

Legal Updates & News

Legal Updates

SEC Adopts Revisions to its Cross-Border Transaction Exemptions and Beneficial Ownership Reporting Rules

October 2008

by [Kristian E. Wiggert](#), [Scott D. Ashton](#)

Related Practices:

- [Corporate](#)
- [Mergers & Acquisitions](#)
- [Public Companies & Corporate Governance](#)

Introduction

On September 19, 2008, the United States Securities and Exchange Commission (the “SEC”) published its final rule and interpretive guidance regarding changes to its cross-border transaction rules and beneficial ownership reporting requirements for non-U.S. institutions.^[1] The rule changes are intended to expand the scope of exemptions for cross-border transactions involving foreign private issuers^[2] from SEC regulation and to allow certain non-U.S. institutions to report ownership on short-form Schedule 13G to the same extent as would be permitted for their U.S. counterparts. Some of the rule changes and guidance also apply to U.S. tender offers and exchange offers. The amended rules will become effective December 8, 2008.

Cross-Border Exemptions

The SEC’s cross-border exemptions are structured as a two-tier system based principally on the percentage of target securities of a foreign private issuer beneficially owned by U.S. holders. Where U.S. holders own no more than 10 percent of the subject securities, a qualifying cross-border transaction is exempt from most U.S. tender offer rules pursuant to the “Tier I” exemptions and from the registration requirements of Section 5 of the Securities Act of 1933, as amended (the “Securities Act”), pursuant to Securities Act Rules 801 and 802. Where U.S. holders own greater than 10 percent but no more than 40 percent of the subject securities, the “Tier II” exemptions can provide relief from certain U.S. tender offer rules, such as the prompt payment and notice of extension requirements.

Revised Eligibility Test: Changes to Look-Through Analysis and Alternate ADTV Test

The cross-border exemptions require acquirors in negotiated transactions to “look through” certain record holders and other nominees in order to determine the level of U.S. beneficial ownership. The SEC has amended the mechanics of the beneficial ownership determination in order to provide some additional flexibility in assessing eligibility for use of the cross-border exemptions.

- First, an acquiror may now calculate U.S. ownership as of any date that is no more than 60 days before and no more than 30 days after the public announcement of the cross-border transaction. This is in contrast to the prior requirement that U.S. ownership be calculated on a set date—the 30th day before the commencement of a tender offer or the solicitation of another type of business combination transaction. Further, an acquiror in a business combination transaction that is unable to calculate U.S. beneficial ownership within the new period may make the calculation as of a date up to 120 days before the public announcement. The additional flexibility in the determination date prior to public announcement should aid in planning transactions, allowing parties to determine the treatment of U.S. holders earlier in the planning process. The ability to delay the beneficial ownership inquiries of record holders and nominees until after public announcement may also assist in keeping certain transactions confidential.

- Next, the SEC no longer requires that individual holders of more than 10 percent of the subject securities be excluded from the calculation of U.S. ownership.^[3] This change may expand the number of foreign private issuers eligible for the cross-border exemptions, particularly benefiting those with controlling or other large shareholders located outside the United States.^[4]
- Finally, the SEC has adopted an alternative test for determining eligibility to rely on the cross-border exemptions, based in part on a comparison of average daily trading volume (ADTV) of the target securities in the United States and worldwide. The alternate ADTV test is similar to and replaces the current “hostile presumption,” which enables unsolicited or “hostile” bidders to assume the level of U.S. ownership using ADTV rather than conducting a look-through analysis, based on the assumption that a hostile bidder will generally have limited access to beneficial ownership information without the cooperation of the target.^[5] The ADTV prong of the alternate test is satisfied if the ADTV for the subject securities in the United States over a twelve-month period ending no more than 60 days before the announcement of the transaction is not more than 10 percent (40 percent for Tier II) of ADTV on a worldwide basis. In addition to the ADTV comparison, the alternate test requires the acquiror or issuer to take into account U.S. beneficial ownership information reported in filings with the SEC and home country regulators or that the acquiror or issuer knows or has reason to know from other sources. Some observers had hoped that an ADTV test would replace the beneficial ownership look-through analysis; however, the alternate ADTV test is available only for (1) non-negotiated transactions and (2) negotiated transactions for which the look-through analysis cannot be conducted. It appears that the ability to use the ADTV test in negotiated transactions will be extremely limited because of the stringent conditions the SEC has placed on its use in such cases.^[6]

The changes to the eligibility test for the cross-border exemptions are applicable to rights offerings as well as business combination transactions. In a rights offering, issuers may calculate U.S. ownership as of a date no more than 60 days before or 30 days after the record date.

Changes to the Tier I and Tier II Exemptions

The SEC has broadened the scope of the Tier I exemptions for affiliated transactions subject to the “going private” provisions of Rule 13e-3 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), to include transaction structures not covered under the existing cross-border exemptions, such as schemes of arrangement, cash mergers or compulsory acquisitions for cash. Also, the SEC is now requiring all Form CBs to be submitted, and thus to be available, electronically via the SEC’s EDGAR system.^[7]

The SEC has amended the Tier II exemptions to:

- extend the relief afforded by the Tier II exemptions to tender offers not subject to Sections 13(e) or 14(d) of the Exchange Act, such as tender offers for securities that are not registered under Section 12 of the Exchange Act;
- allow multiple foreign offers to be conducted contemporaneously with a U.S. offer;
- permit bidders to include foreign holders of ADRs in a U.S. offer and, under specified conditions, U.S. holders in the foreign offer(s);
- allow bidders to suspend back-end withdrawal rights while tendered securities are counted;
- modify the rules applicable to the subsequent offering period in a tender offer;^[8]
- permit the early termination of the initial offering period or any voluntary extension of that period, upon the satisfaction of all offer conditions; and
- codify exemptive relief previously provided to permit certain purchases outside of a Tier II tender offer.^[9]

Other Items Relating to U.S. and Cross-Border Tender Offers and Exchange Offers

The SEC also made certain rule changes that are applicable to both U.S. and cross-border tender offers and exchange offers. First, the SEC eliminated the maximum time limit of 20 U.S. business days on the length of a subsequent offering period for all tender offers. Further, the SEC has expanded the ability of a bidder to commence a U.S. or cross-border exchange offer before effectiveness of the registration statement filed to register the bidder’s securities to exchange offers not subject to Exchange Act Rule 13e-4 or Regulation 14D, such as exchange offers for unregistered debt or equity securities, if certain conditions are satisfied. In addition, the SEC reiterated interpretive guidance related to tender offer and exchange offer rules in the following contexts: (1) foreign target security holders and U.S. all-holders requirements, (2) exclusion of U.S. target security holders from cross-border tender offers and (3) vendor placements.^[10]

Beneficial Ownership Reporting

Under the beneficial ownership reporting requirements in Sections 13(d) and 13(g) of the Exchange Act and the SEC's related rules, subject to certain exceptions, any person who acquires beneficial ownership of more than five percent of a class of equity securities registered under Section 12 of the Exchange Act must report such ownership on a Schedule 13D within 10 days after the acquisition. Certain specified institutional investors holding such securities in the ordinary course of business and not with a control purpose are among those eligible to report their holdings on a short-form Schedule 13G, as opposed to the more detailed Schedule 13D, within 45 days after the end of the calendar year.^[11] Under the existing SEC rules, the list of institutional investors eligible to file on Schedule 13G under this provision is generally limited to U.S. institutions such as brokers, dealers, investment companies and investment advisors registered with the SEC and U.S. regulated banks, insurance companies, employee benefit plans and pension funds.

In a welcome development, the SEC is now permitting comparable non-U.S. institutions to report their beneficial ownership on short-form Schedule 13G to the same extent as their U.S. counterparts, subject to certain conditions. In order to be eligible for the new Schedule 13G provisions, the non-U.S. institution will be required to (i) certify that it is subject to a regulatory scheme substantially comparable to the regulatory scheme applicable to the functionally equivalent U.S. institution(s), (ii) determine that the subject securities are acquired and held in the ordinary course of business and without the purpose or effect of influencing control of the issuer, and (iii) undertake to furnish to SEC staff, upon request, information that would otherwise be disclosed in a Schedule 13D.^[12] As is currently the case, a non-U.S. institution also may rely on certain other passive investor provisions, to the extent it meets the conditions to do so, and file a Schedule 13G rather than a Schedule 13D within 10 days after the acquisition of five percent of a class of registered equity securities.^[13]

The SEC is also making a corresponding amendment to the rules governing beneficial ownership of such non-U.S. institutions for purposes of Section 16 under the Exchange Act.^[14]

Conclusion

Although the changes in the cross-border transaction rules do not represent the sea change in the regulatory framework that some have advocated, they should somewhat expand the utility of the SEC's exemptions in these areas and may encourage greater inclusion of U.S.-resident security holders in cross-border transactions. The changes to beneficial ownership reporting should also provide a welcome reduction to the U.S.-law compliance burdens of non-U.S. institutions that invest in the securities of U.S. public companies. Taken together with the SEC's other recent proposals affecting foreign private issuers, such changes appear to continue a concerted attempt by the SEC to reduce the burden of SEC regulation on non-U.S. entities, which may facilitate cross-border transactions and capital flows.^[15]

Footnotes

^[1] The SEC release, entitled "Commission Guidance and Revisions to the Cross-Border Tender Offer, Exchange Offer, Rights Offerings, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions," is available at <http://www.sec.gov/rules/final/2008/33-8957.pdf>

^[2] The existing cross-border exemptions and the revised exemptions are available only when the target (or in the case of a rights offering, the issuer) is a "foreign private issuer," which is a corporation or other entity organized outside of the U.S. that either has (a) 50% or less of its outstanding voting securities held of record by U.S. residents or (b) if more than 50% of its voting securities are held by U.S. residents, none of the following are true: (1) a majority of its executive officers or directors are U.S. citizens or residents; (2) more than 50% of its assets are located in the U.S.; and (3) the issuer's business is administered principally in the U.S.

^[3] Under the current SEC rules, securities held by persons or entities holding more than 10 percent of the class, whether U.S. or foreign, must be excluded from both the numerator (U.S. ownership) and denominator (worldwide ownership) when calculating U.S. ownership percentages.

^[4] For foreign private issuers with large U.S. shareholders, however, this change could decrease the availability of the cross-border exemptions.

^[5] Where a business combination transaction is not conducted pursuant to an agreement between the acquirer and the target, it is deemed a hostile or non-negotiated transaction. The current hostile

presumption is available only to third-party, unaffiliated acquirors, but under the new rules, the alternate ADTV test will also be available to issuers that are unable to conduct the look-through analysis, for example in the context of rights offerings.

[6] The SEC stated that whether an issuer or acquiror is unable to conduct the look-through analysis will depend on specific facts and circumstances and provided the following non-exhaustive list of factual scenarios that would qualify for use of the alternate ADTV test: (i) where security holder lists are generated only at fixed intervals during the year and are not available as of a date within the range provided by the revised rules and access to more current information is unavailable, (ii) when the subject securities are in bearer form, and (iii) where nominees are prohibited by law from disclosing information about the beneficial owners, in particular, the country of residence of such holders. The revised rules also require that there be a “primary trading market” for the subject securities outside the United States in order for an acquiror to rely on the alternate ADTV test in a negotiated transaction.

[7] An offeror or issuer relying on the Tier I tender offer exemptions or the corresponding provisions of Securities Act Rules 801 and 802 with respect to rights offerings and exchange offers may be required to furnish to the SEC a Form CB, including an English translation of the offering materials. Previously, if the offeror or issuer was not an Exchange Act reporting entity, the Form CB could be submitted in paper form. Any Form F-X for appointment of an agent in the United States for service of process filed in connection with a Form CB must also be submitted electronically under the new rules.

[8] These changes include eliminating the maximum time limit on a subsequent offering period, amending the prompt payment provisions to allow “bundled” payments instead of requiring payments on a rolling basis, permitting the payment of interest on securities tendered during the subsequent offering period and facilitating “mix and match” cross-border tender offers in which tendering holders are permitted to request different allocations of cash and securities.

[9] Subject to certain conditions, new Exchange Act Rules 14e-5(b)(11) and (b)(12) permit purchases and arrangements to purchase securities of a foreign private issuer (1) pursuant to a non-U.S. tender offer(s) where the offeror seeks to acquire subject securities through a U.S. tender offer and concurrent or substantially concurrent non-U.S. tender offer(s); (2) by an offeror and its affiliates outside of a Tier II tender offer; and (3) by an affiliate of a financial advisor outside of a Tier II tender offer.

[10] A vendor placement procedure refers to a cross-border exchange offer in which tendering non-U.S. target holders receive securities, but the securities that would have been issued to tendering U.S. holders are sold offshore by third parties and the proceeds of such sales are distributed to tendering U.S. holders, thus potentially avoiding a requirement to register the issuance of such securities under Section 5 of the Securities Act. Based on the SEC’s guidance, vendor placements would be permitted under limited circumstances. For example, the SEC stated, “We believe that cross-border tender offers eligible to be conducted under the Tier I exemption represent the appropriate circumstances under which bidders may provide cash to U.S. target holders while offering securities to foreign target holders.”

[11] See Exchange Act Rule 13d-1(b). Under this provision, beneficial ownership is reported as of the last day of the calendar year; however, if beneficial ownership exceeds 10 percent of the class of equity securities, the Schedule 13G must be filed within 10 days after the end of the month. Not only is Schedule 13G easier to complete, but it is also not required to be amended as frequently as Schedule 13D.

[12] Previously, non-U.S. institutions seeking to use Schedule 13G as qualified institutions under Rule 13d-1(b)(1)(ii) needed to obtain a no-action position from the SEC’s Division of Corporation Finance based on similar undertakings.

[13] See Exchange Act Rule 13d-1(c). This passive investor provision can only be used if the person beneficially owns (directly and indirectly) less than 20 percent of the class of securities.

[14] See new Exchange Act Rule 16a-1(a)(1)(x), which allows comparable non-U.S. institutions to exclude from beneficial ownership calculations, for Section 16 purposes, the shares they hold for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business without the purpose or effect of changing control of the issuer. Thus, such institutions will be less likely to be 10 percent owners subject to Section 16(a) reporting, Section 16(b) short-swing profit recovery and Section 16(c) restrictions on short sales.

[15] Morrison & Foerster’s summary of the amendments to the Rule 12g3-2(b) exemption from registration for foreign private issuers may be found at: <http://www.mofo.com/news/updates/files/081007SEC12g3.pdf>, and our summary of the revised SEC reporting requirements for foreign private issuers is available at <http://www.mofo.com/news/updates/files/081015SECForeign.pdf>.