The Application of U.S. Securities Laws to Overseas Business Transactions

Stephen D. Bohrer*

Non-U.S. companies may consider privately placing securities in the United States in lieu of a registered public offering in order to avoid becoming subject to the Sarbanes-Oxley Act and other U.S. securities regulations. This strategy, however, can be thwarted in a subsequent business acquisition. U.S. securities laws can apply to an overseas business acquisition and require an acquiror to register its securities in order to close the deal.

One might think that a tender offer or merger involving non-U.S. companies would not need to comply with U.S. securities laws. However, U.S. securities laws are drafted broadly enough to cover transactions involving companies located outside the United States that have U.S. shareholders. Non-U.S. companies selling securities in the U.S. private capital markets may not recognize the potential additional expenses, delays and exposure to liability if U.S. securities laws apply to their subsequent corporate activities. The application of U.S. securities laws to an overseas transaction can create difficult structuring and disclosure issues that can ultimately jeopardize the completion of the deal. Finding an available exemption to the application of U.S. securities laws, therefore, can be a determining factor for whether a company pursues a particular business opportunity.

Depending on the method used to acquire another company, U.S. tender offer rules under the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”) and/or the registration requirements under the U.S. Securities Act of 1933, as amended (the “Securities Act”) can apply to the transaction. Having U.S. tender offer rules apply to a transaction can have a variety of consequences that may increase the cost and uncertainty of completing the deal, including conflicting regulations regarding (i) commencement of the offering, (ii) minimum offering periods, (iii) withdrawal rights, (iv) purchases outside the offer, (v) defensive tactics and (vi) disclosure obligations. 1

* STEPHEN D. BOHRER is a Counsel at Nishimura & Partners in Tokyo, Japan, where he heads the Firm’s Cross-Border Transactions Group. Mr. Bohrer can be contacted by e-mail at s_bohrer@jurists.co.jp

1 See Edward F. Green, Andrew Curran and David A. Christman, “Toward a Cohesive
Registering a transaction under the Securities Act has a variety of consequences that the person making the offer (the “Acquiror”) may consider unacceptable if it is a first time filer with the U.S. Securities and Exchange Commission (the “SEC”), such as:

- preparing an offer document that contains extensive disclosure about itself, the company being acquired (the “Target”), the background and reasons for the transaction and the fairness of the consideration being offered to shareholders;
- producing financial statements prepared in accordance with U.S. generally accepted accounting principles (or reconciled to U.S. generally accepted accounting principles);
- subjecting the offer document to the review and comments of the SEC, which can delay the completion of the transaction by several months;
- complying with the requirements of the Sarbanes-Oxley Act and the U.S. Foreign Corrupt Practices Act;
- becoming subject to the periodic filing requirements of the Exchange Act;\(^2\)
- restricting the form and timing of publicity about itself and the transaction; and
- increasing its exposure to U.S. securities law litigation.

A violation or failure to comply with U.S. securities laws can lead to criminal, civil, or administrative proceedings arising from the alleged violation of law. The SEC can seek a panoply of remedies pursuant to an administrative proceeding, such as ordering the Acquiror to cease and desist from committing any violations or causing any future violations of U.S. securities laws, or the SEC can bar the Acquiror from accessing the U.S. capital markets in the future. Violations of the registration requirements of the Securities Act may also allow purchasers to have the right, for a period of one year from the date of the violation (but in no event may a suit commence more than three years after the securities were bona fide offered), to obtain recovery of the consideration paid for the security or, if they have already sold the security, the losses resulting from the

\(^2\) Pursuant to Section 15(d) and Rule 12h-3 of the Exchange Act, the Exchange Act periodic reporting requirements that are triggered as a result of filing an effective registration statement under the Securities Act could be suspended for Acquiror who is a foreign private issuer for any fiscal year after the fiscal year in which such registration statement became effective if less than (i) 300 shareholders residing in the United States own its securities or (ii) 500 shareholders residing in the United States own its securities and the total assets of such Acquiror is less than $10 million on the last day of each of its three most recent fiscal years. As noted, however, the Acquiror would be subject to Exchange Act periodic reporting requirements for the fiscal year in which its registration statement became effective under the Securities Act regardless of whether it satisfies either of the above tests.
transaction.³

Part I of this article examines the typical methods used to acquire another company. Part II explains how U.S. securities laws may be implicated under each acquisition method. Part III discusses the web of exemptions and procedures that can be used to avoid the application of U.S. securities laws to an overseas business acquisition. The article concludes with a suggested approach for applying U.S. securities laws more equitably to certain overseas business acquisitions.

I. Acquisition Methods

There are various methods an Acquiror may use to acquire a Target. This article examines three common acquisition methods: (i) a tender offer for cash, (ii) an exchange offer⁴ and (iii) a stock-for-stock merger. As the characterization and the steps to effect a particular acquisition method may vary depending on local regulations, the discussion below should not be considered universally applicable but its themes should share common ground. U.S. securities laws may be implicated under each acquisition method depending on whether the stock of the Target (the “Target Stock”) is registered under the Securities Act and the Exchange Act, solicitations are made to holders of Target Stock who are resident in the United States (the “U.S. Target Shareholders”), the stock of the Acquiror (the “Acquiror Stock”) is used as the form of consideration in the transaction, and the percentage of Target Stock owned by U.S. Target Shareholders.

A. Tender Offers and Exchange Offers

Tender offers and exchange offers are normally the method of choice when an Acquiror desires to complete its business acquisition in the shortest possible time period. Once a business acquisition is announced, it may become vulnerable to competing bids, which could prevent an Acquiror from ultimately closing its proposed acquisition of the Target. Completing the acquisition in the quickest possible time frame could reduce the likelihood that a third party makes a successful competing offer for the Target. Depending on the laws of the Target’s “home jurisdiction” (i.e., the Target’s jurisdiction of organization and the jurisdiction of the principal trading market for the Target Stock), cash tender offers and exchange offers frequently require less time to complete than stock-for-stock mergers because a shareholder vote is normally not required. By not requiring a vote of shareholders, time is saved because no notice period must be given to shareholders prior to the shareholders’ meeting and the degree of regulatory review over the disclosure document could be lower. If cash is used as the consideration (as opposed to Acquiror Stock in an exchange offer), then the time to complete the

³ See Sections 12(a)(1) and 13 of the Securities Act.

⁴ The primary difference between a tender offer for cash and an exchange offer is that cash is used as the consideration in the former, while stock is used as the consideration in the latter (i.e., a tender for stock in one company in exchange for stock in another).
transaction could be further reduced because a tender offer should be subject to fewer regulatory and lower disclosure requirements.

There may be disadvantages to structuring an acquisition in the form of a tender offer. In an exchange offer or stock-for-stock merger, an Acquiror does not need to use cash resources as the acquisition currency and it may realize certain tax benefits for itself and the shareholders of the Target (“Target Shareholders”) if stock is exchanged. Depending on the tax rules of the Target’s home jurisdiction, the use of Acquiror Stock also could produce tax savings for Target Shareholders because they may be able to roll-over their existing Target Stock into Acquiror Stock on a tax-free basis. Furthermore, depending on the accounting principles adopted by the Acquiror, the use of Acquiror Stock as the acquisition currency could produce significant accounting benefits to the Acquiror.\(^5\) An Acquiror, however, may prefer a stock-for-stock merger over an exchange offer because an unconditional exchange offer does not guarantee complete control over the Target after the offer.

The following diagram depicts a typical cash tender offer or exchange offer:

\(^{5}\) For example, until 2001 stock transactions could be accounted for as a pooling of interests under U.S. generally accepted accounting principles, not only as a purchase. Under a pooling of interests, it was not necessary to charge goodwill against post-transaction earnings of the combined enterprise. Under recent changes to purchase accounting, goodwill is not amortized but is tested for impairment when events or circumstances occur indicating that an impairment might exist, thereby eliminating the previous principal disadvantage of purchase accounting over a pooling of interests. See *Business Combinations*, FASB Statement No. 141, 1 (Fin. Acct. Standards Bd., Jul. 20, 2001); and *Goodwill and Other Intangible Assets*, FASB Statement No. 142, 1 (Fin. Acct. Standards Bd., Jul. 20, 2001).
In a cash tender offer or an exchange offer, the Acquiror will ordinarily incorporate a wholly-owned subsidiary (the “Acquiror Sub”) to make the offer to the Target Shareholders. Once the Acquiror Sub has gained control of the Target, it will normally merge the Acquiror Sub with and into the Target, with the Target surviving the merger. The resulting formation is the Target becoming a wholly-owned subsidiary of the Acquiror, with the Target Shareholders receiving cash and/or Acquiror Stock, depending on whether the transaction is structured as a cash tender offer or an exchange offer.

B. Stock-for-Stock Mergers

An Acquiror may wish to structure its acquisition of the Target in the form of a stock-for-stock merger for a variety of reasons, such as if: (i) there are inherent deal impediments that prevent the acquisition from being completed quickly and Acquiror Stock is the preferred acquisition currency, (ii) the rules of the Target’s home jurisdiction do not provide a mechanism to squeeze-out minority Target Shareholders, or (iii) there are certain tax efficiencies that can be realized if Acquiror Stock is used as the acquisition currency (similar to the tax considerations mentioned above for exchange offers). In highly regulated industries or deals involving significant antitrust issues, a lengthy process to obtain regulatory or other approvals may be required to effect the acquisition. As a result, transaction closing speed is no longer of paramount importance, thereby obviating the timing disadvantages of having to obtain a shareholder vote. In addition, if the laws of the Target’s home jurisdiction do not allow an Acquiror to effect a compulsory merger to “squeeze out” those Target Shareholders who do not tender their Target Stock in a first-step tender offer or exchange offer, then an Acquiror may need to effect a long-form merger (such as a stock-for-stock merger) in order to ensure that no minority Target Shareholders remain after the Acquiror completes its acquisition. An Acquiror, therefore, may prefer to avoid the first-step cash tender offer or exchange offer in lieu of effecting just a single one-step stock-for-stock merger.

There may be disadvantages to structuring an acquisition in the form of a stock-for-stock merger in comparison to a tender offer or exchange offer, besides the potential time delay to complete the transaction. In a stock-for-stock merger, the Target’s board of directors normally needs to approve the transaction.\footnote{6} This approval

\footnote{6}{In certain jurisdictions, once an Acquiror owns more than a specified percentage of a Target’s outstanding securities (e.g., 90%), then it may effect a merger with such Target in order to cash out the minority shareholders by obtaining the consent of only the Target’s board of directors.}

\footnote{7}{Depending on the laws of the Target’s home jurisdiction or whether the securities of the Target are registered under the Exchange Act, the board of directors of the Target may not need to approve a cash tender offer or exchange offer (but may need to issue a response or
process could increase the risk of litigation to prevent the deal based on lawsuits alleging that the processes employed by the Target’s board of directors to approve the transaction was flawed. For example, a plaintiff may allege that the Target’s board of directors breached its fiduciary duties owed to the Target Shareholders because disinterested directors did not approve the transaction or an inadequate amount of time was spent by the board to evaluate the benefits and fairness of the transaction.

The following diagram depicts a typical stock-for-stock merger:

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In a typical stock-for-stock merger, the Target Shareholders vote on whether to approve a merger agreement among the Target, the Acquiror and Acquiror Sub pursuant to which the Target Shareholders receive Acquiror Stock in exchange for their Target Stock. If the merger agreement is approved by the Target Shareholders, then at the effective time of the merger each outstanding share of Target Stock converts by operation

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recommendation to Target Shareholders) since a cash tender offer or an exchange offer is an offer made by an Acquiror directly to the Target Shareholders.
of law into shares of Acquiror Stock based on a prescribed exchange ratio. The merger between the Target and the Acquiror is normally effected in one of the two ways outlined below.

Due to tax considerations and anti-assignment provisions in key contracts and licenses of the Target, effecting the Acquiror’s corporate control over the Target may take the form of either a reverse subsidiary merger or a forward subsidiary merger. In a reverse subsidiary merger, the Acquiror gains control over the Target by merging the Acquiror Sub with and into the Target, with the Target emerging as the surviving corporation. Since the Target is the surviving company, this structure is often used to prevent the termination of Target’s contracts, leases and licenses because the parties to the arrangement remain the same. In a forward subsidiary merger, the Acquiror Sub is the surviving corporation in the merger with the Target. A forward subsidiary merger is often preferred for tax or other deal structuring reasons.

II. How U.S. Securities Laws are Implicated in an Overseas Business Transaction

Which U.S. federal and state securities laws are implicated in an overseas business acquisition depends on whether the transaction is structured as a cash tender offer, an exchange offer or a stock-for-stock merger.

A. Tender Offers and Exchange Offers

1. Tender Offers

An offer extended by an Acquiror to Target Shareholders to buy some or all of the Target Stock for cash could trigger compliance with U.S. regulations if the offer constitutes a “tender offer” under U.S. securities laws, regardless of how such offer is treated in the Target’s home jurisdiction.

The term “tender offer” is not defined under U.S. securities laws. It is not always clear, therefore, whether a particular offer triggers U.S. tender offer compliance. The method used to acquire Target Stock impacts how U.S. courts analyze the application of U.S. tender offer rules. In large open market purchases by an Acquiror, U.S. courts have identified the following factors to determine whether such purchases should be subject to U.S. tender offer regulation: (i) active and widespread solicitation of the Target Shareholders; (ii) solicitation for a substantial percentage of the Target Stock; (iii) whether the offer to purchase is made at a premium over the prevailing market price for the Target Stock; (iv) whether the terms of the offer are firm rather than negotiable; (v) whether the offer is contingent on the tender of a fixed minimum number of Target Stock; (vi) whether the offer is open only for a limited period of time; (vii) whether the Target

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8 A reverse subsidiary merger could nevertheless trigger a default if the relevant agreement or license prohibits a change in control of the Target.
Shareholders are subject to pressure to sell their Target Stock; and (viii) the existence of public announcements of a purchasing program that precede or accompany a rapid accumulation of stock.9 In stock purchase arrangements privately negotiated between an Acquiror and each Target Shareholder, U.S. courts normally look at the level of sophistication and knowledge of the U.S. Target Shareholders to determine whether they were able to make an educated investment decision without requiring the protections afforded by U.S. tender offer rules.10

U.S. tender offer rules can be grouped into two categories: (i) regulations regarding the type of information that must be sent to U.S. Target Shareholders and other substantive requirements relating to an offer for Target Stock that is registered under the Exchange Act (the Regulation 14D requirements) and (ii) regulations regarding the procedural manner in which an offer should be conducted to prevent fraudulent or deceptive acts, regardless of whether the subject security of the Target is equity or debt or registered under the Exchange Act (the Regulation 14E requirements). Having U.S. tender offer rules apply to an offer could add a layer of complexity because the types of disclosures that are required pursuant to Regulation 14D may be more detailed and costly to produce than the requirements of the Target’s home jurisdiction, and the Regulation 14E procedural requirements could also conflict with the procedures applicable in the Target’s home jurisdiction.

2. Exchange Offers

Exchange offers trigger similar U.S. security law issues as cash tender offers, however, since the acquisition currency is Acquiror Stock compliance with additional U.S. federal and state security laws is necessary absent an applicable exemption.

a. U.S. Federal Securities Laws

The registration requirements under the Securities Act are the crux to the application of U.S. federal securities laws to a proposed transaction. The basic purpose of the Security Act’s registration requirements, as well as its prohibitions and timing limitations on permissible offers to sell securities, is to ensure that an investor has adequate information upon which to base his or her investment decision.11 Generally speaking, Section 5 of the Securities Act provides that it is unlawful to use interstate commerce or the mail (including transactions or communications between any foreign country and any U.S. state) to “sell” or “offer to sell” a “security”12 in the United States

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10 See Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985).
12 A security is broadly defined under Section 2(1) of the Securities Act to include any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, transferable share, investment contract or,
unless a registration statement has been filed with, and eventually declared effective by, the SEC with respect to such offer and sale, or the offer and sale of the security falls under an exemption from the registration requirements under the Securities Act.

The registration provisions under the Securities Act apply to an exchange offer if an “offer” or “sale” of Acquiror Stock is made to U.S. Target Shareholders, unless an exemption from the registration requirements exists. U.S. federal securities laws define broadly the activities that constitute an “offer” or “sale” of a security in the United States that could trigger the registration requirements under the Securities Act. Section 2(3) of the Securities Act defines a “sale” or “offer to sell” as “every attempt to offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.” Accordingly, various types of communications that generate a buying interest in a security can qualify as a “sale” or “offer to sell” under U.S. federal securities laws. Soliciting U.S. Target Shareholders to participate in an exchange offer, such as through the mailing of an offer document to solicit interest, would certainly constitute an “offer” of Acquiror Stock in the United States, and the ultimate exchange of Acquiror Stock for Target Stock held by U.S. Target Shareholders using interstate commerce would be considered a “sale” of a security.

If the registration provisions of the Securities Act apply to an exchange offer, then the Acquiror is required to file with the SEC a registration statement containing detailed financial and non-financial information. There are various forms of registration statements under U.S. federal securities laws depending on the type of transaction and whether the Acquiror is a U.S. or a “foreign private issuer.”

In an exchange offer, a U.S. Acquiror would file with the SEC and comply with the disclosure requirements under a registration statement on Form S-4, while the provisions of a registration statement on Form F-4 would apply to an Acquiror that is a foreign private issuer.

b. Blue Sky Laws

In addition to securities regulation in the United States at the federal level, each U.S. state is entitled to regulate the offer and sale of securities within its jurisdiction, subject to certain exceptions. The securities laws of the various U.S. states are often

in general, any interest or instrument commonly known as a security.

13 A “foreign private issuer” is defined under Rule 405 under the Securities Act and Rule 3b-4 under the Exchange Act as any issuer (other than a foreign government) that is organized in a jurisdiction outside the United States, unless (i) more than 50% of its voting securities are owned by U.S. residents and (ii) either (a) the majority of its directors or executive officers are U.S. citizens or residents, (b) more than 50% of its assets are located in the United States or (c) its business is administered principally in the United States. Under the relevant definitions, an issuer is required to look through the record ownership of brokers, dealers, banks or nominees holding securities for the accounts of their customers to determine the residency of those customers.

14 The National Securities Markets Improvement Act of 1996 amended Section 18 of the Securities Act to provide that U.S. state laws requiring registration, qualification or notice will not
referred to as the “blue sky” laws. Since Acquiror Stock is offered and used as the consideration in an exchange offer, compliance with the relevant blue sky laws of each U.S. state in which a Target Shareholder resides is necessary.

Complying with blue sky laws normally requires completing various forms to provide information about the transaction, submitting a notarized consent to service of process and paying a filing fee. In limited circumstances, the securities administrator of a U.S. state may conduct a merit review of the offering to determine whether the transaction is appropriate for residents of its state. Each U.S. state has developed its own set of exemptions from the application of its securities laws. Many of these exemptions relate to the manner in which the securities are offered or the type of investor to whom offers and sales are made. Since each U.S. state may establish its own criteria for an exemption, an analysis of the relevant jurisdictions should be performed in advance of the transaction.

C. Stock-for-Stock Mergers

In connection with seeking shareholder approval to enter into a stock-for-stock merger agreement, Target Shareholders are normally sent an offer document explaining the proposed merger and the procedures for voting. If an offer document or securities are distributed to U.S. Target Shareholders, then compliance with U.S. federal and state securities laws is necessary.

1. U.S. Federal Securities Laws

Rule 145(a) of the Securities Act states that a plan for reclassification, merger, consolidation or transfer of corporate assets in exchange for securities of another issuer constitutes an “offer to sell” within the meaning of Section 2(3) of the Securities Act, unless an exemption exists. Under the rule, an “offer to sell” occurs when the merger transaction is submitted to U.S. Target Shareholders for their vote. Since a U.S. Target Shareholder’s consideration of a stock-for-stock merger constitutes an “offer to sell” and the ultimate issuance of Acquiror Stock to U.S. Target Shareholders if the merger agreement is approved would constitute a “sale” of a security under U.S. federal securities laws, the transaction would be subject to the registration requirements under the Securities Act, unless an exemption exists.

Similar to an exchange offer, the disclosures required under a registration statement on Form S-4 or Form F-4 would apply to a stock-for-stock merger depending on the foreign status of the Acquiror. The relevant registration statement would also apply to “covered securities” (which is defined in Section 18, and includes securities listed on the New York Stock Exchange or the NASDAQ).

15 Rule 145 does not apply to cash tender offers and exchange offers because these offers are not corporate transactions, but involve arrangements directly between the Acquiror and the Target Shareholders.
include a proxy statement for the stockholders meeting to approve the merger. If the Acquiror is a foreign private issuer, then its proxy statement would not need to comply with U.S. proxy rules.16

2. Blue Sky Laws
Similar to exchange offers, compliance with the blue sky laws of each U.S. state in which a Target Shareholder resides is necessary since securities will be issued in a stock-for-stock merger.

III. Exemptions to the Application of U.S. Federal Securities Laws
There are various exemptions to the application of the registration requirements under the Securities Act and the U.S. tender offer rules under the Exchange Act for a proposed overseas business acquisition involving U.S. Target Shareholders. Exemption usage is not exclusive. For example, a transaction can include a tranche of securities issued in reliance on a private placement exemption while another tranche is issued simultaneously or shortly thereafter in reliance on a Tier I or Tier II Exemption or pursuant to Regulation S (each as described below).

While there are often deal factors that render one exemption preferable over another, absent exigent circumstances, selecting the most appropriate exemption can be determined depending on whether:

- U.S. Target Shareholders own 10% or less of the Target Stock;
- the Acquiror will use Acquiror Stock, not cash, as the consideration offered to U.S. Target Shareholders; or
- U.S. Target Shareholders will be treated as a different tranche in the transaction.

The following table lists the potential exemptions and the aspects of U.S. securities laws that are exempt depending on the transaction structure.17 Regardless of the exemption, the antifraud provisions of U.S. securities laws will apply to a securities offering in the United States.

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16 See Rule 3a12-3(b) of the Exchange Act.
17 The securities received in a transaction exempt from the registration requirements under the Securities Act are considered “restricted securities” under Rule 144 of the Securities Act and, therefore, are not freely tradable in the United States. If the Acquiror Stock is not already trading on a U.S. stock exchange or the principal securities market for the Acquiror Stock is outside the United States, then receiving “restricted securities” should be of little practical significance to a U.S. Target Shareholder.
### Exemptions When U.S. Target Shareholders Own 10% or Less of the Target Stock

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### Exemptions When Acquiror Stock, Not Cash, Will Be Offered to U.S. Target Shareholders

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### Exemptions When U.S. Target Shareholders Will Be Treated as a Different Tranche

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**Δ** Permissibility highly dependant on the laws of the Target’s home jurisdiction.
Determining whether an exemption to the application of U.S. federal securities laws exists requires careful consideration of the deal structure and the offering process. The Cross-Border Rules (as defined below) enable Acquirors to exempt their transactions from U.S. tender offer rules and/or the registration requirements under the Securities Act if the Target is a foreign private issuer, U.S. Target Shareholders hold 10% or less of the Target Stock and other procedural requirements are followed. The Cross-Border Rules are often the first exemption examined because they do not impose any substantive disclosure requirements on the offering documents used in the transaction or require the transaction to proceed according to a prescribed timetable. Unfortunately, the methodology used to calculate the amount of Target Stock held by U.S. Target Shareholders under the Cross-Border Rules can lead to counter-intuitive results and limit the availability of the rules, and the provisions of the Cross-Border Rules concerning what information should be furnished to the SEC and disseminated to U.S. Target Shareholders are not models of clarity, which can lead to countless hours and expense translating informational documents into English.

If U.S. Target Shareholder ownership levels cannot be determined or exceed the 10% threshold or the other requirements of the Cross-Border Rules cannot be satisfied, then Acquirors may wish to determine the availability of the private placement exemptions or the Section 3(a)(10) exchange exemption if Acquiror Stock will be issued to Target Shareholders. The private placement exemptions, however, contain various restrictions on the number of offers and sales that can be made to U.S. Target Shareholders, the manner in which the transaction can be publicized, the type of information that must be disclosed and made available to U.S. Target Shareholders, and the procedures implemented to restrict resales of Acquiror Stock held by U.S. Target Shareholders. As a result, many transactions are unable to comply with the private placement exemptions. If a private placement exemption cannot be perfected, but the Target’s home jurisdiction recognizes a “scheme of arrangement” or similar type of transaction accepted by the SEC, then the Section 3(a)(10) exchange exemption offers an attractive alternative exemption for exchange offers and stock-for-stock mergers. However, since the SEC recognizes only a handful of non-U.S. courts that conduct adequate fairness hearings, the availability of the Section 3(a)(10) exchange exemption is often limited and requires prior consultation with the SEC.

If no exemption to the application of U.S. securities laws is available for a particular transaction, then an Acquiror may need to treat U.S. Target Shareholders as a different tranche in the transaction. Vendor placements are common when U.S. Target Shareholders do not own a significant amount of Target Stock and the laws of the Target’s home jurisdiction permit an Acquiror to offer stock to one set of Target Shareholders and an equivalent cash amount to other Target Shareholders in an exchange offer or stock-for-stock merger. If a vendor placement is not possible, then depending on the value and importance of the transaction, the Acquiror may wish to bifurcate the transaction into two tranches: (i) an offer to U.S. Target Shareholders structured in
compliance with U.S. securities laws and (ii) an offer to non-U.S. Target Shareholders structured in compliance with the laws of the Target’s home jurisdiction. Since conducting two simultaneous offers can increase the complexity and cost to complete the transaction, an Acquiror may prefer to simply exclude U.S. Target Shareholders from the transaction by adopting Regulation S exclusion procedures so long as the laws of the Target’s home jurisdiction permit disparate treatment among Target Shareholders. If this is not possible, then compliance with U.S. securities laws may be required in order to complete the acquisition.

A. The Cross-Border Rules—The Exemption When U.S. Target Shareholders Own 10% or Less of the Target Stock

On October 26, 1999, the SEC adopted new exemptions (the “Cross-Border Rules”)\(^\text{18}\) to facilitate U.S. investor participation in cross-border tender offers, exchange offers, business combinations and rights offerings involving foreign private issuers. The Cross-Border Rules were adopted in part to counter the perceived practice of foreign private issuers excluding U.S. Target Shareholders from cross-border corporate acquisitions in order to avoid the application of U.S. securities laws. The SEC noted in its adopting release that by excluding U.S. Target Shareholders from cross-border transactions, U.S. Target Shareholders are denied the opportunity to receive a premium for their securities or to take part in investment opportunities. The SEC also commented that even if U.S. Target Shareholders are excluded from an overseas tender offer or exchange offer, they nevertheless must react to the offer by deciding whether to sell, hold or buy additional securities. If informational materials are intentionally withheld from U.S. Target Shareholders in order to avoid the application of U.S. securities laws, then U.S. Target Shareholders are placed in a difficult position of having to make an investment decision without the benefit of information required by either U.S. or foreign securities regulations.\(^\text{19}\) Accordingly, the SEC indicated that the purpose of providing exemptive relief from certain aspects of U.S. securities laws through the Cross-Border Rules is to encourage the inclusion of U.S. Target Shareholders in overseas transactions, thereby allowing them to participate on an equal basis with other Target Shareholders.\(^\text{20}\)

The Cross-Border Rules provide self-executing exemptive relief (i.e., the consent of the SEC is not required to rely on the exemption) and can be grouped into two categories: (i) exemptions from the application of U.S. tender offer rules (the “Tier I Exemption” and the “Tier II Exemption”) and (ii) exemptions from the application of the registration requirements under the Securities Act (the “Rule 802 Exemption”). The

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\(^{20}\) See the Cross-Border Release, supra note 18.
Cross-Border Rules do not, however, exempt transactions from the anti-manipulation and anti-fraud provisions of U.S. securities laws\textsuperscript{21} or from U.S. state blue sky laws.\textsuperscript{22}

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\textbf{The Tier I Exemption and the Rule 802 Exemption are typically the exemptions of first choice for an Acquiror if U.S. Target Shareholders own 10\% or less of the Target Stock because they permit the use of offering materials (translated into English) that comply with the regulations of the Target’s home jurisdiction and allow the Acquiror to structure its transaction taking into account the applicable rules of the Target’s home jurisdiction. The Tier II Exemption, to a lesser extent, provides an Acquiror with a degree of structuring flexibility if U.S. Target Shareholders own 40\% or less of the Target Stock.} \\
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1. \textbf{Tier I Exemption and Tier II Exemption}

The Tier I Exemption and Tier II Exemption provide relief from the application of U.S. tender offer rules depending on the amount of Target Stock owned by U.S. Target Shareholders.

a. \textbf{Tier I Exemption}

The Tier I Exemption provides an Acquiror with significant relief from the application of U.S. tender offer rules, and allows the Acquiror to structure its offer taking into account only the applicable rules of the Target’s home jurisdiction.

Under the Tier I Exemption, cash tender offers and exchange offers for securities of a foreign private issuer are exempt from (i) U.S. tender offer obligations under Section 14(d), Regulation 14D and Schedule TO under the Exchange Act,\textsuperscript{23} (ii) the extensive

\textsuperscript{21} To alleviate the concerns of Acquirors about the application of U.S. anti-fraud provisions to offer documents that may not comply with the disclosure requirements of U.S. securities laws, the SEC noted in the Cross-Border Release that “the omission of the information called for by U.S. forms in the context of foreign disclosure requirements and practices would not necessarily violate the U.S. disclosure requirements.”

\textsuperscript{22} In December 2000, the North American Association of Securities Administrators adopted a model state exemption to the Uniform Securities Act exempting from registration any rights offering, exchange offer and business combination that complies with the Cross-Border Rules. Therefore, once the U.S. states where offers and sales will be made has been determined, counsel should check whether the relevant state(s) have adopted the model state exemption (which would reduce any blue sky filing fees and state regulatory oversight).

\textsuperscript{23} Since Rule 14d-1 of the 1934 Act states that the Regulation 14D requirements apply only to equity securities that are registered under the Exchange Act, the extensive disclosure requirements of U.S. tender offer rules will not apply to most overseas corporate acquisitions involving private companies, unless the Target (i) lists its securities on a national stock exchange in the United States (See Section 12(b) of the Exchange Act), (ii) has total assets valued in excess of $10 million and a class of equity securities held by over 500 holders of record worldwide and 300 or
going-private requirements of Rule 13e-3, Schedule 13E-3 and Rule 13e-4 under the Exchange Act, and (iii) the tender offer procedural requirements of Rules 14e-1 (unlawful tender offer practices), 14e-2 (position of the Target with respect to the tender offer) and 14e-5\textsuperscript{24} under the Exchange Act if the following conditions are satisfied:

- Target is a foreign private issuer and U.S. Target Shareholders hold 10% or less of the Target Stock;\textsuperscript{25}
- If the Target Stock is registered under the Exchange Act, then Acquiror (who may be a U.S. company or a foreign private issuer) provides to U.S. Target Shareholders and “furnishes” to the SEC (which means the information is not subject to the express liability provisions of Section 18 of the Exchange Act) under cover of Form CB an English translation of all informational documents (including any amendments) published or otherwise disseminated by it to Target Shareholders no later than one U.S. business day following the publication or dissemination of such materials;\textsuperscript{26}
- If the Target Stock is registered under the Exchange Act, then Acquiror appoints an agent for service of process in the United States by filing with the SEC a Form F-X (assuming the Acquiror

\textsuperscript{24} Rule 14e-5 under the Exchange Act generally prohibits a person who makes a tender offer for an equity security from purchasing or making any arrangements to purchase such security, except as part of such offer from the time it is publicly announced until the expiration of the offer period. Relief from Rule 14e-5 under the Tier I Exemption requires that (i) the offering document furnished to U.S. Target Shareholders prominently discloses the possibility of purchases outside of the offer by the Acquiror and how information about such purchases will be disclosed, (ii) the Acquiror is permitted in its home jurisdiction to make such purchases outside the offer, and (iii) the Acquiror discloses in the United States information about such purchases outside the offer in the same manner that such information is disclosed in the Acquiror’s home jurisdiction.

\textsuperscript{25} If the subject security is debt, not equity, then U.S. holders may hold no more than 10% of the outstanding principal amount of the debt securities that are the subject of the transaction.

\textsuperscript{26} See Rule 14d-1(c)(3)(iii) of the Exchange Act and the Cross-Border Release (“The requirement to submit a Form CB only applies if the tender offer would have been subject to Regulation 14D or Rule 13e-4… If the tender offer would have been subject only to Section 14(e) and Regulation 14E, the offering document and any recommendation do not need to be submitted to the Commission because the current regulations do not require a filing in connection with those offers”).
is a non-U.S. entity);\textsuperscript{27} and

- Acquiror provides U.S. Target Shareholders with English translations of the informational documents (including any amendments) on a basis comparable to that provided to Target Shareholders in the Target’s home jurisdiction (e.g., mailing, U.S. wire service or publication in a newspaper with a U.S. national circulation); and

- U.S. Target Shareholders are treated equally and permitted to participate in the transaction on quantitative and qualitative terms (e.g., duration of the offer, pro-rationing, withdrawal rights, etc) at least as favorable as those offered to non-U.S. Target Shareholders.

Notwithstanding the equal treatment requirement of the Tier I Exemption, an Acquiror may provide different consideration to security holders.\textsuperscript{28} An Acquiror can offer only cash to U.S. Target Shareholders and Acquiror Stock to non-U.S. Target Shareholders so long as the Acquiror has a reasonable basis to believe (usually through a third-party appraisal) at the commencement of the offer that the amount of cash offered is substantially equivalent to the value of the consideration offered to non-U.S. Target Shareholders. An Acquiror may elect this cash option if it is unable to offer Acquiror Stock to U.S. Target Shareholders pursuant to an exemption from the registration requirements under the Securities Act or blue sky laws. The amount of cash consideration must be adjusted during the term of the offer only if the Acquiror no longer reasonably believes that the cash alternative is substantially equivalent to the value of the consideration offered to non-U.S. Target Shareholders.\textsuperscript{29}

\textsuperscript{27} See Rule 14d-1(c)(3)(iii) of the Exchange Act (since no Form CB is submitted, then there is no Form F-X filing requirement).

\textsuperscript{28} See Rule 14d-1(c)(2)(iii) of the Exchange Act.

\textsuperscript{29} If the Acquiror Stock offered to non-U.S. Target Shareholders is a “margin security” (i.e., a security listed or traded in the United States), then the Acquiror must provide upon the request of the SEC or any U.S. Target Shareholder the closing price and daily trading volume of the Acquiror Stock on the principal trading market for the Acquiror Stock as of the last trading day of each of the six months preceding the announcement of the offer and each of the trading days thereafter. If the Acquiror Stock offered to non-U.S. Target Shareholders is not a “margin security,” then the Acquiror must provide upon the request of the SEC or any U.S. Target Shareholder an independent expert’s opinion that the cash consideration offered to U.S. Target Shareholders is substantially equivalent to the value of the non-cash consideration offered to non-U.S. Target Shareholders. The SEC indicated that a valuation for “margin securities” is not required because such securities are sufficiently liquid, so a U.S. Target Shareholder could determine their market value. See Rule 14d-1(c)(2)(iii)(A) and (B).
b. Tier II Exemption

The Tier II Exemption is designed to codify the limited exemptive and interpretive positions provided by the SEC when U.S. tender offer rules conflict with European (primarily English) tender offers. The Tier II Exemption is available to an Acquiror if the Target is a foreign private issuer\(^{30}\) and U.S. Target Shareholders own 40% or less of the Target Stock.

The procedural relief granted under the Tier II Exemption allows an Acquiror to:

- conduct a dual offer by making one offer open to U.S. Target Shareholders and another open only to non-U.S. Target Shareholders so long as the offer made available to U.S. Target Shareholders is on terms at least as favorable as those offered to any other Target Shareholder;\(^{31}\)
- make payments in accordance with the rules of the Target’s home jurisdiction in order to satisfy the prompt payment requirements of U.S. tender offer rules;
- extend its offer in accordance with the notice requirements of the rules of the Target’s home jurisdiction;
- satisfy the announcement and prompt payment requirements of U.S. tender offer rules in an offer than includes a subsequent offer period if the Acquiror announces the results of its tender offer and pays for tendered securities in accordance with the rules of the Target’s home jurisdiction, and the subsequent offer period commences immediately after such announcement;
- not extend withdrawal rights following the close of the initial offer period and prior to the commencement of the subsequent offer period; and
- reduce or waive the minimum acceptance conditions of its offer without extending withdrawal rights during the remainder of the offer if certain conditions are satisfied.

\(^{30}\) But see, Axcel Springer Aktiengesellschaft Offer for ProSiebenSat.1 Media AG, SEC No-Action Letter (September 12, 2005), where the SEC permitted reliance on the Tier II Exemption to allow the bidder to make payment in accordance with German law and practice even though the target company was not a foreign private issuer due to its control by a U.S. private equity firm. Since the SEC noted in its no-action letter that ProSiebenSat had no material assets or operations in the United States and that shareholders who tendered into the offer were given withdrawal rights, it is not clear whether similar relief would be available under a different fact pattern.

\(^{31}\) Unlike the Tier I Exemption, the Tier II Exemption does not permit the Acquiror to offer only cash to U.S. Target Shareholders while offering securities to other Target Shareholders. The SEC indicated that it will consider requests for vendor placements on a case-by-case basis. See the Cross-Border Release, supra note 18.
Because the Tier II Exemption applies to circumstances where U.S. Target Shareholders own a significant amount of Target Stock (i.e., 40% or less), there is a perceived lower risk that U.S. Target Shareholders will be excluded and a greater need to apply relevant U.S. securities laws to such transactions. Accordingly, transactions qualifying for the Tier II Exemption will benefit from very limited relief from the application of U.S. securities laws and must comply with (i) most U.S. tender offer rules and the disclosure requirements under Regulation 14D\(^{32}\) and Regulation 14E and (ii) the registration requirements under the Securities Act because the Rule 802 Exemption \(\text{(discussed below)}\) only applies to transactions qualifying under the Tier I Exemption.

2. **Rule 802 Exemption**

The Rule 802 Exemption provides self-executing exemptive relief from the registration requirements under the Securities Act for shares issued in connection with an exchange offer or stock-for-stock merger if the following conditions are met:

- Target is a foreign private issuer and U.S. Target Shareholders hold 10% or less of the Target Stock;
- Acquiror, who may be a US-domiciled company or a foreign private issuer,\(^{33}\) provides to U.S. Target Shareholders and “furnishes” to the SEC under cover of Form CB, an English translation of all informational documents (including any amendments) published or otherwise disseminated by it to Target Shareholders no later than one U.S. business day following the publication or dissemination of the materials;\(^{34}\)
- Acquiror appoints an agent for service of process in the United States by filing with the SEC a Form F-X (assuming the Acquiror is a non-U.S. entity), which is intended to help U.S. Target Shareholders have recourse in U.S. courts for any fraudulent or materially misleading statements or omissions in the Acquiror’s offer documents;
- the offering documents used by the Acquiror include a legend appearing in a prominent position indicating the foreign nature of the transaction, the Acquiror’s disclosure practices and that investors may have difficulty in enforcing rights against the Target and its officers.

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\(^{32}\) As a result, no Form CB is required to be submitted by an Acquiror relying on the Tier II Exemption since it must file a Schedule TO with the SEC.

\(^{33}\) In the case of a business combination where the Acquiror is not the surviving entity, then the Acquiror and the Target both must be foreign private issuers. See the Cross-Border Release, supra note 18.

\(^{34}\) Unlike the Tier I Exemption, the Form CB furnishing requirement applies even if the Target Stock is not registered under the Exchange Act.
and directors;\textsuperscript{35}

- Acquiror provides U.S. Target Shareholders with English translations of the informational documents (including any amendments) on a basis comparable to that provided to Target Shareholders in the Target’s home jurisdiction; and

- U.S. Target Shareholders are treated equally and permitted to participate in the transaction on quantitative and qualitative terms at least as favorable as those offered to non-U.S. Target Shareholders.

Notwithstanding the equal treatment requirement of the Rule 802 Exemption, an Acquiror may exclude from the offer U.S. Target Shareholders who reside in U.S. states that do not provide an exemption from the registration or qualification requirements under their blue sky laws for the Acquiror Stock offered in the transaction. However, if the Acquiror has offered a cash alternative to U.S. Target Shareholders residing in another U.S. state or jurisdiction, then pursuant to Rules 14d-1(c)(2)(i) and (ii) of the Exchange Act the Acquiror must provide an equivalent cash option to (and not exclude) those U.S. Target Shareholders who reside in U.S. states that do not offer a blue sky exemption for the Acquiror Stock offered in the transaction.

A transaction complying with the requirements of the Rule 802 Exemption will also satisfy the requirements of the Tier I Exemption. This is intentional as exchange offers need to comply with both U.S. tender offer rules and the registration requirements under the Securities Act.

3. Form CB and Form F-X Submission Obligations and Dissemination Requirements for Informational Documents under the Tier I and Rule 802 Exemptions

The Acquiror is required to furnish the SEC under a Form CB with English translations of each “informational document” that it publishes or disseminates to Target Shareholders in connection with a transaction relying on the Tier I Exemption (only if the Target Stock is registered under the Exchange Act) or the Rule 802 Exemption within one U.S. business day after its publication or dissemination. In addition, the party furnishing the Form CB to the SEC is required to provide U.S. Target Shareholders with an English translation of such informational document on a basis at least as comparable

\textsuperscript{35} Rule 802(b) of the Exchange Act provides suggested wording for the legend. Other than the legend requirement, there are no mandated disclosure requirements to perfect the Rule 802 Exemption, such as the various business descriptions and financial statements that are required in a Form S-4 or F-4 registration statement. If the Acquiror is a U.S. company with officers and directors resident in the United States, the legend may be revised so it is not confusing or misleading (i.e., if there are no risks associated with enforcing claims under the U.S. federal securities laws against the Acquiror in the United States, then the legend need not advise U.S. Target Shareholders of this risk). \textit{See Division of Corporate Finance: Third Supplement to the Manual of Publicly Available Telephone Interpretations} (Supp. Jul. 2001).
as that provided to Target Shareholders in the Target’s home jurisdiction. If an informational document is released jointly by the Acquiror and the Target, then the Acquiror should assume the Form CB submission and the U.S. Target Shareholder dissemination obligations.

The term “informational document” is not defined under the Cross-Border Rules, which often generates questions regarding what information is required to be provided to the SEC and U.S. Target Shareholders. As a general practice, the term “informational document” should be construed broadly to include any document, notice or other information relating to the proposed transaction. The following are examples of typical informational documents (because each provides details about the proposed transaction) used in business acquisitions, together with suggested SEC submission and U.S. Target Shareholder dissemination procedures required under the Cross-Border Rules:

a. Documents mailed to Target Shareholders

Informational documents that are mailed to Target Shareholders (e.g., a proxy statement sent to Target Shareholders in a merger relying on the Rule 802 Exemption) by or on behalf of the Acquiror should be translated into English and timely (i) furnished to the SEC under a Form CB (unless the Target Stock is not registered under the Exchange Act for transactions relying on the Tier I Exemption) and (ii) mailed to U.S. Target Shareholders based on the information derived from the shareholders’ list used to determine the contact details for the non-U.S. Target Shareholders.

b. Press releases issued to the media

A press release issued by or on behalf of the Acquiror containing previously undisclosed information about a transaction (e.g., the number of shares of Target Stock tendered in an offer relying on the Tier I Exemption) may be captured by the Cross-Border Rules because its public release can be construed by the SEC as information disseminated with the intent to reach Target Shareholders. Press releases should be translated into English and timely (i) furnished to the SEC under a Form CB (unless the Target Stock is not registered under the Exchange Act for transactions relying on the Tier I Exemption) and (ii) provided to a wire service that distributes press releases to news agencies in the United States. If the press release is also posted on a Web site by or on behalf of the Acquiror, then the provisions regarding “information posted on a Web site” below would equally apply.

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36 If the Target issues a press release containing information supplied to it by the Acquiror that is not contained in the Acquiror’s press release, then the Acquiror should submit to the SEC the press release issued by the Target and comply with the dissemination requirements of the Cross-Border Rules.
c. **Notices published in newspapers**

A notice published in a local newspaper issued by or on behalf of the Acquiror concerning the transaction (e.g., where Target Shareholders should deposit their Target Stock in connection with a merger relying on the Rule 802 Exemption) should be translated into English and timely (i) furnished to the SEC under a Form CB (unless the Target Stock is not registered under the Exchange Act for transactions relying on the Tier I Exemption) and (ii) published in a newspaper with a U.S. national circulation.

d. **Information posted on a web site**

Similar to a press release, previously undisclosed information about the transaction posted on the Web site of the Acquiror or a third-party provider consented to by the Acquiror should be translated into English and furnished to the SEC on a Form CB because the SEC may construe such posting as a publication of information to Target Shareholders. How the Acquiror satisfies its dissemination obligation to U.S. Target Shareholders depends on the intent behind the Web site posting. If the Web site posting is voluntary and not used as a method to satisfy a Target Shareholder delivery or notice obligation pursuant to the laws of the Target’s home jurisdiction, then the Acquiror should be required to post only an English translation of the information along with the non-English version on the Web site. However, if the Web site posting is used by the Acquiror to satisfy a Target Shareholder delivery or notice obligation, then the Acquiror could be required to promptly mail to each U.S. Target Shareholder an English translation of the posted information, other than to those U.S. Target Shareholders who have given their consent to the Acquiror to receive information by electronic means.37

Form CB submission and U.S. Target Shareholder dissemination requirements may also apply to informational documents published or disseminated by the Target if such documents contain information supplied by the Acquiror or is a material informational document that U.S. Target Shareholders would reasonably expect to receive. For instance, in jurisdictions where the Target is required to prepare and disseminate to Target Shareholders a proxy or tender offer statement, such informational document would not ordinarily be furnished to the SEC or disseminated to U.S. Target Shareholders under a literal reading of the Cross-Border Rules because the Target (not the Acquiror) is the party publishing or disseminating the informational document. The SEC, however, may view this result as contrary to the spirit of the Cross-Border Rules to encourage U.S. participation in overseas transactions and could require the Target to submit a Form CB, file a Form F-X and provide U.S. Target Shareholders with English translations of such informational documents in a timely manner.38 Since the SEC has

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37 See the Cross-Border Release, supra note 18.

38 If the Acquiror cannot control the form and substance of the disclosure in an informational document prepared by the Target, then the Acquirer may prefer for the Target to submit such informational document to the SEC on Form CB because the Cross-Border Rules do
not published guidance concerning a Target’s tacit compliance obligations under the Cross-Border Rules, counsel to the Acquiror may wish to contact the SEC well in advance of the planned distribution date of a Target’s informational document to determine which party has the Form CB submission and U.S. Target Shareholder dissemination obligation.

The Form CB and the Form F-X can be furnished to the SEC either electronically through the SEC’s EDGAR system or in paper through the SEC’s filing desk in Washington, D.C. The Form F-X should be filed with the SEC at the time of the first Form CB submission. As coordinating a paper submission with the opening hours of the SEC filing desk can be logistically challenging for transactions effected in time zones significantly different from U.S. Eastern time, making submissions through the EDGAR system is often more practical for foreign private issuers.39 There is no fee for the submission to the SEC of the Form CB or the filing of the Form F-X, and the Acquiror does not need to furnish U.S. GAAP (or U.S. GAAP-reconciled) financial statements or the non-English version of the offering materials.

4. Calculating U.S. Ownership under the Tier I, Tier II and Rule 802 Exemptions

a. Procedure

As of the 30th day before the commencement of a cash tender offer, exchange offer or the shareholder solicitation date for a stock-for-stock merger, as the case may be, the Acquiror is required to determine the percentage of Target Stock owned by U.S. Target Shareholders, subject to certain exceptions as discussed later in this article. To calculate this ownership percentage, the Acquiror must:

- “look through” the ownership records of brokers, dealers, banks or nominees located in (i) the United States, (ii) in the Target’s home jurisdiction, and (iii) the primary trading market for the Target Stock to determine whether Target Stock is actually being

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39 To submit documents through the EDGAR system, a filer must first complete a Form ID, which can be retrieved from the SEC’s Web site at http://www.sec.gov. Rule 12 of Regulation S-T provides that electronic filings may be submitted to the SEC each business day (i.e., any day other than Saturday, Sunday or a U.S. federal holiday) from 8 AM to 10 PM U.S. Eastern time. Rule 13(a) of Regulation S-T provides, however, that any submission that commences after 5:30 PM U.S. Eastern time will be dated the following business day.
held on behalf of U.S. Target Shareholders;\textsuperscript{40}

- exclude from the numerator (i.e., the amount of Target Stock held by U.S. Target Shareholders) and the denominator (i.e., the amount of Target Stock issued and outstanding) all (i) Target Stock held of record or “beneficially owned” by (x) the Acquiror and (y) 10% or greater Target Shareholders and (ii) warrants, options, and other securities that are convertible or exchangeable into Target Stock; and

- include in the (i) numerator all Target Stock underlying American Depositary Shares that are owned by U.S. Target Shareholders and (ii) denominator all Target Stock underlying American Depositary Shares that are issued and outstanding.

b. **Difficulties with the Calculation**

The methodology to calculate percentage ownership of Target Stock held by U.S. Target Shareholders under the Cross-Border Rules may lead to unexpected results and various issues when gathering Target Stock ownership information.

The Cross-Border Rules do not provide exemptive relief for many business acquisitions where the Target is closely held due to the manner in which the level of Target Stock ownership by U.S. Target Shareholder must be calculated. By excluding large shareholders from the calculation of U.S. Target Shareholder ownership levels, the ability of an Acquiror to utilize the Tier I, Tier II and Rule 802 Exemptions is reduced.\textsuperscript{41} For example, suppose the Target is a family-owned business with the family patriarch beneficially owning 40% of the Target Stock and various trust funds holding an aggregate of 38% of the Target Stock on behalf of his two children. Neither the founding father nor his children reside in the United States. U.S. Target Shareholders beneficially own 5% of the issued and outstanding Target Stock. Based on the methodology to calculate ownership under the Cross-Border Rules, U.S. Target Shareholders actually own 22.7% of

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\textsuperscript{40} If the Target Stock is in bearer form, then such securities will be presumed not owned by U.S. Target Shareholders unless the Acquiror knows or has reason to know that such securities are held by U.S. Target Shareholders. See the Cross-Border Release, supra note 18, n. 75.

\textsuperscript{41} An Acquiror, however, may presume that the U.S. ownership limitations of the Tier I, Tier II and Rule 802 Exemptions are not exceeded unless the Target’s most recent annual report (or similar regulatory filing) indicates that U.S. Target Shareholders hold more than the applicable threshold or the Acquiror should reasonably know otherwise (e.g., through public share ownership filings). Accordingly, to discourage an unsolicited or “hostile” takeover, a Target may wish to disclose such U.S. share ownership information in its regulatory filings, assuming U.S. share ownership levels exceed 10%. The presumption does not apply in a negotiated transaction between an Acquiror and a Target, and is lost if a “hostile” transaction subsequently turns “friendly.” See Rule 802(c) of the Securities Act and Instruction 3 to Instructions to paragraphs (c) and (d) of Rule 14d-1 of the Exchange Act.
the issued and outstanding Target Stock (5% divided by 22%). As a result, the Acquiror would not be able to benefit from any of the relief granted under the Cross-Border Rules.

It is also not clear whether record or beneficial ownership should be used to determine the existence of 10% or greater Target Shareholders under the Rule 802 Exemption. For purposes of the Tier I and Tier II Exemption, Rule 14d-1(g)(5) of the Exchange Act defines a “security holder” to mean “holders of record and beneficial owners of the securities which are the subject of a tender offer.” A similar definition is not contained in the provisions relating to the Rule 802 Exemption. 42 Beneficial ownership of securities under U.S. securities laws is determined pursuant to Rule 13d-3 of the Exchange Act, which attributes ownership to persons who have or share voting and/or investment power over a particular security. 43 When determining 10% or greater Target Shareholders under U.S. beneficial ownership rules, an Acquiror should examine the connection of all Target Shareholders to determine whether ownership interests should be aggregated or attributed to U.S. Target Shareholders due to the ability of one Target Shareholder to direct the voting or disposition of the Target Stock held by another Target Shareholder or as a result of an affiliate or other common control relationship. For example, an Acquiror will need to determine whether Target Stock held by an offshore office of a U.S. investment manager should be considered owned by a U.S. Target Shareholder due to its control relationship.

An Acquiror may need to expend great time and expense calculating U.S. ownership information under the Cross-Border Rules. To satisfy its “look through” ownership obligations under the Cross-Border Rules, an Acquiror is obligated to conduct a “reasonable inquiry” concerning the percentage of Target Stock held by U.S. Target Shareholders. If, after a reasonable inquiry, the Acquiror is unable to obtain residency information for nominee customer accounts or the charge for supplying such information is unreasonable, then the Acquiror may assume that the customer accounts are held in the jurisdiction of the nominee’s principal place of business. 44 The SEC, however, has not defined what constitutes a reasonable inquiry or an unreasonable expense, and it is the Acquiror’s obligation to demonstrate upon the request of the SEC that it satisfied its due diligence obligations when calculating the level of Target Stock held by U.S. Target

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42 This omission may have been oversight when the Rule 802 Exemption was submitted for publication in the federal registrar, as the SEC noted in the Cross-Border Release that “by focusing on beneficial ownership rather than record ownership, we have made it more difficult to stay below the relevant ownership ceilings and thus have limited the applicability of the exemptive rules. Indeed, that is one reason why we increased the U.S. ownership threshold in Rules 801 and 802 to 10 percent.”

43 The beneficial ownership provisions of Rule 13d-3 of the Exchange Act are incorporated into the Tier I and Tier II Exemptions through Rule 14d-1(g)(1) of the Exchange Act.

44 See Rule 800(h)(4) of the Securities Act and Instruction 2(iv) to Instructions to paragraphs (c) and (d) of Rule 14d-1 of the Exchange Act, together with the Cross-Border Release, supra note 18.
Shareholders. To meet its “look through” ownership obligations under the Tier I Exemption, the Tier II Exemption, or the Rule 802 Exemption, an Acquiror should undertake all actions within its power that are not prohibitively expensive. For example, with the assistance of counsel an Acquiror may wish to use commercially available shareholder search engines to determine whether a nominee is holding Target Stock on behalf of a U.S. Target Shareholder. Alternatively, an Acquiror could retain a proxy agent to conduct the search and distribute to the nominees of Target Shareholders a request for a NOBO (non-objecting beneficial owner) list if it is believed that such results would be more accurate and the cost is reasonable in light of the transaction value or the other fees being paid to members of the working group. Care should be taken concerning the manner in which searches are conducted because share ownership requests can jeopardize the confidentiality of a potential transaction.\footnote{A Target seeking an acquisition partner may wish to conduct searches of its shareholder base on a regular basis to divert attention.}

An Acquiror must also consider Target securities ownership information that is publicly available, such as proxy statements or other documents that disclose share ownership information, when calculating the level of Target Stock held by U.S. Target Shareholders.\footnote{See Rule 800(h)(5) of the Securities Act and Instruction 2(v) to Instructions to paragraphs (c) and (d) of Rule 14d-1 of the Exchange Act.} This could create difficulties for an Acquiror if the publicly available share ownership information is calculated in a manner that is inconsistent with the methodology used under the Cross-Border Rules (e.g., if a jurisdiction requires that share ownership be attributed to persons that have a pecuniary interest in the Target Stock, resulting in skewed U.S. ownership levels). If the Acquiror decides to exclude such public information when calculating the beneficial ownership of Target Stock held by U.S. Target Shareholders, then it should maintain adequate records for use if ever challenged by the SEC.

\textbf{c. Relief}

The SEC has made publicly available certain relief when determining the ownership of Target Stock by U.S. Target Shareholders pursuant to the Cross-Border Rules. For example, if Target Shareholder ownership information is not available on the 30th day prior to the commencement of the transaction for reasons beyond the control of the Acquiror or the Target (e.g., Target Shareholder ownership information is prepared periodically by a third party), then the calculation of Target Stock held by U.S. Target Shareholders may be based on reasonably reliable information that can be obtained as of another date that is as close to the 30th day as practical, unless the Acquiror or the Target has other means or subsequently gains access to more accurate information. The SEC has also stated that under certain conditions, the 30-day reference period can start from
the “announcement” of the transaction (rather than its commencement).47

To provide a level playing field in the case of competing offers, the SEC has provided within the text of the Cross-Border Rules that if an Acquiror commences a tender offer, exchange offer or stock-for-stock merger during an ongoing offer by another person, the Acquiror will be eligible to use the same Tier I, Tier II or Rule 802 Exemption as the other person, so long as all conditions to that exemption, other than the limitation on U.S. ownership, are satisfied by the Acquiror.48 As a result, the Acquiror will not be disadvantaged by any movement of securities into the United States following the announcement of the first offer.

B. Exemptions Available When Acquiror Stock Will Be Offered to U.S. Target Shareholders and the Rule 802 Exemption is Unavailable

When Acquiror Stock will be offered to U.S. Target Shareholders and the Rule 802 Exemption is unavailable, the Acquiror could place such securities in the United States either through a private placement exemption or a Section 3(a)(10) exchange offer. Selecting which exemption will often depend on whether the laws of the Target’s home jurisdiction has a court or government sanctioned process to review the fairness of the terms and conditions of the transactions that meets the procedural requirements of Section 3(a)(10).

1. Private Placement Exemptions

An Acquiror could offer and sell Acquiror Stock to U.S. Target Shareholders through a private placement exemption rather than through an exchange offer or stock-for-stock merger.49 Section 4(2) and Regulation D are the two principal private placement exemptions available under U.S. federal securities laws.

If the Rule 802 Exemption is unavailable and the number of U.S. Target Shareholders is small enough to make direct negotiations feasible, then a private placement exemption could be utilized by an Acquiror to offer Acquiror Stock to U.S. Target Shareholders. If the value of the Acquiror Stock exceeds U.S.$1 million or all the U.S. Target Shareholders are not institutional “accredited investors,” then Regulation D may not be helpful and counsel should examine whether the Section 4(2) Exemption is available.

48 See Rule 14d-1(c)(1) of the Exchange Act and Rule 802(a) of the Securities Act.
49 For exchange offers dealing with Target Stock registered under the Exchange Act, purchasing Target Stock outside the offer pursuant to a private placement exemption could be impermissible pursuant to the all-holders provisions of Rule 14d-10 of the Exchange Act depending on the manner and timing of such purchases.
a. **Section 4(2)**

Section 4(2) of the Securities Act provides an exemption from the registration requirements under the Securities Act for securities transactions by an issuer that do not involve a “public offering” in the United States. The term “public offering” is not defined under the Securities Act. Accordingly, the U.S. private bar and U.S. courts have interpreted its meaning in various and sometimes conflicting ways. Notwithstanding the foregoing, common features examined to determine whether a public offering exists for purposes of perfecting the Section 4(2) private placement exemption in the context of an overseas business acquisition include:

- the type of U.S. Target Shareholders offered and sold Acquiror Stock, particularly their sophistication as investors and their access to relevant information concerning the Acquiror in order to make an investment decision;
- the number of offers made to U.S. Target Shareholders to receive Acquiror Stock;
- the absence of any general solicitation or advertisement concerning the transaction;\(^50\) and
- the steps implemented (e.g., stock legends) to inform U.S. Target Shareholders about the restrictions on transferability in the United States of the Acquiror Stock received in the transaction.

The factors examined to determine whether a public offering exists create various uncertainties. For example, there is no statutory guidance regarding the maximum number of U.S. Target Shareholders to whom offers can be made. While it is difficult to list categorically how many offerees is too many for purposes of the Section 4(2) exemption, exchanges offers or stock-for-stock mergers involving 100 or more U.S. Target Shareholders presumably would not be acceptable. Section 4(2) also does not mandate the type of information about the Acquiror that should be disclosed to U.S. Target Shareholders. At a minimum, however, U.S. Target Shareholders should be provided with an English translation of the information distributed to non-U.S. Target Shareholders. Additional information resembling the disclosures that would appear in a prospectus for a U.S. public offering concerning the business operations of the Acquiror, the Acquiror’s financial condition and the risks related to the ownership of Acquiror

\(^{50}\) Advertising or other publicity relating to the Acquiror in the United States, even if it does not specifically mention the transaction, may require delaying the transaction if the publicity occurs a short time before the transaction and its frequency is greater than the amount that occurred in the ordinary course of the Acquiror’s business prior to the announcement of the transaction.
Stock should be provided to U.S. Target Shareholders depending on the financial strength of the Acquiror, the cyclical nature of the industry in which the Acquiror competes, the quality of the Acquiror’s financial statements and the accounting standards adopted by it, the price volatility of the Acquiror Stock, and whether the omitted information would be considered important to a reasonable investor when making an investment decision regarding the Acquiror Stock or would materially alter the total mix of information available to the investor.

b. Regulation D

Regulation D under the Securities Act provides a “safe harbor” from the registration requirements under the Securities Act. Compliance with Regulation D ensures compliance with the Section 4(2) exemption or Section 3(b) of the Securities Act depending on which provision is used. Reliance on Regulation D is not exclusive, so if an Acquiror is unable to comply with all of its requirements, then it may still rely on another exemption.

Regulation D provides separate guidelines depending on the dollar value of the offering:

i. Rule 504

Rule 504 of Regulation D provides an exemption from the registration requirements under the Securities Act for offerings in the United States that do not exceed U.S.$1 million in any twelve month period. To qualify for the exemption, the Acquiror must have all of its securities registered under the Exchange Act or be an investment company. In addition, the Acquiror cannot engage in any general solicitation and must take reasonable steps to impose restrictions on resales of Acquiror Stock, unless the placement is: (i) registered under a U.S. state’s securities law that requires the public filing and delivery of a substantive disclosure document to U.S. Target Shareholders or (ii) made only to “accredited investors” under a state law exemption that permits a general solicitation. If Rule 504 is relied upon, the Acquiror is required to file a Form D with the SEC within 15 days after the first issuance of Acquiror

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51 Section 3(b) of the Securities Act entitles the SEC to adopt rules from time to time that exempt security issuances from the Section 5 registration requirements where enforcement is not necessarily in the public interest and the aggregate offering amount is less than $5 million. Rules 504 and 505 of Regulation D were promulgated under Section 3(b).

52 An “accredited investor” is defined under Rule 501(a) of the Securities Act to include various entities such as banks and certain charitable organizations and (i) any natural person whose individual or joint net worth with that person’s spouse exceeds U.S.$1 million at the time of the transaction, (ii) any natural person who had an individual income in excess of U.S.$200,000 in each of the two most recent years or joint income with that person’s spouse in excess of U.S.$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year, and (iii) any director, executive officer or general partner of the Acquiror.
Stock to U.S. Target Shareholders (i.e., the closing of the exchange offer or stock-for-stock merger). A Form D is a simple form that requires the provision of basic information about the offering and is not reviewed by the SEC.

ii. Rules 505 and 506

Rules 505 and 506 apply to offerings in the United States that exceed U.S.$1 million in any twelve month period. Rule 505 provides an exemption for offerings by an Acquiror that is not an investment company of up to U.S.$5 million in Acquiror Stock to accredited investors and up to 35 non-accredited investors in any twelve month period. Rule 506 provides an Acquiror with an exemption for offerings of an unlimited dollar amount of Acquiror Stock to accredited investors and up to 35 non-accredited investors in any twelve month period. Unlike Rule 505, the non-accredited investors in a Rule 506 offering must be “sophisticated” (or have a “sophisticated” purchaser representative) so that they have (or have access to) sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the investment.\(^{53}\)

Both Rules 505 and 506 require an Acquiror to (i) exercise reasonable care to ensure that U.S. Target Shareholders are not acquiring their Acquiror Stock with a view towards distribution,\(^{54}\) (ii) advise U.S. Target Shareholders that are non-accredited investors about the limitations on resale of the Acquiror Stock, (iii) provide U.S. Target Shareholders that are non-accredited investors with the type of business disclosure that would appear in a U.S. registered public offering, together with specified financial information about the Acquiror depending on the size of the transaction,\(^{55}\) (iv) furnish to U.S. Target Shareholders that are non-accredited investors all the information that is provided to the Target Shareholder that are accredited investors, (v) allow each U.S. Target Shareholder the opportunity to ask questions and receive answers concerning the transaction and obtain any additional information that the Acquiror can obtain without unreasonable effort or expense, (vi) avoid any form of general solicitation or general advertising relating to the Acquiror or the transaction, and (vii) file a Form D in the same

\(^{53}\) See Rules 501(h) and 506(b)(2)(ii) of the Securities Act.

\(^{54}\) Rule 502(d) of the Securities Act provides a non-exhaustive list of procedures for an Acquiror to demonstrate that the U.S. Target Shareholder is not acquiring the Acquiror Stock with a view towards distribution, such as (i) conducting a reasonable inquiry to determine if the U.S. Target Shareholder is acquiring the Acquiror Stock for himself or other persons, (ii) providing notice to the U.S. Target Shareholder that the Acquiror Stock has not been registered, and (iii) using legends to indicate that the Acquiror Stock has not been registered and is subject to resale restrictions.

\(^{55}\) Although not mandated by Regulation D, it is common practice to provide accredited investors with the same business and financial information that is provided to non-accredited investors in order to avoid the application of the antifraud provisions of U.S. federal securities laws to the information that is disclosed (or not disclosed) to an accredited investor. See Note to Rule 502(b)(1) of the Securities Act.
manner as described for an offering made in reliance on Rule 504.

The Rules 505 and 506 exemptions will have limited appeal to an Acquiror if a determination cannot be made that each U.S. Target Shareholder is an accredited investor (and for a transaction relying on the Rule 506 exemption, an additional determination cannot be made that each U.S. Target Shareholder is also “sophisticated” or has access to a “sophisticated” purchaser representative). In such instances, the Rules 505 and 506 exemptions may not be helpful to an Acquiror because it would be required to provide U.S. Target Shareholders with a disclosure document containing information similar to what would be disclosed in a U.S. registered public offering.\(^56\) For a foreign private issuer that has not previously accessed the U.S. public capital markets, the requirement to provide financial statements prepared or reconciled in accordance with U.S. generally accepted accounting principles takes considerable time and expense, and the resulting delay could compel the Acquiror to abandon the transaction.

\(c\). Integration

Under the doctrine of integration, two or more separate offerings of securities may be deemed a single offering. Therefore, integration can be an issue under U.S. federal securities laws whenever multiple offerings are conducted and one or more of them are made in reliance upon a U.S. private placement exemption. If two offerings are viewed as a single offering, then the exemption relied upon for one of the offerings may no longer be valid. For example, an Acquiror wishes to rely on the Rule 802 Exemption in connection with a proposed stock-for-stock merger, but U.S. Target Shareholders beneficially own 12% of the Target Stock. To reduce U.S. ownership levels to meet the 10% Rule 802 Exemption threshold, the Acquiror undertakes a private placement with U.S. Target Shareholders to exchange Acquiror Stock for Target Stock. Without an exemption, the Acquiror Stock issued in the subsequent stock-for-stock merger could be integrated with the Acquiror Stock issued in the prior exchange offer, which could void the private placement exemption relied upon in the prior exchange offer.

Integration should not be a concern when an exempt offering is made shortly before or concurrently with an offering complying with the Rule 802 Exemption or Regulation S (discussed below). The Cross-Border Rules specifically provide an exemption to the doctrine of integration. General Note 7 to Rules 800 through 802 of the Securities Act states that a “transaction that complies with [the Rule 802 Exemption] will not be integrated with offerings exempt under other provisions of the [Securities] Act, even if both transactions occur at the same time.” Accordingly, compliance with the Rule 802 Exemption requirements is especially critical when a prior or simultaneous private placement of Acquiror Stock in the United States is contemplated in connection

\(^{56}\) See Rules 505(b)(2)(ii) and 506((b)(2)(i) of the Securities Act in conjunction with Rule 502(b) of the Securities Act.
with an exchange offer or stock-for-stock merger; otherwise, the exemption relied upon in the private offering could be lost (which could give rise to rescission rights to those U.S. Target Shareholders who participated in the private placement transaction). Regulation S also specifically provides an exemption to the doctrine of integration when a U.S. private placement is an add-on or occurs simultaneously with an offer made outside the United States in compliance with Regulation S.57

d. Blue Sky Laws

Blue sky laws are not necessarily exempt as a result of relying on Section 4(2) or Rules 504 or 505 to place Acquiror Stock.58 Therefore, an Acquiror may wish to restrict private placements of Acquiror Stock to institutional accredited investors, since almost every U.S. state provides an exemption from its registration requirements for offers and sales made to specified institutional purchasers.

2. Section 3(a)(10) Exchange Exemption

Section 3(a)(10) of the Securities Act exempts from the registration requirements under the Securities Act schemes of arrangement or similar transactions in which securities are issued in exchange for other securities or when the issuance has been approved by a court or an appropriate administrative body. Relief from U.S. tender offer rules in a scheme of arrangement or similar transaction is not necessary because the Acquiror is not making an offer directly to Target Shareholders.

The following conditions must be satisfied in order for the Section 3(a)(10) exemption to apply:59

- the Acquiror Stock must be issued in exchange for Target Stock, claims, or property interests—it cannot be offered for cash;
- a court (which may include a non-U.S. court) or authorized governmental entity must approve the fairness of the terms and conditions of the exchange.60

57 See General Note 5 to Regulation S of the Securities Act.
58 A transaction exempt under Rule 506 is not subject to blue sky regulation by virtue of Section 18(b)(4)(D).
59 See Revised Staff Legal Bulletin No. 3 (Oct. 20, 1999).
60 The SEC has recognized the following non-U.S. courts as courts qualified to approve
the reviewing court or authorized governmental entity must (i) find, before approving the transaction, that the terms and conditions of the exchange are fair to those to whom securities will be issued and (ii) be advised before the hearing that the Acquiror will rely on the Section 3(a)(10) exemption based on the court’s or authorized governmental entity’s approval of the transaction;
• a governmental entity must be expressly authorized by law to hold the fairness hearing, although it is not necessary that the law require the hearing;
• the fairness hearing must be open to the Target Shareholders and adequate notice must be given; and
• there cannot be any improper impediments to the appearance by Target Shareholders who are entitled to attend the hearing.61

Due to the numerous conditions that must be satisfied in order to comply with the Section 3(a)(10) exemption and since the SEC has not yet provided definitive guidelines for the type of examination that satisfies the requirement of a “fairness hearing,” an Acquiror seeking to rely on Section 3(a)(10) will normally submit a no-action request letter to the SEC to confirm that it will not recommend an enforcement action with respect to the proposed transaction. Consultation with the SEC should commence early in the merger process, because the SEC will not provide no-action relief concerning a proposed Section 3(a)(10) transaction after the fairness hearing has been held.

Section 3(a)(10) exempts a transaction only from the registration requirements under the Securities Act. Therefore, the Acquiror may still need to comply with the blue sky laws of the U.S. states in which the Target Shareholders reside.62

C. Exemptions Available When U.S. Target Shareholders Will Be Treated as a Different Tranche in the Transaction

If there are no available exemptions to the application of U.S. securities laws to a particular transaction, then the Acquiror may wish to treat the U.S. Target Shareholders as a different tranche in the transaction and (i) use a vendor placement procedure to offer

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61 A subtle example of an improper impediment is if a travel visa is required for visitors to enter the Target’s home jurisdiction, but it is not possible to satisfy the visa requirements prior to the court hearing or the costs are prohibitive.

62 See Revised Staff Legal Bulletin No. 3 (Oct. 20, 1999), Part 4.B.2; Section 18(b)(4)(A) of the Securities Act; and HAZEN, supra note 11, at 377.
U.S. Target Shareholders the right to receive only cash for their Target Stock in an exchange offer or stock-for-stock merger, (ii) effect a dual offer structure by conducting parallel offers in the United States and in the Target’s home jurisdiction in a tender offer or exchange offer, or (iii) adopt Regulation S exclusion procedures to exclude U.S. Target Shareholders from the transaction.

Determining how to handle U.S. Target Shareholders in non-exempt transactions will normally depend on the application of shareholder equal treatment laws of the Target’s home jurisdiction. If the laws of the Target’s home jurisdiction do not permit an Acquiror to treat Target Shareholders that hold the same class of security differently, then the Acquiror could consider a vendor placement procedure or a dual offer structure depending on the size of the transaction and the ability to obtain SEC no action relief. If an Acquiror is able to treat the same class of Target Shareholders differently, then it may wish to exclude U.S. Target Shareholders from the transaction by adopting Regulation S exclusion procedures.

1. Vendor Placement Procedure

A vendor placement procedure is useful when the Target’s home jurisdiction requires all Target Shareholders be treated equally, but the Acquiror is unable to utilize an exemption to offer Acquiror Stock in the United States or the Acquiror doesn’t have sufficient financial resources to cash-out U.S. Target Shareholders, and the amount of Acquiror Stock that will be sold in the vendor placement is not expected to impact the trading price of the Acquiror Stock.

An Acquiror can use a vendor placement to extend offers into the United States without subjecting the transaction to the registration requirements under the Securities Act if the shares of Acquiror Stock that accepting U.S. Target Shareholders would have received in the exchange offer or stock-for-stock merger are cashed out and the net proceeds are distributed to them. Although the Tier I Exemption allows an Acquiror to provide Target Shareholders with different consideration (e.g., a cash-only alternative), an Acquiror may prefer to use a vendor placement if it does not have sufficient cash to finance the transaction, as Acquiror Stock is sold under a vendor placement to fund the cash payments to U.S. Target Shareholders, or the Target’s home jurisdiction requires

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63 If U.S. Target Shareholders hold a large percentage of Target Stock, then there may not be adequate market liquidity to absorb large sales of Acquiror Stock after the completion of the transaction in the vendor placement without significantly impacting the trading price of the Acquiror Stock (which could disadvantage other Target Shareholders who exchanged their Target Stock for Acquiror Stock in connection with the transaction).
64 See Rule 14d-1(c)(2)(iii) of the Exchange Act.
that all Target Shareholders be offered the same consideration. Effecting a vendor placement is most practical if the Acquiror is a “Category 1” issuer under Regulation S since there are no offering restrictions or notice requirements during the distribution compliance period.

While there is no standard structure to effect a vendor placement, the typical arrangement calls for the shares of Acquiror Stock that accepting U.S. Target Shareholders would have received in the offer be delivered to a trustee located outside of the United States. The trustee promptly sells the Acquiror Stock on the principal securities exchange on which the Acquiror Stock trades, with the cash proceeds from such sale (net of the costs and expenses associated with the sale) remitted to U.S. Target Shareholders as consideration for their acceptance of the offer. At no time would a U.S. Target Shareholder receive any Acquiror Stock or have any control over the disposition of the Acquiror Stock. The SEC may require an Acquiror to guarantee a minimum net cash price for the Acquiror Stock sold by the trustee in order to reduce the stock price fluctuation risk to the U.S. Target Shareholders between the date the U.S. Target Shareholders accept the offer and the date they receive their net cash proceeds from the sale of their Acquiror Stock.\(^\text{65}\)

A typical vendor placement triggers the application of U.S. federal securities laws because an offer for Acquiror Stock is technically made to U.S. Target Shareholders, even though cash instead of securities is ultimately delivered to accepting U.S. Target Shareholders. The SEC has granted no-action letter relief from the registration requirements under the Securities Act based on arguments that requiring registration statement-type disclosures would not be relevant to an accepting U.S. Target Shareholder’s decision, as such persons will have no ongoing interest in the Acquiror Stock. Thus, there is little need to protect accepting U.S. Target Shareholders from the investment risk of owning the Acquiror Stock.\(^\text{66}\) In addition to considering U.S. federal securities laws, local counsel should determine whether a vendor placement that restricts U.S. Target Shareholders to receiving only cash for their Target Stock (while other Target Shareholders may receive Acquiror Stock) violates any shareholder equal treatment provisions under the Target’s organizational documents or the laws of the Target’s home jurisdiction.

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\(^{65}\) Simultaneously with a vendor placement, an Acquiror may also effect private placements of Acquiror Stock with qualified U.S. Target Shareholders to provide such persons with the option of receiving securities (not just cash) without violating Rule 14e-5 of the Exchange Act (no purchases outside the tender offer). See e.g., SEC No-Action Letters Singapore Telecommunication Ltd. (May 15, 2001); AMP Limited (Sep. 17, 1998); and Australia National Industries Ltd. (Aug. 30, 1994).

\(^{66}\) See e.g., SEC No-Action Letters Singapore Telecommunication Ltd. (May 15, 2001); TABCORP Holdings Limited (Aug. 27, 1999); Durban Roodepoort Deep, Limited (Feb. 23, 1999); and AMP Limited (Sep. 17, 1998).
2. Dual Offer Structure

A dual offer structure is useful for a multi-jurisdiction transaction that must be undertaken and extended to all Target Shareholders, but it is not possible to structure around U.S. securities laws.

A dual offer structure is often utilized when the offer rules of the United States and the Target’s home jurisdiction vary to such a degree that it is impractical to extend a single offer to all Target Shareholders. For example, the Target’s home jurisdiction may require that the offer document (i) include information that is prohibited in United States, (ii) be organized in a designated manner that could confuse U.S. Target Shareholders, or (iii) be written in a language that is foreign to most U.S. Target Shareholders. Accordingly, a tender offer or exchange offer could be divided into two parallel offers—a U.S. offer that is available only to U.S. Target Shareholders that complies with U.S. securities laws and a non-U.S. offer that is available only to non-U.S. Target Shareholders that complies with the regulations of the Target’s home jurisdiction. The consideration offered by the Acquiror in each offer is normally of equivalent value, and the timing of the transactions substantially the same.

SEC no-action letter relief is often sought to effect a dual offer structure because purchases in the non-U.S. offer after the announcement of the offer in the United States could violate the Rule 14e-5 prohibition against an Acquiror purchasing Target Stock outside an offer. SEC no-action relief also may be necessary for other Regulation 14E procedural differences between the offer made in the United States and the other jurisdiction, and for Regulation 14D relief if the Target Stock is registered under the Exchange Act.

Due to the significant time and expense associated with organizing and coordinating a dual offer, this structure is often reserved for very large or critical transactions that must be extended to all Target Shareholders and no exemption exists. If the tender offer qualifies under the Tier I Exemption or the exchange offer qualifies under the Tier I and Rule 802 Exemptions, a dual offer structure is normally unnecessary because these exemptions permit the use of the offering materials (translated into English) that comply with the regulations of the Target’s home jurisdiction and also permit the offer to be conducted in accordance with the laws and practices of the Target’s home jurisdiction.67

3. Regulation S Exclusion Procedures

Regulation S procedures are useful if the Acquiror wants to exclude U.S. Target Shareholders from the transaction, and the laws of the Target’s home jurisdiction permit such action.

An Acquiror may need to exclude U.S. Target Shareholders from a transaction for a variety of regulatory or other reasons. Offers and sales of securities that occur “outside of the United States” pursuant to the safe-harbor provisions promulgated under Regulation S are not subject to the registration requirements under the Securities Act. Accordingly, if an Acquiror structures its transaction so that it is not extended to U.S. Target Shareholders in accordance with Regulation S, then the Acquiror would not need to comply with the registration requirements under the Securities Act. Although Regulation S is a safe harbor only from the application of the registration requirements under the Securities Act, if a transaction is structured to take place outside of the United States, then the Regulation 14D and Regulation 14E tender offer rules should not be applicable as well since no offers will be made in the United States.

For an offer and sale of Acquiror Stock to be deemed to occur outside of the United States, two general conditions must be satisfied: (i) the offer and sale of the securities must be made in an “offshore transaction” (which focuses on the location of the purchaser) and (ii) no “directed selling efforts” can be made in the United States in connection with the transaction. An offer or sale of securities will be deemed to be made in an “offshore transaction” if the offer is not made to a person in the United States and certain objective criteria indicate that the mechanics of the purchase and sale take place outside of the United States. Regulation S establishes two alternative criteria to establish that the mechanics of the purchase and sale take place outside of the United States, namely: (i) the Target Shareholder is outside the United States when it responds to the offer (or the Acquiror reasonably believes that the Target Shareholder is outside the United States at such time) or (ii) the transaction is executed on the physical trading floor of a foreign securities exchange. “Directed selling efforts” in the United States include any actions that are intended to, or that could be reasonably expected to, condition the U.S. market for the Acquiror Stock (e.g., placing advertisements in publications with a “general circulation” in the United States, mailing materials to U.S. Target Shareholders

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68 A “general circulation” in the United States exists if the publication has a U.S. circulation of 15,000 copies or more per issue in the preceding 12 months and/or is a publication printed primarily for distribution in the United States. Where a foreign publication produces a separate edition for circulation in the United States (e.g., The Financial Times), the U.S. edition may be disregarded in determining whether the non-U.S. editions, collectively, meet the above test. See
or conducting promotional seminars in the United States).

In addition to the general conditions, further offering restrictions and notice requirements are necessary under Regulation S depending on the type of securities being offered, whether the Acquiror is a foreign private issuer, whether the Acquiror is required to file periodical reports under the Exchange Act, the location of the principal trading market for the Acquiror Stock, and the nature of the transaction. An Acquiror will need to comply only with the general conditions of Regulation S for a transaction involving its equity securities if it is a foreign private issuer that does not have a “substantial U.S. market interest”69 and none of its securities are registered under the Exchange Act.

While it is not possible to prepare a comprehensive list of methods to effectively exclude U.S. Target Shareholders from any type of transaction that is consistent with Regulation S, the following could be used as baseline steps with additional procedures developed depending on the details of the particular transaction:

- None of the materials relating to the transaction, such as offer documents, proxies or forms of acceptance, should be distributed in the United States, whether on paper or electronically. All materials relating to the transaction should include legends.70
- No press conferences, analyst calls, road shows or one-on-one meetings with Target Shareholders should be held in the United States, either before or during the transaction, which discuss the transaction.
- No press releases relating to the transaction should be distributed in the United States. Furthermore, all press releases distributed outside the United States must contain a legend to the effect that the transaction is not being extended into the United States and cannot be accepted from the United States.
- Any other form of publicity concerning the transaction should be avoided in the United States. In addition, advertisements should

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69 See Rule 902(j) of the Securities Act.

70 A sample legend for an offering of Acquiror Stock could read as follows: “This [transaction] is not being made in or into, and may not be accepted in or from, the United States. Copies of this document and any related materials are not being and should not be mailed or otherwise distributed or sent in or into the United States. The securities offered hereby have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the “U.S. Securities Act”), nor under the laws of any state of the United States, and may not be offered, sold, resold or delivered, directly or indirectly, in or into the United States except pursuant to an exemption from the registration requirements under the U.S. Securities Act. This document does not constitute an offer to sell or the solicitation of an offer to buy any securities in the United States or in any other jurisdiction in which such an offer or solicitation is unlawful.”
not be placed in any publication that has a “general circulation”\textsuperscript{71} in the United States.

- Any portion of the Web sites of the Target or the Acquiror that relates to the transaction should be segregated and protected in order to prevent access by U.S. Target Shareholders. The Web sites should utilize technology that requires information (such as a user’s mailing address or telephone number), to determine that the user is not in the United States before permitting access to the posted materials or responding to inquiries for information. Legends should also be displayed in the relevant sections of the Web sites.\textsuperscript{72}

- The Acquiror and Target should not respond to inquiries concerning the transaction if such inquiries are received from the United States.

- Any form of acceptance, proxy or similar document that will be submitted by Target Shareholders should include a representation by such person that he, she or it is not a U.S. person (as defined under U.S. federal securities laws), is not in the United States and is not using U.S. jurisdictional means (such as the U.S. mail) to participate in the transaction.

- No form of acceptance or similar document should be processed if there is an indication that it has been delivered from the United States (e.g., the Target Shareholder indicates that it is unable to make the representation mentioned above or the form of acceptance is received in an envelope with a U.S. postmark).

- To the extent that the Target has employees in the United States, communications with such employees regarding the transaction must be reviewed to be certain that such communications do not constitute impermissible publicity or a solicitation concerning the proposed transaction.

Notwithstanding the development of effective Regulation S exclusion procedures, it may not be possible or practical to exclude U.S. Target Shareholders from a transaction. Often the laws of the Target’s home jurisdiction or its organizational documents preclude disparate treatment among shareholders owning the same class of security. Therefore,

\textsuperscript{71} See supra, note 68.

\textsuperscript{72} For more information concerning the SEC’s position on the application of U.S. securities laws to information posted on a Web site, see Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore, SEC Release No. 33-7516 (Mar. 23, 1998), the Cross-Border Release, supra note 18, and Use of Electronic Media, SEC Release No. 33-7856 (May 4, 2000).
excluding U.S. Target Shareholders from a transaction that is extended to all Target Shareholders may not be permissible, especially in a merger. To overcome the appearance that a particular action unfairly excludes U.S. Target Shareholders, an Acquiror should examine whether the relevant regulations allow it to develop procedures that are objective on their face, but achieve the desired result. For example, an Acquiror could adopt a policy that it will not extend an offer in any jurisdiction where the making of such offer requires the approval of a governmental authority. If U.S. Target Shareholders are excluded pursuant to a policy that is evenly applied to all Target Shareholders, then such exclusion would be the result of third-party regulatory requirements and not the direct actions of the Acquiror. Applying this policy to a merger and eliminating the voting rights of U.S. Target Shareholders, however, could be difficult under the laws of the Target’s home jurisdiction.

Even if it is possible to exclude U.S. Target Shareholders from a transaction, this could have undesirable consequences to the Acquiror if the U.S. Target Shareholders own a significant block of Target Stock. By excluding such large U.S. Target Shareholders, it could become mathematically impossible or could significantly reduce the likelihood that the requisite number of votes to approve the proposed merger could be obtained, or a sufficient amount of Target Stock will be tendered in the transaction to allow the Acquiror to effect a second-step compulsory merger to squeeze out minority Target Shareholders. Under such circumstances, the Acquiror could be required to prepare additional disclosure documents and regulatory filings to solicit the vote of the remaining U.S. Target Shareholders in order to effect a second-step merger, which could raise additional issues and delay the completion of the transaction.

D. Squeezing Out Minority Shareholders

The plan to acquire a publicly-held Target through a tender offer or exchange offer normally includes a second-step merger or similar structure. While an Acquiror can make a tender offer or exchange offer to shareholdere rs in an effort to expedite the time to complete the acquisition, it rarely will be able to acquire all of the Target Stock through the offer. As a result, a second-step compulsory squeeze-out merger is often implemented if permitted by the laws of the Target’s home jurisdiction to eliminate the Target Shareholders who do not tender their Target Stock in the offer.\(^73\) Since the first step tender offer or exchange offer and the second-step compulsory merger are viewed as separate transactions under U.S. securities laws, to avoid the registration requirements of the Securities Act, an exemption must be available for each step of the transaction. Nothing precludes the Acquiror from relying on the same exemption for each step of the transaction, so long as the conditions for use of such exemption are satisfied in each step.

An Acquiror could rely on one of the following to exempt a second-step squeeze-out merger from the application of the registration requirements of the Securities

\(^{73}\) See supra, note 6.
Act:  (i) the Rule 802 Exemption, (ii) a vendor placement procedure, (iii) the “no-sale” theory, or (iv) a cash out merger.

1. Rule 802 Exemption

The Rule 802 Exemption is often the first exemption examined in connection with the distribution of Acquiror Stock to U.S. Target Shareholders in a second-step compulsory merger to squeeze-out minority shareholders due to its relatively limited restrictions and flexible procedural requirements, as previously discussed. The SEC has also increased the availability of the Rule 802 Exemption to second-step squeeze-out mergers by providing that if the first-step transaction is validly conducted in reliance on a Tier I, Tier II or Rule 802 Exemption, then the Acquiror does not need to recalculate the Target Stock ownership level by U.S. Target Shareholders after the completion of the first-step transaction to determine whether an exemption is available for the second-step compulsory merger to squeeze out minority Target Shareholders. Instead, the initial calculation of U.S. ownership made for the first-step transaction is sufficient to determine eligibility for the use of the exemption in the subsequent squeeze-out step, so long as: (i) the disclosure document for the first step transaction indicates the Acquiror’s intent to conduct the second-step squeeze-out transaction and the terms of the subsequent transaction; and (ii) the second-step transaction is consummated within a reasonable time following the first-step transaction.74

2. Vendor Placement Procedure

If the Rule 802 Exemption is not available (e.g., U.S. Target Shareholders hold more than 10% of the Target Stock), then an Acquiror may determine to cash out U.S. Target Shareholders in the second-step compulsory merger through a vendor placement procedure. In Airline Industry Revitalization Co. Inc.,75 the SEC permitted the bidder in a tender offer for the equity securities of Air Canada to use a traditional vendor placement in a second-step compulsory merger to squeeze out U.S. minority shareholders. In the transaction, Airco offered the shareholders of Air Canada the choice of either cash or Airco shares for their Air Canada shares in an unsolicited tender offer, subject to certain restrictions to confirm that non-Canadians would not own more than 25% of the outstanding Airco shares after the transaction pursuant to Canadian law. The first-step tender offer for Air Canada also included a vendor placement option for U.S. holders who elected to receive Air Canada shares instead of cash. The second-step compulsory merger provided U.S. holders with the option of only a vendor placement for their Air Canada shares, which placement was conducted in accordance with similar procedures established in the first-step tender offer. Since the SEC did not base its no action relief for the vendor placement in the second-step compulsory merger on the basis that a

74 See supra, note 47.
similar vendor placement option was available in the first-step tender offer, an Acquiror that effects a first-step tender offer or exchange offer open to U.S. Target Shareholders without a vendor placement option should be able to use a vendor placement to eliminate U.S. Target Shareholders in a second-step compulsory merger. It is not clear, however, whether the SEC would permit a vendor placement to eliminate U.S. Target Shareholders in a second-step compulsory merger if U.S. Target Shareholders are excluded from participating in the first-step transaction.

3. “No-Sale” Theory

Applying the “no-sale” theory to a second-step compulsory merger could be a challenging exercise. The premise behind the “no-sale” theory is as follows—since U.S. Target Shareholders are required to accept Acquiror Stock in a compulsory merger without being entitled to any investment discretion or right to vote on the transaction (i.e., they must accept the Acquiror Stock, unless appraisal rights are available), then the issuance of the Acquiror Stock should not constitute a “sale” or other “disposition for value” within the meaning of Section 2(a)(3) of the Securities Act. In other words, the transfer of the Acquiror Stock to U.S. Target Shareholders is a forced acquisition and the protections of U.S. securities laws should not be applicable because such laws would not provide any meaningful benefits to U.S. Target Shareholders. The SEC, however, has not yet endorsed this rationale to permit reliance on the “no-sale” theory in connection with securities issued in second-step compulsory mergers.

The SEC views the ability of a U.S. Target Shareholder to elect appraisal rights in lieu of a forced exchange of their Target Stock into Acquiror Stock as normally tantamount to an investment decision warranting the protection of U.S. securities laws. In the adopting release for Rule 145 under the Securities Act, the SEC noted that “if a security is to be issued in such short-form mergers, the Commission is of the opinion that the transaction involves an “offer,” “offer to sell,” or “sale,” within the meaning of Section 2(3) of the Act, and accordingly such transactions are subject to the registration provisions of the Act unless an exemption is available.” The SEC subsequently softened its position.

The SEC has granted no-action relief for the application of the “no-sale” theory when the ability of shareholders to dissent to the transaction is highly limited. For example, in connection with the nationalization of certain French banks in the 1980’s, the Republic of France planned to issue by operation of law government-guaranteed bonds

76 See Notice of Adoption of Rules 145 and 153A, Prospective Rescission of Rule 133, Amendment of Form S-14 under the Securities Act of 1933, and Amendment of Rules 14a-2, 14a-6 and 14c-5 under the Securities Exchange Act of 1934, SEC Release No. 5316 (Oct. 6, 1972) and Division of Corporation Finance’s Interpretations of Rule 145 and Related Matters, SEC Release No. 5463 (Feb. 28, 1974) (providing a question and answer that the issuance of stock in connection with a short-form merger requires registration under Section 5 of the Securities Act, unless an exemption is available).
to persons residing in the United States in exchange for their equity securities and convertible bonds that they held in such nationalized French banks. Counsel asserted in its no-action letter to the SEC that “in abandoning the ‘no sale’ theory in the context of mergers, consolidations and similar corporate transactions…the Commission strongly implied that the issuance of securities solely by operation of law and independent of individual shareholder volition would continue to be deemed not to involve a “sale” within the meaning of the Securities Act.” Counsel further argued that no public purpose would be served if the issuance of the French government-guaranteed bonds required registration under the Securities Act because shareholders to whom the bonds would be issued would have no investment decision to make in connection with the acceptance of the bonds. The staff of the SEC agreed that it would not recommend any enforcement action if the government bonds were issued to persons residing in the United States without registration under the Securities Act. Accordingly, there could be room for the application of the “no-sale” theory to merger transactions where the Target’s home jurisdiction permits a second-step compulsory merger by operation of law without appraisal rights for, or the taking of any action by, Target Shareholders and the number of U.S. Target Shareholders is small. Prior consultation with the SEC is advised if an Acquiror elects to rely on this theory.

4. **Cash Out Merger**

The Securities Act would not be implicated if the Acquiror offers cash, not Acquiror Stock, to U.S. Target Shareholders in a second-step compulsory merger or similar structure because no offer or sale of a “security” is being made to persons resident in the United States. A potential structure to avoid the application of U.S. securities laws to a business acquisition when no other exemption is available, therefore, could be to adopt Regulation S exclusion procedures in a first-step tender offer or exchange offer, and then acquire any remaining Target Stock in a second-step compulsory cash out merger (if permitted by the laws of the Target’s home jurisdiction). The Acquiror, however, may not have sufficient cash resources to finance the acquisition using this structure and various issues concerning valuation and fairness could arise if an exchange offer is used in the first-step of the transaction and cash is used in a second-step compulsory merger.

E. **Piecing It All Together—A Basic Decision Tree**

Failure to find an exemption to the application of U.S. securities laws to an overseas business acquisition can have a significant impact on the time and cost to complete the proposed transaction, and can ultimately jeopardize completion. *Figure 1* at the end of this article presents a basic decision tree to help determine whether and which exemption to U.S. securities laws should be examined with respect to a proposed

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transaction.

The decision tree assumes no exceptional deal characteristics. For example, if the level of Target Stock owned by U.S. Target Shareholders is less than 10% and held by one “accredited investor,” then the Acquiror may prefer to purchase such Target Stock in a private placement exemption rather than complying with the Cross-Border Rules. If the decision tree leads to a particular exemption, therefore, a careful reading and understanding of its requirements in relation to the dynamics of the transaction is necessary prior to concluding reliance.

IV. Conclusion

The application of U.S. securities laws to an overseas business acquisition may seem counter-intuitive to some foreign private issuers, especially if the Target never sold securities in the United States, and its U.S. shareholder base is the result of either resales of securities by initial shareholders or a principal shareholder relocating to the United States. In some jurisdictions, once an Acquiror purchases above a specified percentage of Target Stock, it is required to make a mandatory offer to purchase the remaining Target Stock held by the minority Target Shareholders. These forced acquisitions that trigger compliance with U.S. securities laws can also leave an unsuspecting Acquiror in a tailspin. With minor adjustments to existing U.S. federal securities laws, a more equitable application of such provisions to overseas business acquisitions can be achieved.

While the Cross-Border Rules are a much needed step to permit Acquirors to include U.S. Target Shareholders in their transactions without triggering various U.S. securities laws, by excluding 10% or greater Target Shareholders and Target Stock owned by the Acquiror from the methodology to determine the level of Target Stock owned by U.S. Target Shareholders, the application of the Cross-Border Rules may be unnecessarily restricted. Since (i) large U.S. Target Shareholders may not require the safeguards afforded by U.S. securities laws (which is a foundation for establishing the U.S. private placement exemptions under the Securities Act) and (ii) large non-U.S. Target Shareholders and the Acquiror may not reasonably expect the application of U.S. securities laws over their Target Stock, a more equitable way to calculate U.S. ownership levels under the Cross-Border Rules for Target Stock not registered under the Securities Act or the Exchange Act would be to:

- exclude from the numerator and denominator only the Target

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78 When determining the Target Stock ownership level of U.S. Target Shareholders, the SEC examines residency and not citizenship. Therefore, a Target Shareholder who acquires its Target Stock while outside of the United States but subsequently relocates to the United States would be considered a U.S. Target Shareholder for the period he owns his Target Stock and is resident in the United States. See Rule 800(h) under the Securities Act and Instruction 2 to Instructions to paragraphs (c) and (d) of Rule 14d-1 of the Exchange Act.
Stock held by 10% or greater U.S. Target Shareholders; and

- include in the numerator and denominator the Target Stock held by the Acquirer, unless it is a U.S. Target Shareholder.

This methodology could allow more Acquirors to include U.S. Target Shareholders in their transactions and reduce the need for an Acquirer to register securities when making a mandatory offer to U.S. Target Shareholders pursuant to local regulations. When U.S. Target Shareholders own a de minimis amount of the issued and outstanding Target Stock, the need to apply U.S. securities laws may not be as great when weighing the nexus of U.S. Target Shareholders to the transaction against the costs and possible delays incurred when either complying with U.S. securities laws or structuring around their application.

As the SEC has re-designed the registration, communication and offering process of securities under the Securities Act to maintain the appeal and competitiveness of the U.S. capital markets,79 it may wish to also consider how to further encourage the extension of overseas offers to U.S. Target Shareholders with fewer regulatory burdens. This need is accentuated when the Acquiror is required by non-U.S. law to extend its offer to all Target Shareholders or the existence of U.S. Target Shareholders is not a result of the Target accessing the U.S. capital markets. If a company’s ability to effect its business plans outside the United States is curtailed when U.S. persons own its securities, then foreign private issuers may opt to curb the offering of securities to U.S. persons or restrict the ability of shareholders to transfer securities to U.S. persons.80 If enough foreign private issuers adopt either of these approaches, then the status of the U.S. capital markets as the seat of global finance could be challenged.

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80 As a potential harbinger, a number of British hedge fund advisors are now considering eliminating U.S. investors in their funds so that they will not be required to register with the SEC, according to a report in The Times. The newspaper quotes Charlie Porter, manager of over $7 billion in funds, as saying, “it’s an outrage that the SEC can dictate to the rest of the world. . . . We are considering asking our U.S. investors to leave rather than register with the SEC.” See Patrick Hosking, “Hedge Fund Threat to Boycott U.S. Over New SEC Rules,” The Times (Nov. 12, 2005).
Figure 1: Basic Decision Tree