First rulemaking since '99

The SEC has adopted large changes to its rules on cross-border business combinations. While the amendments provide helpful relief, burdens remain

The US Securities and Exchange Commission (SEC) recently adopted amendments to its rules governing tender offers and other business combinations designed to facilitate the inclusion of US investors in such transactions. These amendments build upon a set of cross-border exemptions adopted by the SEC in 1999 and are the first significant rulemaking by the SEC since 1999. The amended rules seek to address certain aspects of the 1999 rules that made them difficult to apply in practice, limited their usefulness and resulted in US investors continuing to be excluded from cross-border business transactions. In some cases, the recent amendments reflect the codification of no-action, exemptive or interpretive positions taken by the SEC. The amendments will be effective on December 8 2008.

Overview

The SEC's cross-border rules provide relief from onerous disclosure and procedural requirements applicable to participants in US domestic business combinations. They apply to tender offers (including exchange offers) and other business combinations in which the target 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% or less of its outstanding voting securities held of record by US residents or has more than 50% of its outstanding voting securities held by US residents and has no other specified nexus with the US. The acquiring company relying on the cross-border exemptions set forth in the rules need not be a foreign private issuer.

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 target company's securities, as measured by the percentage of target securities of a foreign private issuer held by US investors. The Tier I exemptions apply if no more than 10% of the target company's securities are owned by US persons. A Tier I cross-border transaction is exempt from most of the US tender offer provisions under the US Securities Exchange Act of 1934 (Exchange Act) and (where consideration payable in the transaction includes securities) from the registration requirements of the US Securities Act of 1933 (Securities Act). The Tier II exemptions apply if US holders own more than 10% but no more than 40% of the target 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 non-US 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 US investors.

Before 1999, US holders of non-US company securities were routinely excluded from participating in cross-border tender and exchange offers and other business combinations due to the US regulatory burdens associated with extending offers to US investors, conflicts between procedures mandated by US and non-US laws and regulations 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 combinations if specified conditions were met. However, many practitioners felt that the 1999 rules did not adequately address a number of conflicts between the US and non-US 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 build upon those adopted in 1999 and provide helpful relief to aspects of the 1999 exemptions that made them difficult to apply. The 2008 amendments do not, however, address all aspects of the cross-border rules that have prevented their wider use.

The amendments

Calculation of US ownership of target

company's securities

To assess whether the Tier I or Tier II exemptions may be available, the cross-border rules require an acquirer to determine the US beneficial ownership in 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 US, in the target company's jurisdiction of incorporation and in the jurisdiction that is the primary trading market for the target company's securities to determine the number of securities held by nominees on behalf of US beneficial owners.

Such an inquiry can involve several layers of inquiry and poses practical challenges. Acquirers have found that a variety of factors have precluded them from calculating the percentage of US holders of the target company's securities within the times prescribed in the rules and therefore have limited their ability to rely on the cross-border exemptions, including: (i) the periodic unavailability of current shareholder lists; (ii) prohibitions on the disclosure by nominees of beneficial ownership information (or their unwillingness to provide the information); (iii) the inability of acquirers to verify the information; (iv) regulatory review processes that make it difficult to determine in advance when the transaction will commence; and (vi) the 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 fully address logistical difficulties associated with completing mandated look-through procedures in negotiated transactions where there may be no legal impediment to obtaining beneficial ownership information but where such information may be difficult or impossible to obtain. A summary of the US ownership calculation amendments follows.

Timing

The amended rules provide more flexibility as to when US ownership must be assessed. US ownership may be calculated in negotiated transactions as of any date no more than 60 days (and in some cases 120 days) before and no more than 30 days after the public announcement of the tender offer or other business combinations, rather than as of 30 days before commencement of the transaction, as is the case under the rules at present.

Alternative test for determining percentage

The rules recognise that third-party bidders in non-negotiated tender or exchange offers may face difficulties in obtaining information about the US ownership of target securities where the target may not cooperate with the acquirer in connection with its calculation of US ownership. Where an acquirer that is not affiliated with the target proposes to conduct a tender or exchange offer other than pursuant to a written agreement, subject to certain conditions the bidder may assume that US ownership in the target company satisfies the relevant threshold for Tier I or Tier II exemptions if the average daily trading volume (ADTV) of the target company's securities in the US does not exceed 10% or 40% 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 its scope 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 the primary trading market for the target company's securities is outside the US. In this case, an acquirer's ability to rely on the alternative test would appear to be very limited, for instance, to circumstances where provision to the bidder of beneficial ownership information about target security holders is unavailable as a matter of law or is practically impossible to obtain.

Inclusion of large shareholders

Under cross-border rules, individual holders of more than 10% of the target company's securities, whether US or non-US, are excluded when calculating the percentage of US ownership of the securities. In some cases, such as where the target has a number of large shareholders located outside the US, this has had the effect of skewing upwards the percentage of US 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% shareholders) to be included in the ownership calculation.

"The amended rules provide more flexibility as to when US ownership must be assessed"

Exemption when going private

Cross-border rules provide an exemption from the burdensome disclosure provisions for a going-private transaction conducted as a tender offer or a Securities Act Rule 802 business combination where the Tier I exemptions apply. The amended rules extend Tier I 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 tender offer or a business combination conducted pursuant to Rule 802.

Multiple non-US offers

The rules permit a bidder to make one offer to US security holders and a second offer to non-US 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 US, the amended rules provide that an acquirer in a Tier II transaction may make more than one non-US offer in conjunction with a US tender offer.

Participation in US and non-US offers

Where an acquirer conducts a cross-border tender offer pursuant to separate US and non-US offers, the rules require that the US offer be open only to US holders and that the non-US offer be open only to non-US holders. As a practical matter, acquirers typically wish to include holders of American Depositary Shares (ADSs), wherever resident, in the US offer. In a Tier II transaction, the amended rules expressly permit the inclusion of all ADS holders in the US offer and, where the laws of the jurisdiction governing the non-US offer expressly preclude the exclusion of US holders, permit the inclusion of US holders in the non-US offer.

Back-end withdrawal rights

The Exchange Act and related SEC rules mandate that target securities have so-called 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 tenders received in accordance with non-US law and practice if this process is being undertaken at the time back-end withdrawal rights arise. The amended rules allow 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.

No maximum time limit in a subsequent offering

The rules permit a bidder in a third-party tender offer to provide a subsequent offering period of between three and 20 US business days to afford target security holders that have not tendered their shares an opportunity to do so. The use of a subsequent offering period is customary in various non-US jurisdictions and in many cases the subsequent offering period would have a significantly longer duration than 20 US business days. The amended rules eliminate the maximum time a subsequent offering period may remain open for all tender offers, including domestic transactions.

Purchases in a subsequent offering

The rules require that securities tendered during a subsequent offering period be paid for as they are tendered on a rolling basis, as withdrawal rights typically do not apply in a subsequent offering period. Non-US practice often permits a bidder a longer period in which to pay for tendered securities and non-US law or practice may permit the bundling of tendered securities, with payment being made only on periodic take-up dates. 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 on a more expedited basis under applicable non-US law or practice.

Payment of interest in a subsequent offering

Under the laws of some non-US jurisdictions, 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 amended rules permit bidders in a Tier II transaction to pay interest for securities tendered during a subsequent offering period where such payment is required by non-US 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 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 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

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imposition of a ceiling on any form of alternative consideration offered during the subsequent offering period. The amended rules expressly permit a bidder in a Tier II transaction 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 establish offset and pro-rate securities tendered during the initial and subsequent offering periods separately.

Early termination of offer

Under US tender offer rules, a bidder may amend the expiration date of its offer only by providing notice to target security holders before the initial offering period closes and withdrawal rights terminate. This extension requirement may conflict with the law or practice of some non-US jurisdictions that require the initial offering period to terminate as soon as all offer conditions to the offer have been satisfied. The amended rules permit a bidder in a Tier II transaction 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 certain conditions are met.

Purchases outside of tender offers

SEC rules prohibit 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 apply from the time of the public announcement of the offer until the offer expires. In many cases, these restrictions differ from foreign law or practice where open market purchases and privately negotiated transactions may be customary during the pendency of a tender offer.

Electronic filing

The amended rules 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 US for service of process.

Schedule 13G filings by non-US institutions

Under Section 13(d) of the Exchange Act and related SEC rules, a person that acquires more than 5% of a class of equity securities registered under Section 12 of the Exchange Act (effectively securities that are listed on a US stock exchange or are widely held in the US) must report such holdings on Schedule 13D within 10 days of the acquisition. Certain classes of US institutional investors, however, are permitted instead to file annually a short-form Schedule 13G. The amended rules permit analagous non-US institutions to report their beneficial ownership of securities on Schedule 13G, subject to certain conditions.

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 combinations, including: (i) the circumstances in which a bidder can terminate withdrawal of withdrawal rights after it waives the minimum offer condition (where the SEC has placed restrictions on its prior interpretive position); (ii) the exclusion of non-US security holders in tenders for US companies; (iii) the exclusion of US target security holders from cross-border tender offers; and (iv) the use of vendor placements in exchange offers.

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