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Articles + Publications | October 22, 2018

Locke Lord QuickStudy: Exemptions for your Cross-Border Deals –New SEC Guidance

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On October 17, 2018, the Division of Corporation Finance (the "Division") of the Securities and Exchange Commission (the "SEC") issued a set of interpretations[1] relating to the rules that provide an exemption from the registration requirements of the Securities Act of 1933 for certain offerings of securities by foreign private issuers[2] in connection with rights offerings[3] or in connection with exchange offers or business combinations,[4] and the rules that provide an exemption from certain requirements of the Securities Exchange Act of 1934 in connection with tender offers for securities of foreign private issuers.[5] These rules are collectively referred to as the "Cross-Border Exemptions," and they are conditioned, among other things, on there being a limited number of U.S. shareholders of the applicable foreign private issuer.

The 27 interpretations replace the Division's previously existing telephone interpretations on the Cross-Border Exemptions, and reflect a mix of new guidance, substantive changes to existing guidance, and technical or non-substantive changes.

The new or changed interpretations include the following guidance:

Calculation of U.S. Ownership

- Where a shareholder of the target company in a tender offer is incorporated outside the U.S. but the bidder is aware that investment and dispositive authority over the shares of the subject company rests with a parent company in the U.S., those shares should be counted as part of the U.S. ownership base.
- In a multiple-step business combination such as a tender offer followed by a back-end merger, the initial calculation of U.S. ownership made for the first step in the transaction is sufficient to determine eligibility for the exemptions for subsequent steps, so long as the subsequent steps are adequately disclosed in the disclosure document and are consummated within a reasonable time. An offeror is permitted to recalculate U.S. ownership, however, at a subsequent step if it would make an exemption available that was not previously available.
- Where a tender offer is made for ordinary shares of a foreign private issuer with both ordinary shares and convertible notes traded separately on its home country exchange, U.S. ownership percentage is not calculated on an "as converted basis" (although ADRs, if any, are included).
- The "look-through" procedures of the Cross-Border Exemptions, which involve making inquiries of certain record holders, nominees, and financial intermediaries as a method of calculating U.S. ownership, must be followed even where brokers in a jurisdiction are known to not customarily respond to such inquiries. After a reasonable inquiry, the rules permit assumptions that customers are residents of the jurisdiction where a non-responsive nominee has its principal place of business, but the reasonable inquiry must include a good faith

inquiry of nominees.

- The calculation of U.S. ownership must be made before commencement of an offer, even where the offer is commenced within 30 days of its announcement (and so the range of measurement dates permitted by the rule would otherwise extend beyond commencement).
- The rules exclude the securities of an acquiror from calculation of U.S. ownership. However, in an amalgamation where two companies' stockholders contribute their shares to a new holding company in exchange for the holding company's stock, U.S. ownership should be determined based on the pro forma shareholder base of the holding company, notwithstanding that one of the companies may be considered the "acquiror" for accounting purposes.
- In such an amalgamation, if the exchange ratio is not known at the time that applicable foreign law requires the transaction to be announced, the staff will permit U.S. ownership calculations to be based on the comparative market capitalization of the parties to the transaction, or alternatively to be based on a good faith estimate of the exchange ratio.
- Common and preferred shares that vote together on a merger transaction should not necessarily be considered the same class for purposes of U. S. ownership calculations; other factors such as different pricing, trading characteristics and other voting requirements should be considered.

Tender Offers

- A foreign private issuer conducting a "warrant flush," by temporarily reducing the exercise price of warrants to induce exercise, may rely on the Tier I exception in Rule 13e-4(h)(8) even where the transaction is not subject to regulation as a tender offer in the issuer's home jurisdiction, so long as other protections of the home country's securities laws do apply.[6]
- Where a bidder initially excludes U.S. holders from a tender offer for securities of a foreign private issuer, and then extends the offer to U.S. holders, the "equal treatment" requirement in the Tier I and Tier II exemptions means that the U.S. offer must be kept open at least as many days as the minimum offer period required by the laws of the foreign jurisdiction. For Tier II offerings, the 20-business day rule also applies under U.S. law. The staff will consider relief on a case-by-case basis where either of these would violate the laws of the foreign jurisdiction.
- Where a foreign private issuer excludes U.S. holders from a tender offer, it can voluntarily furnish the offer documents with the SEC on Form 6-K, or post the documents on its website in the case of an issuer exempt from Exchange Act registration under Rule 12g3-2(b), so long as it takes steps to ensure that the information is not used as a means to induce U.S. participation in the offer, such as by omitting a transmittal letter or other means of tendering securities. The materials should also make prominent disclosure that U.S. holders are excluded, and take other precautionary measures to ensure that U.S. persons are not targeted.
- In separate U.S. and foreign offers permitted under Rule 14d-1(d)(2)(ii), the equal treatment principles would prohibit offering only U.S. dollars to those tendering into the U.S. offer while offering a choice of payment currency to the holders tendering into the foreign offer.
- Where U.S. ownership is over 10% in a cross-border tender offer that is not subject to Regulation 14D, the bidder may offer cash to U.S. holders and shares to other holders, because the "all holders" and "best price" rules of Regulation 14D do not apply.
- Even where a bidder will not qualify for the Cross-Border Exemptions, e.g. because U.S. ownership exceeds 40%, a bidder who intends to seek relief from the staff for specific requirements where foreign country law or practice conflicts with SEC rules should still conduct the U.S. ownership inquiry so that the staff can consider the level of U.S. regulatory interest in the transaction in making its decision whether to grant relief.

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Rights Offerings

- Where a rights offering is registered in a foreign private issuer's home jurisdiction, but is exempt in the U.S. under Rule 801, any disclosure documents such as annual and quarterly reports that are incorporated into the registration statement will also need to be translated into English and furnished to the SEC under cover of Form CB, along with the base disclosure document, if those incorporated documents have been made publicly available in the home jurisdiction.

Legends

- The legend required by Rule 802, relating to the potential difficulties in enforcing claims in foreign jurisdictions or against foreign resident directors and officers, may be tailored if the facts require, so long as it is not misleading or confusing.

In addition, the interpretations also reiterated existing guidance that a bidder who excludes U.S. security holders from an exchange offer made in a foreign jurisdiction at a time when U.S. ownership exceeds 10%, and then later extends the same offer to U.S. holders when U.S. ownership falls below 10% and qualifies for the Tier I exemption, would raise concerns if the circumstances indicated that the initial offer was made to cause a migration of securities from the U.S. to the foreign jurisdiction in order to make the Rule 802 exemption available. These facts may be viewed as part of a plan or scheme to avoid registration.—

1. Compliance and Disclosure Interpretations (Cross Border Exemptions), updated 10/17/18, available here.
2. Under Rule 405 of the Securities Act, a "foreign private issuer" is any foreign issuer (other than a foreign government), unless: (1) more than 50% of the issuer's outstanding voting securities are held directly or indirectly of record by residents of the United States; and (2) any of the following applies: (a) the majority of the issuer's executive officers or directors are U.S. citizens or residents; (b) more than 50% of the issuer's assets are located in the United States; or (c) the issuer's business is administered principally in the United States.
3. See Securities Act Rule 801.
4. See Securities Act Rule 802.
5. See Exchange Act Rules 13e-4(h)(8) and 14d-1(c) and (d).
6. Such a warrant flush may be otherwise subject to U.S. tender offer rules under the staff's position reflected in Heritage Entertainment, SEC No Action Letter (avail. May 11, 1987).

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