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A legal update from Dechert's Corporate and Securities Group

SEC Proposes Amendments to Cross-Border Rules

The U.S. Securities and Exchange Commission (the "SEC") published a release on May 9, 2008,¹ providing proposed technical revisions to its rules relating to cross-border business combination transactions in an effort to address areas of conflict with foreign regulations and practice that are encountered in many cross-border transactions. The SEC believes that these amendments will expand and enhance the cross-border exemptions originally adopted in 1999 to facilitate the inclusion of U.S. security holders in foreign transactions. The proposed revisions address recurring issues and unintended consequences of the current rules that have impeded the usefulness of the cross-border exemptions since their inception.

The proposed revisions represent an expansion and refinement of the current exemptions. In addition, many of the rule revisions proposed by the SEC would codify various existing interpretive positions and exemptive orders in the cross-border area which were previously granted only on an individual basis. By codifying these positions, the SEC believes that much of the relief sought in the past through no-action or exemptive letters would now be available as a matter of right, effectively reducing the associated burden and costs for issuers and bidders of extending cross-border offers to U.S. holders.

The most significant revision proposed by the SEC is a refinement of the tests for calculating U.S. ownership of the target company for pur-

poses of determining eligibility to rely on the U.S. cross-border exemptions. The current eligibility test is a threshold test whereby the amount of U.S. ownership is determined as of the 30th day before *commencement* of a cross-border tender offer or business combination. The proposals by the SEC would, among other things, allow acquirers to calculate U.S. ownership as of a date within a 60-day window of *announcement* of a cross-border tender offer or business combination rather than using a single, specified date as previously required.

This proposed change responds to the practical difficulties faced in some jurisdictions which made it impossible to calculate U.S. ownership as of a set date due to logistical problems in the time needed to conduct the mandated look-through analysis or because of the regulatory review process. The SEC believes that the proposed revisions will provide greater flexibility as to the date on which U.S. ownership in the target company may be assessed and thus resolve several of the issues created by the current timing and informational restrictions which have impeded the application of the current cross-border exemptions.

Another important proposed revision is to permit foreign financial institutions to report beneficial ownership of a U.S. reporting company by filing a Schedule 13G as permitted by their similar U.S. counterparts, rather than a Schedule 13D, which requires more extensive disclosure and filing requirements. To be eligible to file on a Schedule 13G, the foreign financial institution would be required to determine and certify that it is subject to a regulatory scheme comparable to the regulatory scheme applicable

¹ Revisions to the Cross-Border Tender Offer, Exchange Offer, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, SEC Release No. 34-8917 (May 6, 2008).

to its U.S. counterparts and certify that it will provide Schedule 13D-type information upon the SEC's request. Schedule 13G is only available to institutions, foreign or domestic, which hold securities in the ordinary course of business for investment purposes only (i.e., without the purpose or intent of changing control of the issuer).

Other proposed revisions provided in the SEC's release include:

- expanding the relief available under the Tier I exemption (applicable where U.S. persons hold 10% or less of the relevant class of target securities) for affiliated transactions subject to Rule 13e-3 for transaction structures not currently covered under the current cross-border exemptions, such as schemes of arrangement, cash mergers, and compulsory acquisitions for cash;
- technical changes to the definition of the term "issuer" in Rule 802;
- extending the specific relief afforded under the Tier II exemption (limited relief applicable where U.S. persons hold more than 10% but no more than 40% of the relevant class of target securities) to tender offers regardless of whether the target securities are subject to the provisions of Rule 13e-4 or Regulation 14;
- expanding the relief under the Tier II exemption to eliminate several conflicts between U.S. and foreign law, including (i) allowing more than one offer to be made abroad in conjunction with a U.S. offer, (ii) permitting bidders to include foreign security holders in a U.S. offer and U.S. holders in a foreign offer or offers, and (iii) allowing separate offset and proration pools for securities tendered during the initial and subsequent offering periods;
- termination of withdrawal rights while tendered securities are counted and before they are accepted for payment in tender offers conducted under the Tier II exemption;
- expanded relief for subsequent offering periods in Tier II cross-border tender offers to allow for a period of greater than 20 U.S. business days currently imposed by the rules;
- codifying frequent exemptions granted from Rule 14e-5's prohibition for Tier II tender offers in three recurring areas: purchases and arrangements to purchase securities of a foreign private issuer (i) pursuant to the non-U.S. tender offer for a cross-border tender offer where there are separate U.S. and non U.S. offers; (ii) by offerors and their affiliates outside of a tender offer; and (iii) by financial advisor's affiliates outside of a tender offer;
- expanding the availability of the early commencement option, whereby exchange offers under the Tier II exemption may commence upon the date of the filing of the registration statement, for cross-border exchange offers subject to the provisions of Regulation 14E only; provided the offeror voluntarily provides the protections required in an offer subject to Rule 13e-4 or Regulation 14; and
- certain other technical changes to other related SEC rules, schedules and forms.

The SEC release also provides guidance and solicits comments on some interpretive issues that have arisen since the original adoption of the cross-border exemptions. One of these issues involves transactions whereby bidders seek to avoid the registration requirements under the Securities Act by establishing a vendor placement arrangement, whereby a third party is employed to sell securities in offshore transactions for the benefit of U.S. target security holders who tender into the offer. However, a vendor placement arrangement does not in all circumstances eliminate the requirement for Securities Act registration. The SEC provides a number of factors which the staff considers in deciding whether a vendor placement arrangement obviates the need for Securities Act registration, such as the level of U.S. ownership in the target company, the amount of bidder securities outstanding before the business combination compared to both the amount issued overall in the offer and the amount tendered to U.S. holders through the vendor placement, and the liquidity and general trading market of the bidder's securities. The SEC believes that a vendor placement arrangement in cross-border exchange offers would be subject to Securities Act registration unless the market for the bidder securities to be issued is highly liquid and robust and the number of bidder securities to be issued for the benefit of tendering U.S. holders is relatively small compared to the total number of securities outstanding.

The SEC issued further interpretive guidance on several other issues, including:

- the ability to terminate an initial offering period before a scheduled expiration date;
- the ability of bidders in tender offers to waive or reduce the minimum tender condition without providing withdrawal rights;
- the application of the “all-holders rule” (Rule 14d-10) to foreign target security holders; and
- the ability of bidders to exclude U.S. target security holders in cross-border tender offers.

Although the proposed amendments focus largely on cross-border business combinations, the SEC has solicited comments on whether many of these changes should apply to business combinations where the target company is a U.S. issuer. The SEC noted that it may choose to adopt such changes at the same time it adopts changes to the cross-border business combination rules.

The SEC is seeking comments on this release by June 23, 2008. Please feel free to contact us if you have any questions or comments on the SEC’s proposals. We will prepare a detailed update when the SEC publishes final rules.

Practice group contacts

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