SEC Amends Cross-Border Business Combination Rules

John M Basnage*

In December 2008, amendments to the rules of the US Securities and Exchange Commission (SEC) governing cross-border business combination transactions became effective (the '2008 amendments'). The amendments build on a set of exemptions adopted by the SEC in 1999 (the '1999 rules') to accommodate cross-border transactions and reflect the first significant rule-making by the SEC since the 1999 rules were adopted. Some of the amendments reflect the codification of no-action, exemptive or interpretive positions previously taken by the staff of the SEC; other amendments were implemented to address specific aspects of the 1999 exemptions that made these exemptions difficult to apply in practice and limited their usefulness. While the amendments provide additional relief in respect of many legal and procedural conflicts that arise in cross-border transactions, they do not address fully one of the most notable deficiencies in the current rules: practical difficulties associated with assessing the interest of US investors in a transaction and the ability of parties to rely on the cross-border exemptions.

Overview of exemptions for cross-border transactions

US securities and tender offer laws and regulations potentially apply to any transaction made using US jurisdictional means (including the post and telephone, fax and internet communication to, in or from the United States). The SEC's cross-border tender offer rules provide exemptions from onerous disclosure and procedural requirements applicable to US domestic business combination transactions. They apply to tender offers (including exchange

* John M Basnage, Hogan & Hartson LLP. The author can be contacted by e-mail at **jmbasnage@hhlaw.com**.

offers) and other business combinations in which the subject company is a 'foreign private issuer' pursuant to SEC rules. (In general, a foreign private issuer is a non-US company that either has 50 per cent or less of its outstanding voting securities held of record by US residents or has more than 50 per cent of its outstanding voting securities held by US residents and has no other specified nexus with the United States.) The acquiring company relying on the cross-border exemptions need not be a foreign private issuer and may be a US company.

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

Before 1999, US 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 US regulatory burdens associated with extending offers to US investors, conflicts between procedures mandated by US and foreign law and practice and the perceived risks of litigation associated with the inclusion of US investors. In response to some of these concerns, the SEC adopted rules in 1999 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 US 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. The 2008 amendments seek to address a number of these conflicts.

2008 Amendments

Calculation of US ownership of subject 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 US ownership of the subject 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 subject company's jurisdiction of incorporation and the jurisdiction that is the primary trading market for the subject company's securities to determine whether the brokers, dealers and other nominees hold on behalf of US holders. 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 US holders of the subject company's securities within the times prescribed in cross-border rules and therefore have limited their ability to rely on the cross-border exemptions, such as:

- the periodic unavailability of current shareholder lists in many overseas jurisdictions;
- foreign prohibitions on the disclosure by nominees of beneficial ownership information or the nominees' unwillingness to provide the information;
- the inability of acquirers to verify the information;
- foreign regulatory review processes that make it difficult to determine in advance when the transaction will commence; and
- 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 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. As a result, many acquirers continue to find it more attractive to exclude all US holders from a business combination transactions (in an attempt to avoid the use of application of US jurisdictional and therefore the reach of US laws and regulations), rather than seek to rely on an exemption that may not be available.

Changes introduced by the 2008 amendments relating to the calculation of US ownership include:

- *Time as of which calculation must be undertaken.* The 2008 amendments provide additional flexibility in relation to the time at which US ownership must be assessed: US ownership may now be calculated in negotiated transactions as of any date no more than 60 days (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 prior rules.
- *Alternative test for determining percentage of US holders.* The 1999 rules recognised that third-party bidders in non-negotiated tender offers may face difficulties in obtaining information about the US ownership of subject company securities where the subject company does not cooperate with the acquirer in connection with its calculation of US ownership. Where an acquirer that is unaffiliated with the subject company proposes to conduct a tender offer other than pursuant to a written agreement, the 1999 rules generally permitted the bidder to assume that US ownership in the subject company satisfied the relevant threshold for the Tier I or Tier II exemption if the average daily trading volume (ADTV) of the subject company's securities in the United States did not exceed ten per cent or 40 per cent of worldwide ADTV over a 12-month period ending 30 days before commencement of the transaction. The 2008 amendments 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. Secondly, the 2008 amendments 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 subject company's securities outside the United States. 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 subject company 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 subject 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 1999 rules, individual holders of more than ten per cent of the subject company's securities, whether US or foreign, were excluded when calculating the percentage of US ownership of the securities. In some cases, such as where the subject company has a number of large shareholders located outside the United

> States, this had the effect of skewing upwards the percentage of US ownership of the subject company, preventing an acquirer that otherwise would have been able to rely on the cross-border exemptions from doing so. The 2008 amendments require all subject company shareholders (including ten per cent shareholders), but excluding securities held by the acquirer, to be included in the ownership calculation.

The 2008 amendments to not alter other aspects of US ownership test, such as the requirement that securities underlying American depositary shares (ADSs) be included in the calculation, and convertible and exchangeable securities be excluded.

Expansion of Tier I relief to 'going private' transactions

The 2008 amendments expand relief under the Tier I exemptions for Rule 13e-3 'going private' transactions. Rule 13e-3 applies to transactions by issuers and their affiliates that have a 'going private' effect (typically this would involve the purchase of securities that are listed on a US national securities exchange 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. 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 2008 amendments 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.

Multiple foreign offers

Prior rules permitted a bidder to make one offer to US security holders and a second offer to foreign security holders to facilitate an acquirer's compliance with the regulations of two jurisdictions and to minimise procedural and technical conflicts. Recognising that an acquirer may be subject to more than one regulatory regime outside the United States, the 2008 amendments provide that a foreign private issuer in a Tier II transaction may make more than one non-US offer in conjunction with a US tender offer.

Participation in US and foreign offers

Where an acquirer conducts a cross-border tender offer pursuant to separate US and foreign offers, prior rules required that the US offer be open only

to US holders and that the foreign offer be open only to non-US holders. As a practical matter, acquirers typically wish to include holders of ADSs, wherever resident, in the US offer. The 2008 amendments expressly permit the inclusion of all ADS holders in the US offer and, where the laws of the jurisdiction governing the foreign offer expressly preclude the exclusion of US holders, permit the inclusion of US holders in the foreign offer.

Back-end withdrawal rights

The Exchange Act and related SEC rules mandate that subject company security holders have 'back-end' withdrawal rights permitting such holders to withdraw tendered securities if the offer remains open 60 days after its commencement. Such withdrawal rights may, however, interfere with a bidder's ability to centralise and tally definitively tenders received in accordance with foreign law and practice if this process is undertaken at the time back-end withdrawal rights arise. The 2008 amendments 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.

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 after expiration of the initial offering period of between three and 20 US business days. A subsequent offering period would typically be implemented to afford subject company security holders who have not tendered their shares an opportunity to do so prior to any later compulsory acquisition. The use of a subsequent offering period is customary in various foreign jurisdictions, including the United Kingdom, and in many cases the subsequent offering period may extend significantly longer than 20 US business days. The 2008 amendments eliminate the maximum time a subsequent offering period may remain open for all tender offers, including US domestic tender offers.

Purchases of securities tendered during subsequent offering period

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. Foreign laws and regulations often permit a bidder a longer period in which to pay for tendered securities (for instance, in Canada tendered securities

must be taken up and paid for within ten calendar days) and may permit the 'bundling' of tendered securities, with payment being made only on periodic 'take-up' dates. The 2008 amendments permit bidders in a Tier II tender offer 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 on a more expedited basis, if required by applicable foreign law or practice.

Payment of interest on tendered securities during subsequent offering period

Under the laws of some foreign jurisdictions, including Germany and Brazil, bidders are required to pay interest on securities tendered during the subsequent offering period. These payments, however, conflict with US 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. The 2008 amendments 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.

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 subject company 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 subject company shareholders' mix-and-match elections, one for the initial offering period and another for the subsequent offering period. Mix-and-match offers may violate US 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. The 2008 amendments 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 2008 amendments also permit a bidder to offset and

pro-rate separately securities tendered during the initial and subsequent offering periods.

Early termination of offer

Under the 1999 rules, a bidder was permitted to amend the expiration date of its offer only by providing notice to subject company security holders before the initial offering period closes and withdrawal rights terminate. This extension requirement conflicts with the law or practice of a number of foreign jurisdictions (including the United Kingdom and South Africa) that require the initial offering period to terminate as soon as all conditions to the offer have been satisfied. The 2008 amendments 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 US 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.

Purchases outside tender offers

Prior SEC rules generally prohibit a bidder, its affiliates and certain transaction participants (covered persons) 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 apply from the time of the public announcement of the offer until the offer expires. In many cases, these restrictions conflict with foreign law or practice, including offers conducted in the United Kingdom in accordance with the UK City Code on Takeovers and Mergers (the 'City Code'), where open market purchases and privately negotiated transactions are customary during the pendency of a tender offer. Prior rules provided an exception to these prohibitions for purchases or arrangements to purchase made outside of, but during, Tier I tender offers (as well as purchases and arrangements to purchase conducted in compliance with the City Code). Since 1999, the SEC frequently granted relief in Tier II transactions to permit purchases or arrangements to purchase subject company securities, in particular to accommodate: (1) purchases by the bidder pursuant to separate US and foreign offers; (2) purchases made by bidders and their affiliates outside 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 2008 amendments in effect codify the exemptive relief granted by the SEC, conditioning the availability of the relief on the existence of specified safeguards to protect US investor.

Electronic filing

The 2008 amendments require various forms associated with the cross-border exemptions to be filed electronically via the SEC's EDGAR system. 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 of the SEC under it, a person that obtains more than five per cent of a class of equity securities registered under section 12 of the Exchange Act (for example, securities listed on US securities exchanges, such as the New York Stock Exchange or NASDAQ Stock Market or unlisted equity securities that are 'widely-held' by US-resident investors) must disclose such holding on Schedule 13D within ten days of acquisition. However, certain US 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-US institutions were not eligible to report their holdings on Schedule 13G without express relief from the SEC. The 2008 amendments permit non-US 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).

To be eligible to file on Schedule 13G, a non-US institution must determine, and certify on Schedule 13G, that it is subject to a regulatory scheme substantially comparable to the regulatory scheme applicable to US 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 US 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 US 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 US subject company security holders from cross-border tender offers (where the SEC identified certain precautionary measures that bidders may take to avoid triggering the application of US securities laws, where bidders may have legitimate reasons for excluding US 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).

Conclusion

The 2008 amendments provide a number of useful accommodations to participants in cross-border business combination transactions, which address recurring legal and procedural conflicts that arise in cross-border transactions, particularly in transactions that fall within the Tier II exemption. It is unclear whether the 2008 amendments will expand significantly the proportion of cross-border transactions that are extended to US security holders, where the participation of such holders is not essential for the success of the transaction. This is largely due to the timing, cost and continuing uncertainties associated with the look-through analysis required of an acquirer in a negotiated transaction to determine its ability to rely on the Tier I or Tier II exemptions.