security

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holders would receive different consideration from their non-U.S. counterparts. Generally, the SEC believes that the parameters of the Tier I cross-border exemptions should represent the appropriate limits under which a bidder in a tender offer subject to Regulation 14D may offer cash to U.S. security holders while issuing shares to their counterparts outside the United States.

Bidders making a cross-border exchange offer sometimes seek to exclude some U.S. target holders and include in the exchange offer only those U.S. target holders (such as accredited investors) for whom an exemption from the registration requirements of the Securities Act may be available. The SEC has stated that exchange offers for securities subject to Section 14(d) of the Exchange Act may not be made in the United States on a private offering basis, consistent with the all-holders provisions of Rule 14d-10. Thus, even where the bidder is eligible to rely on an exemption from Securities Act Section 5 for such offers, it would violate the equal treatment provisions applicable to such offers by excluding target security holders for whom an exemption was not available. Similarly, as discussed above, offering cash under a vendor placement arrangement to some U.S. holders and bidder securities to others (such as institutions) is not permitted in tender offers subject to the all-holders rule.

Where a bidder seeks to use the vendor placement structure for a tender offer subject to Rule 14d-10 at U.S. ownership levels above Tier I, it must seek an exemption from those rules, which is granted only where it is in the interests of U.S. investors (i.e., rarely).

Questions regarding this client advisory may be directed to **Guy P. Lander** at (212-238-8619, lander@clm.com).

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