October 26, 1999

Commission Adopts Regulations Regarding
Takeovers and Shareholder Communications/
Cross-Border Tender and Exchange Offers,
Business Combinations and Rights Offerings

On October 19, 1999, the Securities and Exchange Commission ("SEC" or the "Commission") voted unanimously to adopt two releases that significantly alter the regulation of domestic and cross border merger and acquisition transactions. The first new regulation, referred to as “Regulation M-A”, is intended to update, harmonize and simplify the regulation of tender and exchange offers, mergers and similar extraordinary transactions, as well as facilitate security holder communications. The second set of new rules contained in the “Cross Border Release” is intended to facilitate the inclusion of U.S. security holders of foreign companies in cross-border tender and exchange offers, mergers and similar transactions, and rights offerings. The anticipated effective date for the new rules is late January 2000.

The text of the new rules has not yet been made publicly available. Nevertheless, at the meeting on October 19, key staff members of the SEC’s Division of Corporation Finance (the “Staff”) responsible for Regulation M-A and the Cross Border Release provided the members of the Commission—as well as the public—with an overview of the new rules.

Described below are some fundamental changes contained in the new rules. We also highlight areas where the new rules appear to differ from the rules proposed last November. For a more detailed discussion of the proposed rules, refer to our “To Our Clients” memoranda discussing Regulation M-A (December 3, 1998) and the Cross-Border Release (December 14, 1998).

I. Regulation M-A

The changes in the current rules as a result of Regulation M-A fall under three categories: reducing restrictions on transaction-related communications; balancing the regulatory treatment of cash and stock tender offers; and updating, simplifying and harmonizing the disclosure requirements.
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A. Reducing Restrictions on Communications

The Commission adopted as proposed the safe harbor for public communications made prior to and after the filing of a registration, proxy or tender/exchange offer statement. The new rules relax restrictions on communications with security holders by permitting the dissemination of more information on a timely basis. Under the safe harbor, there are no restrictions on the content of the communications, but anyone relying on the new rules is required to file any written communications when first issued, so that all security holders have access to the information. In particular, the new rules facilitate communications:

- before the filing and public dissemination of a registration statement relating to either a stock merger or a stock tender offer;
- before the filing and public dissemination of a proxy statement (regardless of whether the solicitation involves a business combination transaction); and
- regarding a proposed tender offer without “commencing” the offer and requiring the filing and dissemination of specified information (the current “five day” rule of Rule 14d-2).

The new rules harmonize the treatment of business combination transactions under the Securities Act of 1933, tender offer rules and proxy rules. In addition, the Staff concluded that confidential treatment of merger proxy statements will be retained, but only under limited circumstances. The new rules will not change the current requirement that the security holder receive a mandated disclosure document (prospectus, proxy statement or tender offer material) before being able to vote or tender the securities.

B. Distinction Between Oral and Written Communications

At the October 19 meeting, the Commissioners and Staff discussed the question of what constitutes a “written” communication under the new rules. The Staff explained that language will be inserted into the new rules that will indicate that scripts used by parties to the transaction to communicate information to the public and any other materials—such as presentation slides—relating to the transaction that are shown to investors may be considered a writing that would have to be filed upon first use. The determination of whether such materials are “written” would depend on the facts and circumstances of the transaction and could have ramifications outside the M&A context.
C. Balancing the Regulatory Treatment of Cash and Stock Tender Offers

Under the current rules, stock tender offers (exchange offers) registered under the Securities Act are subject to regulatory delays not imposed on cash tender offers. While a cash tender offer may commence as soon as a tender offer schedule is filed and the information is disseminated to security holders, an exchange offer, in contrast, may not commence before a registration statement becomes effective (often after a lengthy SEC staff review period).

The new rules permit exchange offers to commence as early as the initial filing of a registration statement, or on a later date selected by the bidder, and before effectiveness of the registration statement. Consequently, a bidder offering securities would not need to wait until effectiveness to commence an offer. Early commencement is not mandatory but, rather, at the election of the bidder. The new rules will provide that:

- any securities tendered in an exchange offer may not be purchased until after the registration statement becomes effective, the minimum 20 business day tender offer period has expired, and disclosures regarding all material changes are disseminated to security holders with adequate time remaining in the offer to review and act upon the information;
- a bidder need not deliver a final prospectus to security holders if all material information has been disseminated to security holders; and
- security holders may withdraw tendered securities at any time before they are purchased by the bidder.

D. Disclosure Requirements

Under the current rules, the procedural and disclosure requirements for business combination transactions vary depending upon the form of the transaction. The new rules clarify and harmonize the requirements. They also make the disclosure requirements easier to understand and facilitate compliance with the regulations.

The substantive disclosure requirements for tender offers, going-private transactions, and other extraordinary transactions will now appear in one central location, called “Regulation M-A”. The disclosure rules will also be updated in several respects. According to an SEC summary:
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- existing schedules for issuer and third-party tender offers will be combined into one new schedule, to be called “Schedule TO”;
- a Plain English summary term sheet will be required in all tender offers, mergers, and going-private transactions, except when the transaction is already subject to the Plain English rules under the Securities Act;
- financial statements required for business combinations will be generally reduced; and
- pro forma and related financial information in negotiated cash tender offers will be required when the bidder intends to engage in a back-end securities transaction.

E. Permitting Securities to be Tendered During a “Subsequent Offering Period”

The new rules will permit an optional subsequent offering period after completion of a tender offer during which security holders may tender their shares without withdrawal rights (similar to an extended offering period under the laws of the United Kingdom). Moreover, Rule 10b-13, which prohibits purchases outside a tender offer, will be clarified and prior interpretations of and exemptions from the rule will be codified. Several new exceptions will be added to Rule 10b-13, and it will be redesignated as new Rule 14e-5.

F. Safe Harbor for Forward-Looking Statements Denied to Tender Offers

Currently, safe harbors for forward-looking statements contained in the Securities Act and the Exchange Act of 1934 that were added by the Private Securities Litigation Reform Act of 1995 (“PSLRA”) do not apply to statements made in connection with a tender offer, but do apply to statements made in connection with a proxy solicitation relating to a merger. At the October 19 meeting, Staff members explained that, in light of the unsettled case law interpreting the scope of the PSLRA’s safe harbor, they decided not to extend the safe harbor to tender offers at this time. Staff members noted that case law in this area is still developing, and issuers may continue to rely upon existing “bespeaks caution” doctrine where available.

G. The Five Day Rule and Rule 14e-8

Under the current tender offer rules, a bidder who publicly announces a cash tender offer “commences” the tender offer upon announcement, unless the bidder either
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files a tender offer statement or announces the discontinuation of the tender offer within five business days (the “five day rule”). In addition, a bidder who publicly announces an intent to commence an exchange offer must promptly file a registration statement after the public announcement. In contrast, the new rules permit competing bidders to communicate more quickly and more effectively. Under the new rules, a bidder would not be required to file a tender/exchange offer statement until the bidder first disseminates transmittal letters or other instructions to security holders on how to tender into an offer, at which point the tender offer would “commence”. In order to prevent parties from announcing tender/exchange offers without the intent or ability to follow through with the offer, the new regulation introduces Rule 14e-8, which prohibits such conduct as fraudulent under the tender offer rules.

At the October 19 meeting, Commissioners and Staff members discussed the new anti-fraud rule and the applicable intent standards. Members of the SEC’s Enforcement Division indicated that violations of Rule 14e-8 would be established in appropriate cases based on circumstantial evidence. The Enforcement Staff noted that the rule also contains an objective test: whether a bidder had a “reasonable belief” that it had the means to purchase securities to complete the offer.

II. Cross-Border Release

Since 1990, the SEC has considered the applicability of U.S. securities laws to international tender and exchange offers and rights offerings. The purpose of the Cross Border Release is to encourage bidders and issuers to extend tender and exchange offers, rights offerings and business combinations involving foreign companies to U.S. security holders. The new rules contain exemptions from certain U.S. securities laws for cross-border tender and exchange offers, mergers and similar transactions, and rights offerings.

New provisions in the tender offer rules would exempt:

- tender offers for the securities of foreign private issuers from most provisions of the Exchange Act and rules governing tender offers when U.S. security holders hold 10 percent or less of the foreign company’s securities that are subject to the offer (the “Tier I exemption”);
- tender offers from certain limited provisions of the Exchange Act and the tender offer rules when U.S. security holders hold 40 percent or less of a foreign private issuer’s securities that are subject to the offer (the “Tier II exemption”); and
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- tender offers for the securities of foreign private issuers from new Rule 14e-5 under the Exchange Act, which would permit certain purchases made outside the tender offer during the offer when U.S. security holders hold 10 percent or less of the subject securities.

In addition, two new exemptions from the Securities Act registration provisions exempt:

- under new Rule 801, rights offerings of equity securities by foreign private issuers from the registration requirements of the Securities Act when U.S. security holders hold 10 percent or less of the securities; and
- under new Rule 802, securities issued in an exchange offer, merger or similar transaction for a foreign private issuer from the registration requirements of the Securities Act and the qualification requirements of the Trust Indenture Act when U.S. security holders hold 10 percent or less of the subject class of securities.

According to the SEC, the Cross Border Release as adopted will differ from the 1998 proposal in the following areas:

- The U.S. ownership thresholds for the Rule 801 and Rule 802 registration exemptions have been increased from five to 10 percent.
- Under a “cash-only alternative” for Tier I tender offers, bidders are permitted to offer cash in the United States while offering securities offshore without violating the equal treatment requirements of the tender offer rules. The bidder must have a reasonable basis to believe that the cash being offered to U.S. security holders is substantially equivalent to the value of the consideration being offered to non-U.S. holders.
- The Tier II exemption has been revised to harmonize it with the amendments to the tender offer rules contained in Regulation M-A.
- In determining U.S. ownership, an offeror would be required to “look through” the record ownership of certain brokers, dealers, and banks or nominees holding securities for the accounts of their customers. In response to specific comments made by this firm and other comments, the Staff determined that 10 percent holders, foreign or domestic, should be excluded from the calculation, rather than just foreign 10 percent holders as had been proposed. Under the new rules, securities held by the bidder also would be excluded from the calculation.
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As proposed, Rules 801 and 802 imposed certain restrictions on the transferability of the securities that an acquirer may issue in exchange offers or business combinations and restrictions on equity securities that may be purchased upon the exercise of the rights. Under the new rules, securities issued in an exchange offer, merger or similar transaction, or rights offering will be restricted only to the extent that the securities held by the U.S. holder at the time of the offering were restricted. The new rules will also expand upon the Commission’s 1998 Internet Release by providing guidance on what precautions bidders can take when posting offshore tender and exchange offer materials on the Internet so as not to trigger U.S. tender offer and registration requirements.

We intend to prepare a more detailed memorandum covering these releases once the adopting releases are made publicly available. In the interim, if you have any questions or comments about the content or effects of either the M&A Release or the Cross Border Release, please feel free to contact any of the attorneys listed below.

New York, NY
Charles M. Nathan
Kenneth R. Blackman

Washington, DC
K. Susan Grafton
Edward B. Whittemore
Taylor Young Hong

London, England
Robert P. Mollen