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Cross-Border M&A –
SEC Proposes Revisions to Cross-Border Transaction Exemptions

Eight years after adopting the current regulatory regime for cross-border transactions, and in the face of an increasing number of non-U.S. tender and exchange offers and business combination transactions in some way subject to U.S. securities laws, the SEC has proposed revisions to those rules. SEC Release No. 33-8917 (May 6, 2008). The revisions represent a modest advance toward clarifying existing exemptions and, if implemented, would provide U.S. and non-U.S. bidders somewhat greater certainty and flexibility in structuring deals for non-U.S. targets. The release also requests comments on a number of additional possible changes that could further broaden the exemptions. The proposed revisions do not address a key concern with the existing regulations, which is that existing regulations subject foreign issuers – in many cases already subject to complex and complete regulation in their home jurisdiction – to potential exposure under the anti-fraud, anti-manipulation and civil liability provisions of the U.S. federal securities laws in connection with transactions with relatively modest U.S. entanglements. The risk of such exposure under U.S. law has persuaded many international issuers and bidders to avoid U.S. markets and U.S. investors altogether, to the detriment of global capital markets in general and U.S. investors in particular. The present amendments may thus be a way-station to a more comprehensive future revision of the cross-border rules.

The current rules presumptively subject non-U.S. transactions to the full regulatory force of the federal securities laws. Relief from U.S. regulatory obligations is available when the transaction qualifies for one of two exemptions. The "Tier I" exemption applies where U.S. persons hold no more than 10% of a security subject to a tender offer (after "looking through" record ownership). Tier I transactions are exempt from almost all of the disclosure, filing and procedural requirements of the U.S. federal tender offer rules, and securities issued in Tier I exchange offers, business combination transactions and rights offerings need not be registered under the U.S. Securities Act. The "Tier II" exemption applies where U.S. ownership is more than 10% but not more than 40%. Tier II provides narrow relief from specified U.S. tender offer rules that often conflict with non-U.S. law and market practice (such as with respect to prompt payment, withdrawal rights, subsequent offering periods, extension of offers, notice of extension and certain equal treatment requirements) but does not exempt the transaction from most of the procedural, disclosure, filing and registration obligations applicable to U.S. transactions. Non-U.S. transactions where U.S. ownership in the target company exceeds 40% are subject to U.S. regulation as if the transaction were entirely domestic.

The primary thrust of the proposals is to clarify application of the existing 10%/40% thresholds for business combination transactions. Perhaps the most significant proposed revision is that the ownership levels would be assessed at any point within a 60-day range prior to public announcement of the transaction instead of precisely at the 30th day before commencement. Setting the date of public announcement as the trigger point would be a welcome change as a target's shareholder base may change significantly post-announcement as arbitrageurs enter the stock. In addition, bidders facing extended home-country regulatory review often cannot predict at the time of announcement whether the exemption would remain available at commencement. Although the SEC has solicited comment on alternative eligibility tests (such as a trading volume standard), the continued use of the "look-through" test is a reminder that target companies must manage the risk of premature disclosure as they contact nominees and other holders of record for the "look-through" analysis in negotiated transactions.

With respect to unsolicited offers, present SEC rules do not "look through" record ownership but instead allow bidders to rely on relative average daily trading volumes of the target's securities in the U.S. and worldwide over a 12-month period in determining Tier I or Tier II eligibility (absent actual or constructive bidder knowledge as to the applicability of a presumption). Under the proposed rules, this period would end no later than 60 days before announcement of the offer instead of 30 days before commencement (as is now the case). The proposed rules also clarify that only information that is "publicly available" *prior to announcement* will be imputed; post-announcement developments and knowledge gained after the announcement will be irrelevant.

Competing bids would also be affected by the proposed rules. Bidders would no longer be permitted to terminate withdrawal rights in Tier II-eligible offers after reducing or waiving the minimum acceptance condition to non-majority levels, even where the primary, non-U.S. regulatory regime has no such requirement. This change would complicate efforts by an initial bidder to obtain a minority blocking position against a subsequent bid. In addition, the revisions should enhance the competitiveness of exchange offers against cash bids by ensuring that the "early commencement" option for exchange offers is available even where offers for unregistered equity or non-debt securities are coupled with offers for registered equity securities. Importantly, the proposed revisions preserve the ability of a second or subsequent acquirer to rely on the same cross-border exemption used by the initial bidder even if U.S. ownership levels have increased.

The proposed rules would also expand relief in certain areas of recurring regulatory conflict and codify exemptions currently provided on a case-by-case "no-action" basis. Tier I transactions would be fully exempt from Rule 13e-3's heightened "going-private" disclosure requirements regardless of transaction structure, and the exemption from Rule 14e-5's prohibition on purchases outside a tender offer would apply to Tier II as well as Tier I transactions if certain conditions are met. Codified Tier II relief would include extending the exemption to qualifying offers not subject to Rule 13e-4 or Regulation 14D under the Exchange Act such as offers for unregistered equity securities, non-equity securities and certain partial offers; authorizing unlimited non-U.S. offers in conjunction with a U.S. offer (a single proration pool must still be used); permitting U.S. offers to include non-U.S. holders of American Depositary Receipts, and non-U.S. offers to include U.S. holders, if appropriate risk disclosure is made and home-country rules do not permit their exclusion; and permitting bidders to suspend back-end withdrawal rights during the counting of tendered securities.

Guidance is also provided on what special precautions bidders conducting exclusionary offers limited to non-U.S. holders may or should take to prevent triggering the application of U.S. rules (*e.g.,* legends coupled with adequate measures reasonably designed to guard against sales to and purchases and tenders from U.S. holders; limiting Internet availability of materials; certain vendor placement arrangements). The proposals also solicit comment on whether, and under what circumstances, equal protection principles and the "all-holders" rule should be loosened to permit tender offers generally subject to U.S. rules, including those for U.S. target companies, to exclude foreign target security holders.

As significant as the proposed revisions is the SEC's request for comment on increasing the Tier I threshold from 10% to 15%. So long as the Tier I exemption remains unavailable or uncertain, the risk of U.S. regulatory exposure will create a disincentive for bidders and targets to include U.S. security holders in transactions involving non-U.S. companies and have an often material impact on principally non-U.S. transactions where the inclusion of U.S. holders is necessary (for instance because of non-U.S. anti-discrimination regulations) or difficult or impossible to avoid as practical matter. Increasing the U.S. ownership threshold for the Tier I exemption to 15% – or higher – would appear to be the most direct way to ensure the availability of such transactional and market opportunities for U.S investors and further enhance the global integration of the U.S. capital markets. Nonetheless, even at a 15% threshold, the U.S. regulatory burden will remain significant and complicated for non-U.S. transactions involving companies with relatively minor U.S. shareholdings and sophisticated home-country regulation. Accordingly, whether the revised regime will be fully successful in appropriately limiting U.S. regulatory and legal involvement in transactions not principally involving U.S. companies or U.S. security holders – and thereby not discouraging non-U.S. issuers from having their securities held by U.S. persons – remains to be seen.

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