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SEC Modifies Regime Governing Cross-Border Business Combinations and other Similar Transactions

The SEC has revised the rules governing cross-border tender offers, exchange offers, rights offerings and business combinations and published guidance on certain issues that arise in connection with such transactions. It has also published amendments to the beneficial ownership reporting rules for certain foreign institutions.

As stated in the promulgating release,¹ the revisions to the cross-border exemptions are intended to address areas of recurrent inconsistency between U.S. and foreign regulations and market practices, thereby facilitating the inclusion of U.S. investors in cross-border transactions. The revisions will not eliminate all conflicts in cross-border transactions and the staff of the Division of Corporation Finance (the “Staff”) will continue, as is its current practice, to address issues not covered by the rules, as amended, on a case-by-case basis. Many of the new provisions codify existing interpretative positions of the Staff and exemptive relief granted by the Staff in respect of the cross-border exemptions.

The exemptions discussed in this memorandum are available for “cross-border” transactions, which, for these purposes, include business combinations, tender offers (bids for cash) or exchange offers (bids using stock consideration) involving non-U.S. targets (regardless of the location of the acquirer) and rights offerings conducted by non-U.S. issuers.

Overview of the Rules Governing Cross-Border Transactions

The cross-border exemptions are structured as a two-tier system based on the level of U.S. interest in the relevant transaction. Such interest is assessed based on the percentage of securities held by U.S. investors in a target that is a foreign private issuer. The key concepts that underpin the regulatory regime governing cross-border transactions are set out below.

SEC Rules on Cross-Border Tender Offers. Three sets of regulations are potentially relevant to a cross-border tender offer:

- Regulation 14D of the Securities Exchange Act of 1934 (the “Exchange Act”) applies to tender offers where the target securities are listed or otherwise registered in the United States;

¹ <http://www.sec.gov/rules/final/2008/34-58597.pdf>

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- Regulation 14E of the Exchange Act applies to all tender offers that are extended to U.S. security holders of the target, whether or not the target securities are listed or registered in the United States; and
- Rule 13e-3 of the Exchange Act (the “going private” rule) applies to transactions where the issuer or affiliate of the issuer seeks to buy-out the public (*i.e.*, non-controlling) security holders of an SEC registrant and has the effect of taking the target private.

The availability of the cross-border exemptions (*Tier I* and *Tier II*) from the tender offer regulatory scheme varies depending on U.S. shareholder base of the target. As such, the lower the percentage of target securities held by U.S. persons, the broader the exemption. The principal focus of the exemptions for purposes of availability is the relative ownership in percentage terms, and not the average daily trading volume (“ADTV”).

Tier I exemption and Rule 802. In a tender or exchange offer, if no more than 10% of the target’s securities are held by U.S. persons, such transaction will be exempt from most U.S. tender offer rules (*e.g.*, disclosure, filing of a Schedule TO, dissemination, minimum offering period, withdrawal rights and proration requirements); further, securities issued in such transaction, that otherwise would be required to be registered under the Securities Act of 1933 (the “Securities Act”), will be exempt from the registration requirements. Tier I transactions are also not subject to the going private rules, and the target in a Tier I offer is not subject to the requirement under Rule 14e-2(a) to express an opinion on the offer.

Tier II exemption. If U.S. holders hold more than 10%, but less than 40%, of the target’s securities, the bidder must comply with all applicable U.S. tender offer rules except where specific relief is provided in the Tier II provisions. Securities issued in Tier II exchange offers are not exempt from the registration requirements of the Securities Act. Tier II transactions are also not exempt from the going private rules.

Rule 801. Rule 801 under the Securities Act provides an exemption from the registration requirements of the Securities Act for securities issued in connection with rights offerings by foreign private issuers. The exemption is available where U.S. security holders hold not more than 10% of the subject securities and the offering permits U.S. security holders to participate in the offer on terms at least as favorable as those offered to the other security holders participating in the offering.

Calculation of U.S. beneficial ownership. To be eligible to rely on the Tier I or Tier II exemption, the bidder is required to calculate the percentage of the target’s securities beneficially owned by U.S. residents. In negotiated transactions, the bidder is required to “look through” securities held of record by nominees in specific jurisdictions to identify those securities held for the accounts of persons located in the United States. If the bidder, after “reasonable inquiry,” is unable to obtain such information, it may assume that the customers are residents of the jurisdiction in which the nominee has its principal place of business. In hostile transactions, the bidder has a presumption available, given the difficulty in obtaining information about the target.

The revised cross-border exemptions maintain the two-tier structure and do not alter the threshold percentages of U.S. beneficial ownership for relying on the exemptions. Also, the cross-border exemptions continue to be available only where the target is a foreign private issuer.

Amendments to the Calculation of the U.S. Beneficial Ownership

Refined look-through analysis. The revised rules allow the bidder, in negotiated transactions, to calculate U.S. beneficial ownership as of a date within a range of dates that are no more than 60 days before, and not more than 30 days after, *public announcement*² of a transaction. The revised rules allow a bidder to use a date within 120 days before public announcement if the combined 90-day period is not sufficient to complete the look-through analysis. Use of the 120-day period is only warranted where necessary.

The shift to the announcement date rather than the commencement date is intended to allow bidders to make the determination of eligibility at an earlier point in time, which is particularly important in jurisdictions where applicable local rules require public disclosure about the treatment of overseas shareholders. More broadly, it allows bidders to inform the market and investors as to their plans in respect of U.S. shareholders of the target at an earlier point in time. For those bidders that need to seek Staff relief for Tier II issues, an earlier determination date will provide more time to seek the relief. The amendment further insulates the calculation from share movements triggered by public announcement of the transaction. Finally, the change further harmonizes compliance issues related to Rule 14e-5, which regulates purchases outside an offer and applies from the date of announcement.

Alternate test. If the bidder is unable to conduct the modified look-through analysis, an alternate eligibility test is available. Whether a bidder is unable to complete the look-through analysis in the periods available under the revised rules will depend on the facts and circumstances of the bid. The alternate test is available outside the hostile transaction context only in very limited circumstances, which are to be determined on a case-by-case basis. The SEC has stressed that issues relating to time, cost, completeness or accuracy of information obtained from the analysis is unlikely to be deemed a sufficient basis to use the alternate test. Other than hostile transactions, the use of this test would be justified (i) when the U.S. ownership information is outdated (*i.e.*, as of a date outside of the 120-day period); (ii) where the subject securities are in bearer form (*i.e.*, securities for which there is no registry of ownership); and (iii) where nominees are prohibited from disclosing information about the beneficial owners of the securities, as can be the case in certain jurisdictions.

The use of the alternate test requires that the following three prongs be met:

- (i) *Comparison of the U.S. ADTV with the worldwide float.* This prong is met if the U.S. ADTV over a 12-month period ending no more than 60 days before announcement of the transaction is not more than 10% (and 40% for Tier II) of the worldwide ADTV. Note that the bidder is not allowed to use a range of dates that extends beyond announcement as it may when using the look-through analysis. In addition, there must be a foreign “primary market”³ for the subject securities.
- (ii) *Information filed by the issuer.* The bidder must consider the U.S. ownership figures reported in publicly available information, including filings with the SEC and home country regulators.

² For these purposes, “public announcement” includes any oral or written communication made by the bidder or any other party acting on its behalf, which is *reasonably designed to inform or has the effect of informing* the public or security holders in general about the transaction.

³ Meaning that at least 55% of the trading volume takes place in a single, or not more than two, foreign jurisdictions during the last 12-month period; note that if the trading occurs in two foreign markets, the trading in at least one of them must be larger than the trading in the United States.

- (iii) “*Reason to know.*” The bidder cannot take advantage of an exemption if such bidder knows, or has “reason to know”, that the U.S. beneficial ownership of the target securities exceeds the relevant threshold. The revised rules provide that the bidder’s knowledge or “reason to know” refers to knowledge as of the date of announcement of the transaction. Second, the rules make clear that a bidder will have “reason to know” based on publicly available information, as well as information filed with the SEC (such as reports on Schedules 13D, 13G and 13F). Note that a bidder is no longer required to engage a third-party service to determine ownership, but the SEC notes that bidders cannot ignore credible information about the target securities held by U.S. persons from non-public sources, such as investment bankers or other market participants, including the target company. Such information, however, would have to be available before announcement to disqualify the bidder from relying on this presumption.

Note also that the revised rules do not affect the ability of a second bidder to rely on the exemption available to the first bidder, notwithstanding shifts in the holdings of U.S. security holders after the launch of the first bid.

Hostile transactions. The revised rules specify that where a transaction is not made pursuant to an agreement between the bidder and the target, the bidder is not required to conduct a look-through analysis, given the bidder’s difficulty in obtaining information about the target; in other words, the bidder can always use the alternate eligibility test to calculate the U.S. beneficial ownership figures.

Rights offerings. Similar changes have been made to methods of calculating U.S. beneficial ownership for purposes of the exemption for rights offering (Rule 801). Issuers may now calculate U.S. beneficial ownership as of a date no more than 60 days before and 30 days after the record date for the rights offering. In addition, the alternate test is also available for issuers unable to conduct the look-through analysis. Note that the revised rules do not alter the determination date for rights offerings (which is the record date).

Exclusion of 10%-target holders. The former requirement to exclude from the calculation of U.S. ownership securities held by persons holding greater than 10% of target securities has been eliminated. The securities held by the bidder will, however, continue to be excluded from the calculation.

Amendments to the Tier I Exemption

The revised rules eliminate restrictions on the types of cross-border transactions that qualify for the Tier I exemption from Rule 13e-3, which formerly only applied to tender or exchange offers or business combinations. The new rule includes within the exemption any kind of transaction that would otherwise meet the conditions for Tier I or Rule 802 eligibility. As a result, schemes of arrangement, cash mergers and other similar kinds of transactions are now eligible for this exemption.

Amendments to the Tier II Exemption

The following amendments apply to offers that are otherwise eligible for the Tier II exemption.

Extension to cover Regulation 14E offers. Under the former rules, the Tier II exemption applied only to transactions governed by Regulation 14D or by Rule 13e-4. (Rule 13e-4 applies to

issuer self tender offers, where the subject securities are not registered under Section 12 of the Exchange Act but another class of the issuer's securities is so registered). The revised rules extend the exemption to cover any offer regardless of whether the target securities are subject to Regulation 14D or Rule 13e-4. Accordingly, although it may be of limited value, the revised rules provide that the exemptions are available to offers for securities as to which there are no SEC reporting obligations.

Multiple non-U.S. offers. The revised rules allow bidders to make multiple concurrent non-U.S. offers. Under the former rules, a bidder could make a U.S. offer together with one single concurrent non-U.S. offer.

Persons included in offers. Non-U.S. holders of ADRs are now allowed to participate in U.S. offers. Under the former rules, only U.S. resident security holders could participate in a U.S. offer. The revised rules also allow U.S. holders to participate in non-U.S. offers where required under local law (that is, where the local law expressly precludes the exclusion of U.S. persons from the local offer) and where adequate disclosure about the implications of participating in the foreign offer or offers is provided to U.S. security holders.

Proration. The revised rules clarify that bidders relying on a dual or multiple offer structure must use a single proration pool (*i.e.*, the securities tendered into the U.S. offer and the non-U.S. offer or offers must be prorated on an aggregate basis).

“Back-end” withdrawal rights. The revised rules permit bidders 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 payment. This permits withdrawal rights to be terminated at the end of an offer and during the counting process where no subsequent offer period is provided. At the time withdrawal rights are suspended, all conditions must have been satisfied or waived (except to the extent the minimum acceptance condition has not yet been met due to ongoing counting of tenders) and the bidder has provided an offer period (including withdrawal rights) of at least 20 U.S. business days. Note that withdrawal rights must be reinstated immediately after the securities are counted to the extent that the offer is not terminated by the acceptance of tendered securities. Under the former rules, back-end withdrawal rights were suspended between the end of an initial offering period and the commencement of a subsequent offering period.

Length of subsequent offering periods. The revised rules eliminate the former 20-business day limit on subsequent offer periods. No maximum limit is imposed. This change also applies to offers for securities of domestic targets.

Prompt payment of securities tendered during the subsequent offering period. The revised rules modify the prompt payment requirement for subsequent offer periods in Tier II offers by introducing a modified rolling period. In lieu of the former requirement to aggregate daily, bidders are now permitted to “bundle” securities and pay for them within 20 business days of the tender date.

Mix and match offers. In mix and match offers, bidders offer a mix of cash and securities in exchange for target securities, but permit holders to request a different proportion of cash or securities. Given the U.S. tender offer rules on prompt payment and subsequent offering periods, bidders typically requested SEC relief to use two proration pools. Bidders are now allowed, in mix and match offers, to use different proration and offset pools: one for securities tendered in the initial offer and another for the subsequent offer. The revised rules also eliminate

the prohibition on a ceiling for the form of consideration in a Tier II mix and match offer, where the target holders may elect to receive alternate forms of consideration in the offer.

Payment of interest on securities tendered during the subsequent offering period.

Bidders are now allowed to pay interest on securities tendered during a subsequent offering period, where (and only if) required by foreign law. Note that the revised rules do not permit the payment of interest in the initial offering period.

Rule 14e-5. The amendments to Rule 14e-5, which prohibits purchases of, or arrangements to purchase, target securities outside and during the pendency of an offer, except pursuant to such offer, codify recurrent Staff's exemptive relief for tender offers relying on the Tier II exemption.

First, if the offer is structured as two or more offers (one made to U.S. security holders and one or more made to non-U.S. security holders), the amendments allow purchases of the securities in the foreign offer or offers during the U.S. offer, provided that U.S. security holders are treated as favorably as the non-U.S. security holders. The amendments also allow cash consideration to be paid to U.S. security holders to be converted from the currency paid in the foreign offer to U.S. dollars at the exchange rate disclosed in the U.S. offering materials. The new exception is limited to purchases in foreign offers and does not apply to open market transactions or other transactions conducted outside the offer.

Second, if the offer is structured as a single offer conducted in and outside the United States, the amendments allow purchases outside the offer when such purchases are permitted under the laws of the target's jurisdiction, provided that (i) no purchases or arrangements to purchase are made in the United States except pursuant to the offer; (ii) the U.S. offering materials prominently disclose the possibility of purchases outside the offer; and (iii) disclosure is made in the United States regarding the purchases made outside the offer (if such information is disclosed in the target's home jurisdiction).

In case an affiliate of a financial advisor purchases or arranges to purchase outside the offer, the amendments impose additional requirements, including (i) an obligation of the financial advisor and affiliate to maintain and enforce written policies to prevent the flow of information; (ii) an obligation of the financial advisor to have a registered broker-dealer affiliate in the United States; and (iii) a prohibition on the affiliate having officers or employees in common with the financial advisor that directly effects or recommends transactions in the subject securities. Purchases should be consistent with the affiliate's normal and usual business practices.

Termination of withdrawal rights after reduction or waiver of a minimum acceptance condition. The U.S. tender offer rules require a bidder to maintain a tender offer open for a certain period of time after a material change of the terms of the offer (*e.g.*, a reduction or waiver of a minimum acceptance condition) is communicated to the security holders. In the Cross-Border Adopting Release (1999), the SEC explained that a bidder meeting the conditions of the Tier II exemption may waive or reduce the minimum acceptance condition without providing withdrawal rights during the time remaining in the offer, subject to certain conditions. The SEC has now clarified that the ability to waive or reduce a minimum acceptance condition is limited to cases where local law and market practice make it impossible or unnecessarily burdensome to comply with the U.S. extension requirements (*e.g.*, in the United Kingdom); therefore, the mere inability to comply with the U.S. extension requirements under local law is not sufficient. In addition:

- five business days before the actual waiver or reduction, the bidder must announce (by means of a press release or similar methods, which involves the newsprint media)⁴ that it may waive or reduce the minimum acceptance condition, and disclose the percentage to which the minimum acceptance condition may be reduced;
- withdrawal rights must be provided for the five-business day period after that announcement;
- the offer must be open for at least five business days after the actual waiver or reduction;
- all conditions must be satisfied or waived when withdrawal rights are terminated;
- the bidder must fully disclose and discuss in the offering materials the procedures for waiver or reduction as well as all their potential implications; and
- the bidder cannot waive or reduce the minimum acceptance condition below the percentage required for the bidder to control the target after the offer under foreign law and, in any case, below a majority of the outstanding target securities that are subject to the tender offer.

Early termination or voluntary extension of initial offering period. Consistent with existing Staff no-action guidance, bidders are now allowed to terminate the initial offering period prior to its scheduled expiration, thereby terminating all withdrawal rights upon the satisfaction of all offer conditions, provided that the initial offering period was open for at least 20 business days, the bidder opens a subsequent offering period (after the termination of the initial offering period and upon satisfaction of all offer conditions), and the bidder discloses the possibility and impact of early termination in the initial offering materials.

Expanded Availability of Early Commencement of an Exchange Offer

The new rules expand the ability of bidders to commence an exchange offer before a registration statement filed with the SEC is declared effective, allowing “early commencement” for all exchange offers eligible for the Tier II exemption, as long as withdrawal rights are provided to the same extent, and the same minimum time periods after specified changes are observed, as required under Rule 13e-4 or Regulation 14D. Under the former rules, early commencement of an offer was allowed only when the offer was subject to Rule 13e-4 or Regulation 14D. This requirement was particularly burdensome where a bidder was making a single offer for both a Section 12 security (under Regulation 14D) and a non-Section 12 security (under Regulation 14E), in effect forcing the bidder to wait until its registration statement had been declared effective. The early commencement provision remains unavailable for going private transactions.

Amendment to Forms and Schedules

Forms CB and FX. All Forms CBs and F-Xs (filed in connection with a Form CB) can now be filed electronically. Under the former rules, a Form CB was required to be filed electronically only where the person furnishing it already was subject to Section 13(a) or 15(d) of the Exchange Act.

⁴ The Staff has acknowledged that newspaper advertisements may in the future become unnecessary as practice changes, and the Internet and other means of communication evolve.

Form S-4/F-4 and Schedule TO. Further, the revised rules have amended the cover pages of Form S-4, F-4 and Schedule TO, requiring the filer to check a box specifying the applicable cross-border exemption it is relying on.

Schedule 13G. The revised rules permit specified foreign institutions (institutions of the same type as the domestic institutions listed in Rule 13d-1(b)(1)(ii) of the Exchange Act) to report beneficial ownership of more than 5% of a subject class of securities on Schedule 13G (a short-form filing for holders of more than 5% of a class of securities that is registered under the Exchange Act), rather than filing a Schedule 13D, as was required, provided such institutions acquire securities in the ordinary course of business and not with the purpose or effect of changing or influencing the control of the issuer of the securities. To be able to take advantage of the new rule, these foreign institutions need to assess whether their home country regulatory scheme is substantially comparable to the regulatory scheme applicable to their U.S. counterparts.

Interpretative Guidance

In addition to the new rules, the SEC has provided interpretative guidance with respect to the following:

All-holders rule applied to non-U.S. holders. The all-holders provisions⁵ apply equally to U.S. and non-U.S. target holders. The SEC has reiterated that tender offers subject to Section 13(e) or 14(d) do not allow a bidder to exclude non-U.S. holders of target securities (including of U.S. targets). Interestingly, the SEC also notes that, although foreign holders may not be excluded from U.S. tender offers, the equal treatment requirement does not necessarily require that offering materials be mailed into foreign jurisdictions. The SEC also expressed the view that it is not appropriate for a bidder to require a target security holder to certify that tendering securities complies with local law or is subject to an available exemption.

Exclusion of U.S. holders. When a bidder permits U.S. security holders of a target to participate in a tender offer, it must follow U.S. rules (except if an exemption is available). U.S. tender offer rules, however, do not mandate that offers made offshore be extended to include U.S. security holders, and the Staff has remained consistent in its view to this effect. Thus, there is no automatic extraterritorial application of the all-holders rule or rules on equal treatment of security holders. The key, however, to legitimately avoiding the application of U.S. rules to a cross-border tender offer lies in not triggering U.S. jurisdictional means and, in the age of global internet access, how one avoids triggering U.S. jurisdictional means is not clear.

The critical question then is how bidders can conduct exclusionary offers with some certainty. (Note that the SEC is of the view that it is inappropriate for a U.S. bidder to exclude from its offer U.S. security holders of a non-U.S. target.) The SEC emphasizes that bidders must take special precautions to ensure offers are not in fact made in the United States.

Several measures have consistently been highlighted by the SEC, such as (i) including legends in the offering materials and on the issuer's web site to the effect that the offer is not being made, and materials are not being distributed, in the United States; (ii) taking special precautions to ensure that there are no acceptances from, or sales to, residents in the United States, including responding to inquiries and processing letters of transmittal and obtaining adequate information to determine whether a security holder is a U.S. investor; and (iii) requiring representations by tendering holders that they are not U.S. residents.

⁵ Rules 13e-4(f) and 14d-10 of the Exchange Act.

In its May 2008 release,⁶ the SEC notes that the inclusion of legends and disclaimers (see (i) above) is not sufficient to avoid triggering the application of U.S. rules to an offer since U.S. holders are not *prevented from participating* in the offer. In the view of the SEC, stating that an offer “is not being made in the United States” is not sufficient if, as a practical matter, U.S. security holders of the target are not, and may not be, prevented from participating by using U.S. jurisdictional means. Bidders can, in addition to requiring representations of tendering security holders, if possible under local rules and where tenders are made through nominees, require nominees to certify that tenders are not being made on behalf of U.S. holders.

The SEC has indicated that it will closely monitor tender and exchange offers that exclude U.S. holders to determine if any action is necessary in order to protect such holders. (Note that the Staff has previously stated that an acquiror, other than a bidder in a tender or exchange offer, should not be permitted to avoid payment of the same consideration to U.S. holders.)

Vendor placements. In a vendor placement, a bidder employs a third party to sell securities to which the U.S. holders would be entitled (typically in a Tier II transaction) and pays the cash over to the U.S. holders. This process allows a bidder to extend an exchange offer into the United States and avoid the registration requirement of the Securities Act (as cash, and not a security, is provided to the U.S. holders). Given that Tier I may be used in exchange offers to issue cash to U.S. holders, the Staff no longer intends to issue vendor placement no-action letters regarding the registration requirements of Section 5.

When granting no-action relief in respect of vendor placements, the Staff historically has considered several factors, including (i) the level of U.S. ownership of the target; (ii) the amount of securities to be issued overall; (iii) the amount of securities to be issued to tendering U.S. holders; (iv) the liquidity and general trading market of the bidder’s securities; (v) the likelihood of the bidder disclosing material information before the closing; (vi) the timing of the vendor placement relative to the tender; and (vii) the process used to effect the sales of the subject securities.

In the May 2008 release, the SEC notes that a bidder should be cognizant of U.S. ownership levels. It also notes that the market for the subject securities should be robust and highly liquid and that the number of bidder securities to be issued in respect of U.S. holders should be relatively small compared to the total number of outstanding bidder securities. The SEC would also consider (i) whether sales of securities are effected within a few business days of the closing of the offer; (ii) whether the bidder announces material information before the process is complete; and (iii) whether the vendor placement involves special selling efforts by brokers (or other persons acting on behalf of the bidder).

In cases where bidders use vendor placement arrangements for a tender offer subject to Regulation 14D, and the U.S. ownership level is above Tier I, the bidder needs to seek an exemption from those rules; relief will only be granted if in the interest of U.S. investors. The SEC also reiterates that in a tender offer subject to Regulation 14D, offering cash to some U.S. holders and securities to those U.S. holders who can receive the securities in a transaction exempt from registration under the Securities Act violates the all-holders rule.

⁶ <http://www.sec.gov/rules/proposed/2008/33-8917.pdf>

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