Cross Border Rights Offerings, Tender Offers and Mergers

Implications of a US Shareholder Base

Presentation to
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Cross-Border Transactions: US Shareholder Base

Introduction

1. Rights Offerings

2. Tender Offers

3. Mergers
Introduction

*Source: Thomson Financial - Transactions valued at US$ 50 M and over
2004 values projected based on January - September data
M&A by Target Region, 2000-2004*

*Source: Thomson Financial - Transactions valued at US$ 50 M and over 2004 values projected based on January - September data
M&A by Target Industry, 2000 vs. 2004*

*Source: Thomson Financial - Transactions valued at US$ 50 M and over
2004 values projected based on January - September data
Section 1

Rights Offerings
SEC Registration Requirements

SEC View: Distribution of rights to shareholders to purchase additional stock involves an “offer” of the underlying shares under the US Securities Act of 1933, requiring registration or an exemption.

*This analysis applies to all US and non-US companies. It makes no difference whether:

- the issuer is registered with the SEC, or
- the issuer has ever offered shares for sale in the United States*
Illustration: Acme S.A. is a company with no US assets or operations, no US stock exchange listing and no history of US capital raising (public or private). Acme’s financial success gradually attracts a US shareholder base through ordinary secondary market trading. If Acme offers its shareholders rights to purchase additional stock in the company, it will need to consider what to do about its US shareholders in order to comply with the US securities laws.
Options for Dealing with US Shareholders

- Rule 801 exemption,
- SEC registration, *or*
- Prohibit exercise from US
Rule 801

- Rights offering by non-US issuer exempt from registration when US residents own 10 percent or less of the issuer’s “free float”

- Conditions:
  - Must be “foreign private issuer” per SEC definition
  - Pro rata distribution to existing shareholders of the same class (including ADR holders)
  - Disclosure distributed or published in home country must be translated into English and distributed or published in US on comparable basis
  - Submit offering materials to SEC (Form CB) and appoint US agent for service of process (Form F-X)
Rule 801

Drawbacks

- Calculation of US ownership: Instead of US trading volume test (as in Regulation S), SEC adopted *inflexible* US ownership test:
  - 10%-or-greater shareholders excluded from calculation:
    
    *Exclusion of large US and non-US shareholders artificially inflates US ownership level*
    
    *One 30% shareholder, or two 15% shareholders, effectively decrease US ownership threshold from 10% to 7% of total outstanding shares*
Rule 801

Calculation of US Ownership:

- Look-through analysis: must inquire of brokers, dealers, banks and nominees in US, home country and principal trading market, as to amount of securities held by them for the account of US residents
  
  *Raises concerns about delay, cost, tipping*

- Information used to make calculation must be *exactly* as of record date for rights offering
  
  *Makes planning difficult (need to know earlier if exemption is available; insufficient time for inquiry between record date and launch)*

  *Presents logistical issues (often difficult to obtain information from all nominees as of a single specified date)*
Rule 801

- Mandatory SEC submissions may not appeal to non-SEC reporting companies.

  - Feeds directly into common fear among non-US companies of US litigation: too high a price to pay for allowing small US shareholder base to participate?
SEC Registration

- **Non-SEC reporting companies**
  - Registration is a time-consuming and expensive process, requiring US GAAP financial information and US-style disclosure.
  - Usually not practical except in cases where company has a sizeable, non-institutional US shareholder base

- **SEC reporting companies**
  - Less onerous because disclosure already prepared and short-form registration (Form F-3) may be available
  - Still, timing and tipping considerations relating to uncertainty surrounding SEC review and availability of confidential treatment process

*Universal shelf could solve these problems*

*But market overhang?*
Prohibit Exercise from US

- Still common, even for SEC reporting companies
- Examples:
  - France Telecom’s €15 billion rights offering in February 2003
  - Allianz’s €5 billion rights offering in March 2003.
  - Both FT and Allianz are SEC reporting companies and probably could have used short-form registration

Uncertainty regarding availability of Rule 801
No time for SEC process
Prohibit Exercise from US

- Special procedures to ensure shares not offered or sold in the US

Common steps include:
- placing restrictive legends on all documentation
- requiring representations as to non-US status in all exercise notices
- rejecting all correspondence from US addresses, and
- avoiding US publicity or other communications
Prohibit Exercise from US

- Rights attributable to excluded US shareholders often sold for their account offshore (Regulation S) *but*:
  - US shareholders pay transaction costs and are deprived of opportunity to purchase discounted shares
  - If rights are non-transferable, US shareholders get nothing
Prohibit Exercise from US

- Drawbacks
  - Loss of US market participation. Possible erosion of US investor goodwill
    
    *But* many US institutional investors maintain (or can move) their shares offshore in order to participate in offer outside US (Regulation S). Also, private placement (discussed later) may allow them to participate
  
  - Exclusion of shareholders based on US status may conflict with home country corporate law. Many jurisdictions require equal treatment of shareholders

    **UK Practice:** Exception for “legal or practical problems” under foreign law; UK counsel frequently take view that burden of SEC registration meets this standard
Prohibit Exercise from US

- Private Placement
  - Exclusion of US shareholders need not extend to institutional investors if private placement procedures are implemented
  - Non-institutional investors continue to be excluded through procedures described earlier
Prohibit Exercise from US

- **Private Placement**
  - Institutional investors permitted to participate subject to traditional private placement procedures, such as limitation on number of offerees and purchasers, delivery of adequate information, proof of sophistication of investors and resale restrictions:
    - Securities issued in private placement upon exercise of rights by US institutional investors are “restricted securities”
    - May be resold in the US only in accordance with volume, manner of sale and other limitations (Rule 144) or, if securities are not listed on US exchange, to QIBs (Rule 144A)
    - But may be freely resold offshore (Regulation S) on "designated offshore securities market.”
Summary: What to do?

- Depends on a number of different factors, such as:
  - Necessity/desirability of including US shareholders (retail, institutional or both)
    - *Legal considerations (shareholder rights)*
    - *Deal success considerations*
    - *Investor relations considerations*
  - Availability and practicality of Rule 801
    - *Permits all US shareholders to participate*
    - *No resale restrictions on new shares (unless existing shares were subject to restrictions)*
    - *Some cost and effort, but maybe less than procedures required to exclude US shareholders*
  - Difficulty of SEC registration (first-time registrant?)
Section 2

Tender Offers
Principal SEC Requirements

- All tender offers extended to US shareholders are subject to *SEC tender offer rules*
  - No private placement exemption
  - Fewer rules if target is not an SEC reporting company
- Share-for-share exchange offers involve an “offer” of the acquiror’s securities to the target’s US shareholders under the US Securities Act of 1933, requiring registration or an exemption
- Cash exchange offers do not raise registration issue, only need to address SEC tender offer rules
Rules Applicable to All Tender Offers

- Regulation 14E applies to all tender offers extended into the United States, regardless of whether target has shares listed in US or registered with SEC. Principal requirements include:
  - Minimum length of 20 days
    - Mandatory extension of 10 days if consideration or minimum condition is changed
  - “Prompt” payment after expiration of tender offer
    - Not fixed but generally viewed as 2 business days
  - Bidder and related persons may not purchase shares “outside” of tender offer (subject to exceptions)
    - Regulation M may impose additional restrictions
  - Target must publish recommendation to shareholders regarding tender offer within 10 business days
Rules Applicable to *Some* Tender Offers

In addition, Regulation 14D applies to tender offers extended into the United States for equity securities of SEC reporting company. Principal requirements include:

- Pre-commencement communications by bidder and target must be filed with SEC
- Bidder must file detailed disclosure document (Schedule TO) with SEC at launch of offer
- Target must respond (Schedule 14D-9) within 10 business days of launch of offer
- Withdrawal rights until expiration of offer
- Must be open to all holders for equal consideration
- Partial tender offers permitted but tenders in excess of maximum must be allocated pro rata
- Self-tenders and going-private transactions are subject to enhanced disclosure standards
(Some) Options for Dealing with US Shareholders

- Many ways to deal with SEC tender offer rules and registration requirements
  - Experienced US counsel can help craft best structure for specific transaction
- If available, rely on Tier I (broad) or Tier II (narrow) exemption from certain tender offer rules and, if securities are offered, (1) rely on Rule 802 exemption or (2) register securities with SEC or (3) cash out US shareholders
- Exclude US from transaction, avoiding SEC tender offer rules and registration requirements
- Vendor placement (comparable to cash out)
  - SEC tender offer rules still apply
Availability of Tier 1 and Tier 2 Exemptions

Is target a foreign private issuer?

YES

Do US shareholders hold 10% or less of target’s “free float” (as calculated under SEC rules)?

YES

Tier 1 exemption likely to be available
• Most U.S. rules carved-out
• Can use home country offer document

NO

Do US shareholders hold 40% or less of target’s “free float” (as calculated under SEC rules)?

NO

Tier 2 exemption likely to be available
• Most rules apply, but additional flexibility provided
• Form TO must be filed with SEC if target is SEC reporting company

NO

Tiers 1 and 2 unavailable: Register offer with SEC, find another exemption or exclude US

NO

YES
Scope of Tier I Exemption

- Tier I tender offers are exempt from almost all of the SEC’s tender offer rules described earlier and, if securities are offered, from SEC registration requirements (Rule 802)

- Conditions:
  - Target must be foreign private issuer
  - US residents own 10 percent or less of target’s “free float”
  - Equally favorable terms for US shareholders (but separate cash offer to US shareholders permitted)
  - Disclosure distributed or published in home country must be translated into English and distributed or published in US on comparable basis
  - Submit offering materials to SEC (Form CB) and appoint US agent for service of process (Form F-X)
Scope of Tier II Exemption

Tier II tender offers obtain only limited relief from the SEC’s tender offer rules and, if securities are offered, are not exempt from SEC registration requirements (Rule 802). Limited relief includes:

- Bidder may divide offer into separate US and non-US offers if US offer is no less favorable than non-US offer
- Extensions of offer period may be announced in accordance with home country practices
- Payment must be made in accordance with home country practices
- Minimum condition may be waived without 10-day extension subject to certain safeguards

Conditions:

- Target must be foreign private issuer
- US residents own 40 percent or less of target’s “free float”
Similar requirements – and drawbacks – as calculation of US ownership in rights offerings:

- 10%-or-greater shareholders and bidder excluded from calculation:
  Again, exclusion of these shareholders artificially inflates US ownership level

- Look-through analysis: must inquire of brokers, dealers, banks and nominees in US, home country and principal trading market, as to amount of securities held by them for the account of US residents
  Raises concerns about delay, cost, tipping

- Information used to make calculation must be exactly as of 30th day prior to commencement of tender offer
  Logistical challenges and heightened tipping concern
  ! Beware of timing of announcement!
Special rule for calculation of US ownership where no agreement exists between unaffiliated bidder and target ("hostile tender offer")

Bidder may assume US ownership limitation is not exceeded unless:

- Aggregate trading volume of target’s securities in US exceeds applicable percentage of worldwide trading volume;
- Information filed with foreign or US regulators indicates that US ownership exceeds applicable percentage; or
- Bidder knows or has reason to know that US ownership exceeds applicable percentage

If hostile offer turns friendly, assumption continues to apply unless transaction is restructured
Exclusion of US

Still common after adoption of Tier I and II exemptions in 1999, at least where exemptions are unavailable or impractical

Theory – Offer not subject to US securities laws if “US jurisdictional means” are not used. Common steps include (among others):

- avoiding all contact with US mails, securities exchanges, telephone lines
- placing restrictive legends on all documentation
- requiring representations as to non-US status in all exercise notices
- rejecting all correspondence from US addresses,
- avoiding US publicity or other communications
Exclusion of US

- Drawbacks
  - Impact of exclusion on success of offer?
    But many US institutional investors maintain (or can move) their shares offshore in order to participate in offer outside US (Regulation S)
  - Exclusion of shareholders based on US status may conflict with home country corporate law. Many jurisdictions require bidders to treat all shareholders equally

*UK Practice:* Exception for “unduly onerous” foreign law requirements; UK counsel frequently take view that SEC rules are sufficiently onerous to meet this standard
Exclusion of US

- **Drawbacks**
  - May involve significant risks, particularly if:
    - *Procedures are inadequate in design or operation*
    - *Minimum tender condition is inconsistent with exclusion of US shareholders*
    - *Target is listed in US*
Vendor Placement

- Exchange offer is extended into US but new shares issuable to accepting US shareholders in the offer are immediately sold offshore by third party for their account
- Avoids SEC registration issue because it effectively results in cash offer vis-à-vis US shareholders (in other words, no “investment risk” involved)
  - Analysis is very fact-dependent. Transaction-specific relief from SEC is advisable
  - If liquid secondary market for new shares does not exist, investment risk analysis may be less certain
- SEC tender offer rules remain applicable
  - If target is SEC reporting company, equal treatment rule may be implicated. Transaction-specific relief from SEC should cover this issue also
Vendor Placement

- Possible to structure transaction in order to permit US institutional investors to receive their shares in private placement – not forced into vendor placement
  - Resale restrictions on shares delivered to QIBs

- Drawback
  - Simultaneous sale of all shares issuable to US shareholders could have impact on market for acquiror’s shares. As a result, if US ownership level is significant, vendor placement may not be appropriate

But, as mentioned above, US institutional shareholders may move their shares outside the US in order to participate or be permitted to receive shares on a private placement basis, thereby reducing amount of shares sold in market through vendor placement
Section 3

Mergers
SEC Registration Requirements

- **SEC View:** Submission of merger plan to target’s shareholders pursuant to which they will vote whether to exchange their shares for acquiror’s shares involves an investment decision (and thus an offer and sale of securities), requiring registration or an exemption.

  *This analysis applies to all US and non-US companies.*

  *It makes no difference whether:*

  - the target is registered with the SEC, or
  - the target has ever offered shares for sale in the United States

- US proxy solicitation rules do not apply to non-US companies, whether or not SEC reporting.

- Cash only merger between non-US companies do not involve significant US federal securities law issues.
Illustration: Acme S.A. is a company with no US assets or operations, no US stock exchange listing and no history of US capital raising (public or private). Acme’s financial success gradually attracts a US shareholder base through ordinary secondary market trading. XYZ S.A., also a company with no significant US contacts, approaches Acme, and the two parties agree to a merger plan whereby Acme’s shareholders will receive XYZ shares. Before Acme sends proxy materials to its shareholders, it will need to consider what to do about its US shareholders in order to comply with the US securities laws.
Options for Dealing with US Shareholders

- Rule 802 exemption,
- SEC Registration,
- Cash out US shareholders, or
- Exclusion of US shareholders from merger vote (maybe)
Rule 802

- Share-for-share merger exempt from registration when US residents own 10 percent or less of the acquired company’s “free float”
  - If neither company will survive merger and new securities are issued by successor, pro forma calculation required based on both companies’ shareholder base

- Conditions:
  - Must be “foreign private issuer” per SEC definition
  - Disclosure distributed or published in home country must be translated into English and distributed or published in US on comparable basis
  - Submit offering materials to SEC (Form CB) and appoint US agent for service of process (Form F-X)
Rule 802: US Ownership Calculation

- Similar requirements – and drawbacks – as calculation of US ownership in rights offerings:
  - 10%-or-greater shareholders and acquiror excluded from calculation:
  - Look-through analysis: must inquire of brokers, dealers, banks and nominees in US, home country and principal trading market, as to amount of securities held by them for the account of US residents
  - Information used to make calculation must be exactly as of 30th day prior to commencement of solicitation of shareholder vote

*Again, plan timing of announcement carefully*
SEC Registration

- Non-SEC reporting acquiror
  - Registration is a time-consuming and expensive process, requiring US GAAP financial information and US-style disclosure. Probably not practical unless target is SEC reporting company

- SEC reporting acquiror
  - Less onerous since disclosure is ready and short-form registration may be available
Cash Out for US Shareholders

- SEC registration not necessary if US shareholders are offered cash instead of securities for their shares
  - Cash may be provided directly by acquiror or (possibly) through a vendor placement arrangement
  - SEC has not formally blessed vendor placement in merger context but has indicated informally that in theory this approach should be possible
- However, it may be difficult to identify and deal separately with US shareholders in context of merger
- Home country corporate law may not permit this approach
Exclusion of US Shareholders

- **Theory:** If US shareholders are excluded from shareholder vote to approve merger, then they do not make investment decision and exchange of their old shares for new shares does not involve “offer or sale”

- SEC acknowledged in 1999 that non-US merger parties sometimes take this approach, but has not blessed it

- No guidance as to types of procedures that would be deemed adequate to exclude US shareholders from merger vote (if permitted by home country law)
  - Procedures followed to exclude US shareholders in tender offer can be adapted

- Involves risk, although some practitioners believe risk of SEC enforcement is low where merger involves two non-US, non-SEC reporting companies
Carlos J. Spinelli-Nosedan

Carlos J. Spinelli-Noseda joined the firm in September 1994. Mr. Spinelli graduated from Yale College (B.A., summa cum laude, Phi Beta Kappa, 1991) and from Harvard Law School (J.D., cum laude, 1994). He became a partner of the firm in 2003.

Carlos Spinelli-Noseda has worked on a broad variety of capital markets and M&A transactions, primarily in Latin America. Currently he is representing the international banks managing the restructuring of approximately US$ 90 billion of Argentina’s defaulted public debt. Other recent Latin American capital markets experience includes his work on the stock-for-stock exchange offers in 2002 and 2003, valued at approximately US$ 2.5 billion, by Tenaris S.A. (part of the Argentine Techint Group) for securities of Siderca (Argentina), TAMSA (Mexico) and Dalmine (Italy) and his extensive involvement in the Siderca IPO of May 2001, at that time the first Argentine ADS offering in four years. Earlier equity offerings he worked on include those by the Mexican companies Desc and Grupo Industrial Maseca and the Argentine company Siderar, as well as the privatizations of YPF, ENI, ENEL and Sidor.

As part of his practice Mr. Spinelli-Noseda is also regularly involved in sovereign debt offerings by the Republic of Argentina, the Federative Republic of Brazil, United Mexican States, the Republic of Panama, the Republic of Peru and the Bolivarian Republic of Venezuela, and acts as sole U.S. counsel in offerings by Province de Québec and Hydro-Québec. His work with sovereign offerings has focused on the structuring and execution of approximately fifteen SEC-registered and unregistered exchange offers (by Colombia, Argentina, Brazil, Mexico, Panama, Peru and Venezuela), including the Republic of Colombia’s US$ 507 million exchange offer for SEC-registered global bonds in July 2002, and its award-winning US$ 750 million SEC-registered global bonds offering with a World Bank guarantee in April 2001. He has also worked on debt offerings by Empresa de Generación Eléctrica Fortuna, PEMEX and Telmex, among others.

His experience in Latin America extends beyond capital markets transactions and includes, among other transactions, work, as counsel to Banamex, on Citigroup’s acquisition of Banamex in 2001. Outside Latin America, Mr. Spinelli-Noseda is often involved in capital markets transactions by, among others, Corning, The Goldman Sachs Group and Inco.

Mr. Spinelli-Noseda, who is of Argentine origin, speaks Spanish, French and Italian fluently.