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Featured Article

The SEC Amends Cross-Border Business Combination Rules

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On September 19, 2008 the U.S. Securities and Exchange Commission (SEC) adopted amendments to its rules governing cross-border business combination transactions.[1] The rules extend exemptions from U.S. regulations for certain types of cross-border tender offers and other business combinations involving the securities of non-U.S. target companies. The amendments build upon a set of cross-border exemptions adopted by the SEC in 1999 and reflect the first significant rulemaking by the SEC since the 1999 rules were adopted. In many cases the amendments reflect the codification of no-action, exemptive or interpretive positions previously taken by the staff of the SEC and generally address aspects of the 1999 exemptions that made these exemptions difficult to apply in practice and limited their usefulness. The rule amendments became effective on December 8, 2008. The following article provides a summary of the principal changes brought about by the amendments.

Overview of Exemptions for Cross-Border Transactions

The SEC's cross-border rules provide relief from onerous disclosure and procedural requirements applicable to U.S. domestic business combination transactions. They apply to tender offers (including exchange offers) and other business combinations in which the target company (or subject company in a business combination transaction not involving a tender offer) is a "foreign private issuer" pursuant to SEC rules. In general, a foreign private issuer is a non-U.S. company that either has 50 percent or less of its outstanding voting securities held of record by U.S. residents or has more than 50 percent of its outstanding voting securities held by U.S. residents and has no other specified nexus with the United States.[2] The acquiring company relying on the cross-border exemptions set forth in the rules need not be a foreign private issuer and may be a U.S. company.

The exemptions under the cross-border rules are structured as a two-tier system based on the level of interest of U.S. investors in the target company's securities, as measured by the percentage of target securities held by U.S. investors. The "Tier I" exemptions apply if no more than 10 percent of the target company's securities are owned by U.S. holders.[3] A Tier I cross-border transaction is exempt from most U.S. tender offer rules under the U.S. Securities Exchange Act of 1934 (Exchange Act) and, where consideration payable in the transaction includes securities, from the registration requirements of the U.S. Securities Act of 1933 (Securities Act). The "Tier II" exemptions apply if U.S. holders own more than 10 percent but less than 40 percent of the target company's securities.[4] The Tier II exemptions provide targeted relief from certain U.S. tender offer rules and seek to minimize timing and logistical conflicts between U.S. and foreign regulatory regimes. The cross-border exemptions under both the Tier I and Tier II exemptions are conditioned on the observance by transaction participants of various requirements in order to protect the interests of U.S. investors.

Before 1999, U.S. holders of foreign company securities were routinely excluded from participating in cross-border tender and exchange offers and other business combination transactions due to the U.S. regulatory burdens associated with extending offers to U.S. investors, conflicts between procedures mandated by U.S. and foreign law and practice and the perceived risks of litigation associated with the inclusion of U.S. investors. In response to some of these concerns, the SEC adopted rules in 1999[5] providing exemptions for certain cross-border business combination transactions if specified conditions were met. Many practitioners, however, felt that the 1999 rules did not adequately address a number of conflicts between the U.S. and foreign regulatory systems and the use of the exemptions was undermined by difficulties in applying some of their conditions and confirming their availability for proposed transactions.[6] The SEC has acknowledged that it has "become aware of certain difficulties that can make application of [its beneficial ownership] threshold eligibility test problematic in practice.[7] The 2008 amendments build upon the 1999 exemptions and provide helpful relief to aspects of the 1999 exemptions that made them difficult to apply in practice. The 2008 amendments do not, however, address certain aspects of the cross-border rules that have prevented their wider use, in particular difficulties relating to conducting the "look-through" procedures required to assess the percentage of the target company's security owned by U.S. holders.

The Amendments

Calculation of U.S. ownership of target company's securities. To assess whether the Tier I or Tier II exemptions may be available, the SEC's cross-border rules require an acquirer to determine the U.S. ownership of the target company's securities. Application of the rules requires an acquirer to "look-through" the record holdings of brokers and other nominees located in the United States, the target company's jurisdiction of incorporation and the jurisdiction that is the primary trading market for the target company's securities to determine whether the brokers, dealers and other nominees hold on behalf of U.S. holders.[8] Such an inquiry can involve several layers of inquiry and poses significant practical challenges. Acquirers have found that a variety of factors have precluded them from calculating the percentage of U.S. holders of the target company's securities within the times prescribed in the cross-border rules and therefore have limited their ability to rely on the cross-border exemptions, such as: (1) the periodic unavailability of current shareholder lists in many overseas jurisdictions, (2) foreign prohibitions on the disclosure by nominees of beneficial ownership information or the nominees' unwillingness to provide the information, (3) the inability of acquirers to verify the information, (4) foreign regulatory review processes that make it difficult to determine in advance when the transaction will commence, and (5) the perceived risk that the acquirer's inquiry could give rise to a leak about the proposed transaction. The 2008 amendments seek to address some of these concerns, but largely fail to address logistical difficulties associated with completing mandated look-through procedures in negotiated transactions where there is no legal impediment to obtaining beneficial ownership information, but where as a matter of practice such information may be difficult or impossible to obtain. The amendments addressing U.S. ownership calculation amendments include:

- *Time as of which calculation must be undertaken.* The amended rules provide additional flexibility in relation to the time at which U.S. ownership must be assessed: U.S. ownership may be calculated in negotiated transactions as of any date no more than 60 days (or 120 days where the calculation cannot be completed earlier) before and no more than 30 days after the *public announcement* of the transaction, rather than as of 30 days before *commencement* of the transaction, as was the case under the prior rules.[9]

- *Alternative test for determining percentage of U.S. holders.* The prior rules recognized that third-party bidders in non-negotiated tender offers may face difficulties in obtaining information about the U.S. ownership of target securities where the target does not cooperate with the acquirer in connection with its calculation of U.S. ownership. Where an acquirer that is unaffiliated with the target proposes to conduct a tender offer other than pursuant to a written agreement, the prior rules generally permitted the bidder to assume that U.S. ownership in the target company satisfied the relevant threshold for the Tier I or Tier II exemption if the average daily trading volume (ADTV) of the target company's securities in the United States did not exceed 10 percent or 40 percent of worldwide ADTV over a 12-month period ending 30 days before commencement of the transaction. The amended rules preserve the alternative test for non-negotiated transactions and broaden the scope of the test in several ways. First, the 12-month period for assessing ADTV can be concluded as of any date up to and including the 60th day before public announcement of the transaction. Second, the amended rules extend the alternative test to negotiated transactions where the bidder is "unable" to conduct the required look-through analysis as long as there is a "primary trading market" for the target company's securities outside of the United States.[10] In this case, an acquirer's ability to rely on the alternative test would appear to be limited to circumstances where beneficial ownership information about target security holders is practically impossible to obtain, for instance because securities holder lists are generated only at fixed intervals not falling within the mandated look-through period, the target company's securities are held in bearer form, or applicable laws prohibit the disclosure of beneficial ownership information by nominees.

- *Inclusion of large shareholders.* Under the prior cross-border rules, individual holders of more than 10 percent of the target company's securities, whether U.S. or foreign, were excluded when calculating the percentage of U.S. ownership of the securities. In some cases, such as where the target has a number of large shareholders located outside of the United States, this had the effect of skewing upwards the percentage of U.S. ownership of the target, preventing an acquirer that otherwise would have been able to rely on the cross-border exemptions from doing so. The amended rules require all (including 10 percent shareholders) to be included in the ownership calculation.[11]

Expansion of Tier I relief to "going private" transactions. The amended rules expand relief under the Tier I exemptions for Rule 13e-3 "going private" transactions. Rule 13e-3 applies to transactions by issuers or their affiliates that have a "going private" effect. Typically, a going private transaction involves the purchase of securities listed on a U.S. national securities exchange by the issuer or its affiliate, resulting in such securities being delisted from such exchange or deregistered under the Exchange Act. Rule 13e-3 also prescribes specific filing and heightened disclosure requirements because of the inherent conflicts of interest that such transactions may involve. The prior cross-border rules provided an exemption from the disclosure and other provisions of Rule 13e-3 where a transaction was a Tier I-eligible transaction. The amended rules extend relief to other transaction structures, such as schemes of arrangement, cash mergers and compulsory acquisitions for cash, that otherwise meet the requirements for a Tier I transaction.[12]

Multiple foreign offers. The prior rules permitted a bidder to make one offer to U.S. security holders and a second offer to foreign security holders to facilitate an acquirer's compliance with the regulations of two jurisdictions and to minimize procedural and technical conflicts. Recognizing that an acquirer may be subject to more than one regulatory regime outside of the United States, the amended rules provide that a foreign private issuer in a Tier II transaction may make more than one non-U.S. offer in conjunction with a U.S. tender offer.[13]

Participation in U.S. and foreign offers. Where an acquirer conducts a cross-border tender offer pursuant to separate U.S. and foreign offers, the prior rules required that the U.S. offer be open only to U.S. holders and that the foreign offer be open only to non-U.S. holders. As a practical matter, acquirers typically wish to include holders of American Depositary Shares (ADSs), wherever resident, in the U.S. offer. The amended rules expressly permit the inclusion of all ADS holders in the U.S. offer and, where the laws of the jurisdiction governing the foreign offer expressly preclude the exclusion of U.S. holders, permit the inclusion of U.S. holders in the foreign offer.[14]

Back-end withdrawal rights. The Exchange Act and related SEC rules mandate that target security holders have "back-end" withdrawal rights permitting such holders to withdraw tendered securities if the offer remains open 60 days after its commencement.[15] Such withdrawal rights may, however, interfere with a bidder's ability to centralize and tally tenders received in accordance with foreign law and practice if this process is undertaken at the time back-end withdrawal rights arise. The amended rules provide an exemption allowing bidders to suspend back-end withdrawal rights for tender offers conducted under the Tier II exemptions while tendered securities are being counted and before the securities are accepted for payment.[16]

Elimination of maximum time limit in a subsequent offering period. The prior cross-border rules permitted a bidder in a third-party tender offer to implement a subsequent offering period of between three and 20 U.S. business days to afford target security holders who have not tendered their shares an opportunity to do so.[17] The use of a subsequent offering period is customary in various foreign jurisdictions and in many cases the subsequent offering period would have a significantly longer duration than 20 U.S. business days.[18] The amended rules eliminate the maximum time a subsequent offering period may remain open for all tender offers, including domestic tender offers.[19]

Purchases of securities tendered during subsequent offering period. The prior rules required that securities tendered during a subsequent offering period be paid for as they were tendered on a "rolling basis," since withdrawal rights typically do not apply in a subsequent offering period.[20] Foreign laws and regulations often permit a bidder a longer period in which to pay for tendered securities and foreign law and practice may permit the "bundling" of tendered securities, with payment being made only on periodic "take-up" dates.[21] The amended rules permit bidders in Tier II tender offers to pay for securities tendered during a subsequent offering period within 20 local business days of the date of tender in circumstances where payment may not be made, or on a more expedited basis if required by applicable foreign law or practice.[22]

Payment of interest on tendered securities during subsequent offering period. Under the laws of some foreign jurisdictions, bidders are required to pay interest on securities tendered during the subsequent offering period.[23] These payments, however, conflict with U.S. rules that mandate that consideration paid to any tendering security holder be the highest consideration paid to any other security holder and that security holders that tender during the subsequent offering receive the same form and amount of consideration as security holders tendering into the initial offering period.[24]

The amended rules permit bidders in a Tier II cross-border tender offer to pay interest for securities tendered during a subsequent offering period where such payment is required by foreign law.[25]

Prompt payment in mix-and-match offers. In a mix-and-match offer, bidders offer a set mix of cash and securities in exchange for each target security, but permit tendering security holders to request a different allocation of cash and securities. These elections are satisfied to the extent that other security holders make offsetting elections. To facilitate the timely payment of consideration to tendering security holders, bidders typically provide for two separate pools of cash and securities to be used to accommodate target shareholders' mix-and-match elections, one for the initial offering period and another for the subsequent offering period. Mix-and-match offers may violate U.S. rules that mandate that security holders who tender into the subsequent offering receive the same form and amount of consideration as those who tender into the initial offering period, as well as rules that prohibit the imposition of a ceiling on any form of alternative consideration offered during the subsequent offering period.[26] The amended rules expressly permit a Tier II-eligible bidder that has established a pool of consideration in a subsequent offering to offset elections of tendering security holders against one another and to pro-rate the consideration to the extent that the elections cannot be satisfied in full. The amended rules also permit a bidder to offset and pro-rate separately securities tendered during the initial and subsequent offering periods.[27]

Early termination of offer. Under the prior cross-border rules, a bidder was permitted to amend the expiration date of its offer only by providing notice to target security holders before the initial offering period closed and withdrawal rights terminated.[28] This extension requirement conflicted with the law or practice of some foreign jurisdictions that require the initial offering period to terminate as soon as all conditions to the offer have been satisfied.[29] The amended rules permit a bidder eligible to rely on the Tier II exemptions to terminate the initial offering period before its scheduled expiration (including where the initial offering period was voluntarily extended), at which point withdrawal rights will no longer apply, if, at the time of termination, the offer has been open for at least 20 U.S. business days, adequate disclosure has been made, the bidder provides a subsequent offering period after termination of the initial offering period and all offer conditions are satisfied at the time of early termination of the initial offering period.[30]

Purchases outside of tender offers. The prior SEC rules generally prohibited a bidder, its affiliates and certain transaction participants from purchasing or arranging to purchase securities that are the subject of a tender offer or any related security, except as part of the tender offer. These restrictions applied from the time of the public announcement of the offer until the offer's expiration.[31] In many cases, these restrictions conflicted with foreign law or practice, where open market purchases and privately negotiated transactions may be customary during the pendency of a tender offer. The prior rules provided an exception to these prohibitions for purchases or arrangements to purchase made outside of, but during, Tier I tender offers.[32] Since 1999, the SEC frequently granted relief in Tier II transactions to permit purchases or arrangements to purchase target securities, in particular to accommodate (1) purchases by the bidder pursuant to separate U.S. and foreign offers, (2) purchases made by bidders and their affiliates outside of the tender offer, such as open market purchases and privately negotiated transactions, and (3) similar transactions undertaken by affiliates of the bidder's financial advisers. The amended rules in effect codify the exemptive relief granted by the SEC, conditioning the availability of the relief on the existence of specified safeguards to protect U.S. investors.[33]

Electronic filing. The amended rules require various forms associated with the cross-border exemptions to be filed electronically via the SEC's EDGAR system.[34] These include Form CB, which is most commonly used to file an English translation of offering materials distributed in connection with Tier I transactions and Form F-X, which is used for the appointment of an agent in the United States for service of process.

Schedule 13G filings by foreign institutions. Under Section 13(d) of the Exchange Act and the rules promulgated thereunder,[35] a person who obtains more than five percent of a class of equity securities registered under Section 12 of the Exchange Act (for example, securities listed on U.S. securities exchanges, such as the New York Stock Exchange or NASDAQ Stock Market, or unlisted equity securities that are "widely-held" by U.S.-resident investors) must disclose such holding on Schedule 13D within 10 days of acquisition. However, certain U.S. institutional investors are permitted to file, instead, a short form Schedule 13G within 45 days of the end of the calendar year in which the acquisition occurred. Under prior rules, non-U.S. institutions were not eligible to report their holdings on Schedule 13G without express relief from the SEC. The amended rules permit non-U.S. institutions to report their beneficial ownership of securities on Schedule 13G on an annual basis without obtaining express exemptive relief from the SEC (and subsequently to disclose changes in information reported on its Schedule 13G on an annual basis, rather than promptly, as in the case of Schedule 13D).[36]

To be eligible to file on Schedule 13G, a non-U.S. institution must determine, and certify on Schedule 13G, that it is subject to a regulatory scheme substantially comparable to the regulatory scheme applicable to U.S. institutions eligible to file on Schedule 13G. It must also undertake to deliver to the SEC, on request, the information that it otherwise would be required to file with the SEC on Schedule 13D. As is the case for U.S. institutions, only foreign institutions that acquire and hold securities in the ordinary course of business, and not with the purpose of influencing or changing control of the company whose securities it beneficially owns, are permitted to use Schedule 13G.

Interpretive Guidance

In connection with the amendments, the SEC provided detailed interpretive guidance in relation to a number of issues that frequently arise in cross-border business combination transactions, namely: (1) the circumstances in which a bidder can terminate withdrawal rights after it waives the minimum offer condition (where the SEC has placed restrictions on its prior interpretive position), (2) the exclusion of foreign security holders in tenders for U.S. companies (where the SEC declined to adopt amendments to the cross-border rules to implement *de minimis* or other exceptions to the "all-holders" provisions of its rules), (3) the exclusion of U.S. target security holders from cross-border tender offers (where the SEC identified certain precautionary measures that bidders may take to avoid triggering the application of U.S. securities laws, where bidders may have legitimate reasons for excluding U.S. security holders), and (4) the use of vendor placements in exchange offers (where the SEC discussed the factors that a bidder should consider when contemplating the use of vendor placement arrangements and indicated that it no longer intends to issue vendor placement no-action letters regarding the registration requirements of the Securities Act, but will continue to consider requests for relief under the equal treatment provisions of the Exchange Act).[37]

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[1] SEC Release Nos. 33-8957 and 34-58597 (Sept. 19, 2008) (Adopting Release).
[2] Securities Act Rule 405 and Exchange Act Rule 3b-4.
[3] Exchange Act Rule 14d-1(c).
[4] Exchange Act Rule 14d-1(d).
[5] SEC Release Nos. 33-7759 and 34-42054 (Oct. 22, 1999).
[6] See John M. Basnage *et al.*, "Cross-Border Tender Offer Rules and Other Business Combination Transactions and the U.S. Federal Securities Laws: An Overview", *The Business Lawyer*, Vol. 61, May 2006, at 1085.
[7] SEC Release Nos. 33-8917 and 34-57781 (May 9, 2008) (Proposing Release).
[8] Exchange Act Rule 14d-1(d), Instructions to Paragraphs (c) and (d), and Rule 12g3-2(a).
[9] Exchange Act Rule 14d-1(d), Instructions to Paragraphs (c) and (d), and prior Securities Act Rule 802(h).
[10] Exchange Act Rule 14d-1(d), Instructions to Paragraphs (c) and (d), and Securities Act Rule 802(h).
[11] Exchange Act Rule 14d-1(d), Instructions to Paragraphs (c) and (d), and Securities Act Rule 802(h).
[12] Exchange Act Rule 13e-3(g)(6).
[13] Exchange Act Rules 13e-4(i)(2)(ii) and 14d-1(d)(2)(ii).
[14] Exchange Act Rules 13e-4(i)(2)(ii) and 14d-1(d)(2)(ii).
[15] Exchange Act Section 14(d)(5) and Rule 13e-4(f)(2) (where the period is 40 business days in the case of an issuer tender offer).
[16] Exchange Act Rules 13e-4(i)(2)(v) and 14d-1(d)(2)(vii).
[17] Prior Exchange Act Rule 14d-11.
[18] In the United Kingdom, for instance, an offer must remain open for 14 days following the date on which the offer becomes unconditional as to acceptances. See the Takeover Code, Rule 31.4. In practice, transactions in the United Kingdom are often structured so as to provide for a subsequent offer period open for a period longer than the mandatory 14 calendar days and longer than the 20 U.S. business days provided for in Exchange Act Rule 14d-11, in many cases until further notice is given.
[19] Exchange Act Rule 14d-11.
[20] Prior Exchange Act Rule 14d-1(d)(2)(iv).
[21] In the United Kingdom, Rule 31.8 of the Takeover Code permits settlement during the subsequent offering period within 14 days of receipt of a tendering security holder's acceptance.
[22] Exchange Act Rule 14d-1(d)(2)(iv).
[23] Proposing Release at note 167.
[24] Exchange Act Rules 14d-11(f) and 14d-10(a)(2).
[25] Exchange Act Rule 14d-1(d)(2)(vi).
[26] Exchange Act Rules 14d-11(b), 14d-11(f) and 14d-10(c).
[27] Exchange Act Rule 14d-1(d)(2)(viii).
[28] Exchange Act Rules 13e-4(e)(3), 14d-4(d) and 14e-1(b).
[29] Adopting Release at note 246.
[30] Exchange Act Rule 14d-1(d)(2)(ix).
[31] Exchange Act Rule 14e-5.
[32] Exchange Act Rule 14e-5(b)(10).
[33] Exchange Act Rule 14e-5(b)(11) and (12).
[34] Securities Act Rule 101(a) of Regulation S-T.
[35] Exchange Act Section 13(d) and Rules 13d-1 to 13d-7.
[36] Exchange Act Rules 13d-1 to 13d-7.
[37] Adopting Release at II.C.5 and II.G.