
Securities Law Developments

CORPORATE FINANCE DEVELOPMENTS

SEC Proposes Rules Accommodating Cross-Border Tender Offers, Business Combinations and Rights Offerings

On November 13, 1998, the Securities Exchange Commission ("SEC") proposed new rules designed to encourage foreign companies to include U.S. holders in their rights offerings, business combinations and tender offers.^{1/} Under current law, U.S. holders of securities of foreign companies often are excluded from these offerings because the foreign company is unwilling or unable to comply with U.S. securities laws. This exclusion can deprive U.S. holders of the full economic benefit of their investments. The release proposes exemptions for cross-border rights offerings, business combinations and tender offers in those instances in which U.S. ownership is minimal or, for certain tender offers, where there is a direct conflict between U.S. and foreign regulations.

Summary of Proposed Exemptions

The release proposes the following exemptions under the U.S. securities laws (which are described in more detail below):

Rights Offerings -- Securities Act Exemption. For rights offerings by foreign private issuers^{2/} in which no more than 5% of the subject securities are held by U.S. holders, the rights offering would be exempt from the registration requirements of the Securities Act.

Exchange Offers and Business Combinations -- Securities Act and Trust Indenture Act Exemptions. Securities offered in exchange offers or in certain business combinations by foreign private issuers in which no more than 5% of the subject securities are held by U.S. holders would be exempt from the registration requirements of the Securities Act and the qualification requirements of the Trust Indenture Act of 1939 (the "Trust Indenture Act").

Tender Offers -- Williams Act and Rule 10b-13 Exemptions. For tender offers for securities of foreign private issuers in which no more than 10% of the subject securities are held by U.S. holders, the tender offer would be exempt from the tender offer provisions of the

Exchange Act. For tender offers for securities of foreign private issuers in which more than 10% but less than 40% of the subject securities are held by U.S. holders, limited tender offer exemptive relief would be available.

In connection with all of the proposed exemptions, the U.S. anti-fraud and anti-manipulation rules would continue to apply to the transactions.

Rights Offerings -- Securities Act Exemption

In a rights offering, an issuer typically distributes rights to purchase additional securities to its shareholders on a pro rata basis. This generally involves a public offering of the securities that can be acquired on exercise of the rights, which requires registration under the Securities Act. Although uncommon in the U.S., rights offerings are common in many foreign jurisdictions. Generally, foreign private issuers either “cash out”^{3/} U.S. holders or let the rights of the U.S. holders lapse, rather than register the offering in the U.S.

In the release, the SEC proposes the adoption of new Rule 801 that would exempt certain rights offerings from the registration requirements of the Securities Act.^{4/} In order for a rights offering to be exempt, the following requirements would need to be satisfied:

Issuer Eligibility. The issuer must be a foreign private issuer.

Ownership Threshold. U.S. holders must own of record not more than 5% of the foreign company's securities that are subject to the offering. The method of calculating U.S. ownership, which applies to all of the proposed exemptions, is described in the final section of this newsletter.

It is significant that the SEC chose to rely on a percentage of ownership, rather than a maximum dollar amount, for the exemption. With this approach, a large foreign private issuer with a small percentage of U.S. ownership could include its U.S. holders in the offering even though the overall size of the rights offering is very large.

Equal Terms. The terms and conditions of the offer must be at least as favorable for U.S. holders as they are for foreign holders.

Transfer Restrictions for Rights and Underlying Securities. The rights must not be transferable by U.S. holders except offshore pursuant to Regulation S. In addition, the securities issued on exercise of the rights will be “restricted” securities under Rule 144. As a result, the securities would be subject to significant resale restrictions in the U.S. However, Regulation S should be available for offshore resales back into the principal market.

Information Dissemination Requirements. No specific disclosure document would be required. Instead, an English language copy of any document, notice or other information provided to the offshore offerees must be distributed to the U.S. offerees.

Notification and Appointment of Agent for Service of Process Requirements. A notification of the rights offering must be submitted to the SEC on Form CB no later than the business day after dissemination or publication of information about the offering in the home jurisdiction. The notice would include, as an attachment, a copy of any document, notice or other information provided to the U.S. offerees. In addition, the issuer would be required to file a Form F-X with the SEC appointing a U.S. agent for service of process.

Legend Requirement. The offering document must include a specific legend notifying offerees that the disclosure may differ from that required by U.S. law and that the offerees may find it difficult to enforce certain rights.

Type of Securities. The rights offering must relate to securities of the same class as already held by the U.S. holders, and the securities must be equity securities. As proposed, equity securities would not include convertible securities, warrants, rights or options.

Exchange Offers and Business Combinations -- Securities Act and Trust Indenture Act Exemptions

Tender offers that are structured as exchanges of securities for outstanding securities (called “exchange offers”) must comply with both the registration requirements of the Securities Act and the tender offer rules under the Exchange Act. A merger or other business combination in which a foreign issuer's securities will be issued as the consideration also requires registration under the Securities Act. In many cases, foreign issuers exclude U.S. holders from these transactions because they are unwilling to register their securities under the Securities Act.

The SEC proposes to address this problem through the adoption of new Rule 802 that would exempt the offer and sale of securities in certain exchange offers and business combinations from the registration requirements of the Securities Act. The requirements in Rule 802 would be similar to those in proposed Rule 801 for rights offers. In order for the securities offered in an exchange offer or other business combination to be exempt, the following requirements would need to be satisfied:

Eligible Offerings. The target company must be a foreign private issuer.

Ownership Threshold. U.S. holders must own of record not more than 5% of the foreign company's securities that are subject to the offering, and, in a business combination, U.S. holders must own of record not more than 5% of the class of offered securities of the successor immediately after the transaction. As with the rights offering exemption, the focus on the percentage of U.S. holdings, rather than the dollar amount, should allow significant worldwide exchange offers and other business combinations to be extended to U.S. holders.

Equal Terms. The terms and conditions of the offer must be at least as favorable for U.S. holders as they are for foreign holders.^{5/}

Restrictions on Transfer. The securities would be freely transferable unless the securities exchanged were "restricted" securities. If they were restricted, then the new securities would also be restricted.

Information Dissemination Requirements. No specific disclosure document would be required. Instead, an English language copy of any document, notice or other information provided to the offshore offerees must be distributed to the U.S. offerees.

Notification and Appointment of Agent for Service of Process Requirements. A notification of the exchange offer or other business combination must be submitted to the SEC on Form CB, which includes as an attachment a copy of any document, notice or other information disseminated to the U.S. offerees. In addition, the offeror would be required to file a Form F-X with the SEC appointing a U.S. agent for service of process.

Legend Requirement. The offering document must include a specific legend notifying offerees that the disclosure may differ from that required by U.S. law and that offerees may find it difficult to enforce certain rights.

Type of Securities -- Trust Indenture Act Exemption. Under proposed Rule 802, there are no restrictions on the type of securities that may be offered. If the business combination or exchange offer contemplates debt securities, such debt securities would not need to be qualified under the Trust Indenture Act.

Tender Offers -- Williams Act and Rule 10b-13 Exemptions

Tender offers in the U.S. are subject to regulation under Sections 14(d) and 14(e) of the Exchange Act and Regulations 14D and 14E thereunder. Regulation 14E under the Exchange Act applies to all tender offers in the U.S. It imposes restrictions regarding minimum offering and extension time periods, prompt payment requirements and notice of extension of offers. Regulation 14D applies to tender offers for equity securities that are registered under Section 12

of the Exchange Act. Regulation 14D imposes a number of additional requirements, including filing of certain information with the SEC and conducting the offering in accordance with detailed rules.^{6/} The provisions of the Exchange Act that govern tender offers are known as the “Williams Act”.

The release proposes two levels of exemptions for cash or stock tender offers for securities of foreign private issuers based on the percentage of ownership by U.S. security holders. The “Tier I Exemption” would apply to tender offers in which no more than 10% of the securities sought in the tender offer are held by U.S. security holders. The “Tier II Exemption” would apply to tender offers in which between 10% and 40% of the securities sought in the tender offer are held by U.S. security holders. The Tier I and Tier II exemptions would be available to both U.S. and foreign bidders.

Tier I Exemption

Under the proposed Tier I Exemption, eligible tender offers (including eligible self tender offers and “going-private transactions”) would not be subject to the disclosure, dissemination, minimum offering period, withdrawal rights and proration requirements of the Williams Act.^{7/} To be an eligible tender offer, in addition to the 10% ownership restriction, the following requirements must be met:

Equal Terms. U.S. security holders must be allowed to participate in the offer on terms at least as favorable as those offered to any other holders.^{8/}

Information Dissemination Requirement. Bidders must provide U.S. security holders an English language copy of the offering materials on a comparable basis as the other security holders.

Notification and Appointment of Agent for Service of Process Requirements. If the class of securities subject to the tender offer would be subject to Rule 13e-4 or Regulation 14D, the bidder must submit an English language translation of the offering materials to the SEC with Form CB and file an appointment of agent for service of process on Form F-X.

If the foregoing requirements are met, a bidder could take advantage of the Tier I Exemption and, instead of complying with the tender offer provisions of the Exchange Act, comply with any applicable home jurisdiction tender offer requirements.

Rule 10b-13 Exemption.

Rule 10b-13 under the Exchange Act prohibits a person who is making a tender offer from purchasing or arranging to purchase, directly or indirectly, the security that is subject to the offer otherwise than pursuant to the offer.^{9/} The SEC proposed that bidders in cash or stock tender offers under the Tier I Exemption be permitted to make purchases outside the offer if the following conditions have been satisfied:^{10/}

- The U.S. offering documents disclose prominently the possibility of any purchases, or arrangements to purchase, or the intent to make purchases otherwise than pursuant to the terms of the tender offer
- The bidder discloses information in the U.S. regarding such purchases in a manner comparable to disclosures made in the home jurisdiction
- The purchases comply with the applicable tender offer laws and regulations of the home jurisdiction

Tier II Exemption

Under the proposed Tier II Exemption, eligible tender offers would be provided limited exemptive relief from certain provisions of the Williams Act and the tender offer regulations. The provisions from which exemptions would be granted were viewed by the SEC as common impediments to extending tender offers in the U.S., based on the SEC's experience in granting individual relief requests. Since only limited exemptive relief would be granted under the proposed Tier II Exemption, tender offers relying on the Tier II Exemption would still be subject to the disclosure, filing and most of the procedural and equal treatment requirements of the U.S. tender offer rules that would otherwise apply to the offer.

The limited exemptive relief permitted under the Tier II Exemption includes relief with respect to:

- commencement of an offer
- withdrawal rights
- all-holders/best price
- notice of extensions

- prompt payment
- reductions of minimum condition

Commencement of an Offer. Under Rule 14d-2(b), in connection with third-party cash offers for registered equity securities, the bidder must “commence” the offer by filing with the SEC and disseminating a mandated disclosure document within five business days of a public announcement of the significant terms of the offer.^{11/} By contrast, some foreign jurisdictions require a bidder to publicly announce its intention to make a tender offer before the bidder is prepared to commence the offer. The proposals would allow the bidder to delay the commencement of the offer until mailing or publication of the offer as long as this is required by, and is done in a manner consistent with, home jurisdiction law or practice. In addition, any materials provided in the U.S. must contain a legend noting that the offer will not commence until the bidder mails or publishes the offering document and, if the offer will proceed, offer documents must be mailed no later than 30 days following the announcement.

Withdrawal Rights. Under U.S. tender offer rules, a bidder must permit tendering security holders to withdraw shares during the term of the offer and through any extension of the offer (including after the close of the offer if within 60 days after the commencement of the offer the bidder has not accepted the tendered securities for payment).^{12/} Under the Tier II Exemption, a bidder may terminate withdrawal rights before the expiration of the offer if the following conditions are met:

- the offer is for all of the outstanding shares
- all of the conditions to the offer are satisfied or waived before the withdrawal rights are terminated
- the bidder satisfies all minimum U.S. tender offer time periods
- the bidder extends withdrawal rights during the minimum time periods
- the bidder accepts and promptly pays for all previously tendered securities upon termination of withdrawal rights
- the bidder immediately accepts and promptly pays for all securities tendered thereafter
- the bidder previously advised U.S. security holders of the possibility of early termination of withdrawal rights

All-Holders/Best Price. The “All-Holders/Best Price Rule” provides that a bidder must open a tender offer to all security holders and the consideration paid to any security holder must be as high as the consideration paid to any other security holder.^{13/} The Tier II Exemption would provide relief from this rule in two situations. First, the bidder would be permitted to divide the tender offer into two separate offers, one that would comply with the U.S. regulatory requirements and the other that would comply with the home jurisdiction regulatory requirements. The offer to U.S. holders would be required to be made on terms at least as favorable as those offered to other holders. Second, the bidder could offer a loan note alternative to the security holders that would receive beneficial tax treatment with respect to such loan note alternative, while not being required to extend such alternative to the other security holders that do not receive such beneficial tax treatment.

Notice of Extensions. Under U.S. tender offer rules, if a bidder wants to extend an offer beyond its scheduled expiration date, it must publish notice of the extension by the beginning of the next business day prior to the commencement of trading.^{14/} The Tier II Exemption would permit bidders to announce extensions of a tender offer in accordance with the requirements of the home jurisdiction.

Prompt Payment. The U.S. tender offer rules require the bidder to promptly pay for or return any tendered securities after the expiration of the offer.^{15/} The Tier II Exemption would permit payment in accordance with home jurisdiction law or practice.

Reduction of Minimum Conditions. At least five business days must remain in an offer following the waiver of a minimum tender condition.^{16/} In the release, the Commission indicated that it would not object if bidders qualifying for the Tier II Exemption reduce the minimum condition without extending withdrawal rights (unless an extension is required by Rule 14e-1) if the following conditions are met: the bidder must announce by press release and advertisement in a U.S. newspaper of national circulation that it may reduce the minimum condition five business days before any reduction

- the press release must state the exact percentage to which the minimum condition may be reduced and state that a reduction is possible
- the bidder must declare its actual intentions once it is required to do so under the regulations of the home jurisdiction
- during the five-day period, security holders who have tendered their shares in the offer will have withdrawal rights

- the announcement must contain language advising the security holders to withdraw their tenders immediately if their willingness to tender into the offer would be affected by a reduction of the minimum conditions
- the procedure for reducing the minimum condition must be described in the offering document
- the bidder must hold the offer open for acceptance for at least five business days after the satisfaction of the minimum condition

Although the limited exemptive relief under the Tier II Exemption is based primarily on the provisions of the Williams Act that conflict with the City Code, the law that governs tender offers in the United Kingdom and the Republic of Ireland, the SEC has proposed that such relief be extended to tender offers in any jurisdiction.

Determination of U.S. Ownership for Purposes of each of the Exemptions

A person is a "U.S. holder" for purposes of all of the exemptions if the person's address as it appears on the records of the issuer of the subject securities, or of any voting trustee, depositary, share transfer agent, or any person acting in a similar capacity on behalf of the issuer of the subject securities, is located in the United States. For ADRs, unless information provided by the depositary demonstrates otherwise, holders of ADRs would be counted as U.S. holders of the underlying securities.

Additionally, U.S. ownership percentages would be based on the non-affiliated worldwide public float. Any shares that are held by non-U.S. holders of more than 10% of the class of the subject securities would be excluded from the calculation in determining the percentage of U.S. ownership.

For a third party bidder in a hostile tender offer, the SEC recognized that such a third party bidder generally would not have access to the information necessary to determine the percentage of the target company that is held by U.S. security holders. Such third party bidders will be entitled to a presumption that the percentage threshold requirements of the Tier I, Tier II and Rule 802 exemptions are not exceeded unless:

- the aggregate trading volume of the subject class of securities on national securities exchanges in the United States, Nasdaq Stock Market or on the OTC market, exceeds 10% in the case of Tier I offers, 40% in the case of Tier II offers or 5% in the case of Rule 802, of the worldwide aggregate trading volume of that class of securities over the twelve month period prior to commencement of the offer,

- the most recent annual report of other financial form filed by the issuer with the securities regulator in its home jurisdiction or elsewhere indicates that U.S. holdings exceed the applicable threshold, or
- the bidder knows or has to reason to know from other sources that the level of ownership of the subject class exceeds the thresholds.

These presumptions are only available in the hostile tender offer situation. Negotiated third-party offers could not rely on these presumptions.

* * *

These proposals would provide important relief to foreign issuers, and likely would result in less frequent exclusion of U.S. holders from foreign issuer offers. Although some of the requirements are complex and may be viewed by some as not going far enough, overall the proposals represent a strong step in the right direction. The comment period on the proposals expires on February 16, 1999.

If you have any questions, please call Meredith B. Cross (202/663-6644), Roger J. Patterson (202/663-6246) or Denise Manning-Cabrol (202/663-6131).

WILMER, CUTLER & PICKERING

2445 M Street, N.W.
Washington, D.C. 20037-1420
Telephone: (202) 663-6000
Facsimile: (202) 663-6363
www.wilmer.com

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^{1/} Release No. 33-7611 (November 13, 1998).

^{2/} The term “foreign private issuer” is defined in Rule 405 under the Securities Act of 1933 (the “Securities Act”) and Rule 3b-4 under the Securities Exchange Act of 1934 (the “Exchange Act”). Generally, a foreign private issuer is a non-governmental foreign issuer that does not have the following characteristics: (1) more than 50% of the issuer's voting securities are held by U.S. residents, and (2) either (a) the majority of the issuer's executive officers or directors are U.S. citizens or residents, (b) more than 50% of the issuer's assets are located in the U.S., or (c) the business of the issuer is administered principally in the U.S.

^{3/} Rights are sold on behalf of the U.S. security holders in the overseas market, with the proceeds of such sale being sent to the U.S. security holders.

^{4/} The exemption would not cover state “blue sky” registration requirements. Although many states exempt sales to existing security holders, it will be important to consider state requirements.

^{5/} Specific exceptions to the equal treatment rule would be provided to address Blue Sky law issues and foreign tax issues.

^{6/} Many foreign equity securities are not registered under Section 12. Generally however, any securities of a foreign issuer that are listed on a U.S. securities exchange or quoted on the Nasdaq Stock Market would be registered.

^{7/} Rules 13e-3 and 13e-4, Regulation 14D and Rules 14e-1 and 14e-2.

^{8/} Specific exceptions to the equal treatment rule would be provided to address Blue Sky law issues and foreign tax issues.

⁹ The rule includes any securities that are immediately convertible into or exchangeable for the subject security.

^{10/} A separate limited exemption from Rule 10b-13 is proposed for tender offers subject to The City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisition of Shares, the law that governs tender offers in the United Kingdom and the Republic of Ireland (the “City Code”). See proposed Rule 10b-13(e).

^{11/} The SEC has proposed to relax the commencement requirement for all tender offers in its proposals to reform the regulation of takeovers and shareholder communications. See Release 34-40633 (November 3, 1998).

^{12/} Exchange Act Section 14(d)(5); Rule 14d-7.

^{13/} Rule 14d-10.

^{14/} Rule 14e-1(d).

^{15/} Rule 14e-1(c).

