JONES DAY

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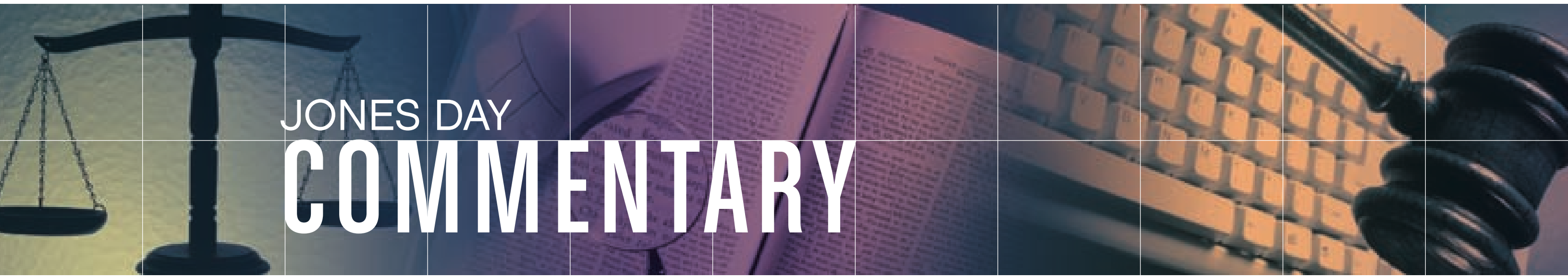

TAKEOVER OFFERS FOR ENGLISH COMPANIES WITH U.S. SHAREHOLDERS: SOME CONSIDERATIONS FOR BIDDERS

This *Commentary* considers some of the legal and regulatory issues that arise when a securities exchange offer is made for an English target company that has a substantial shareholder base or a secondary listing in the United States. U.S. securities and tender offer laws and rules can impose significant additional obligations on bidders, especially those offering paper consideration, and in some circumstances these obligations can conflict with English requirements. Issues similar to those described in this *Commentary* also may arise in the case of offers for non-U.S. target companies incorporated in jurisdictions other than England and Wales.

SECURITIES EXCHANGE OFFERS AND REGISTRATION

A major issue for bidders that arises when the offer is a securities exchange offer is the potential requirement to register the consideration securities under the U.S. Securities Act of 1933 (the "1933 Act"). It is well known that registration in the U.S. is generally a costly and time-consuming exercise, and bidders for English companies frequently seek to avoid this requirement, using exemptions available under English company law. The effect of these exemptions is that takeover offers may, in order not to contravene the law of a country or territory outside the U.K., exclude shareholders who do not have a registered address in the United Kingdom, provided that the offer is published or notified in the *Gazette*.[1] Accordingly, in cases

1. The official newspaper of the Crown. It contains a wide range of office notices including State and Parliamentary notices, as well as other notices that are statutory in nature and are used in legal proceedings.

that do not contravene U.S. tender offer requirements, U.S. shareholders have hitherto frequently been excluded from receiving securities in securities exchange offers for English companies and the shares to which they would otherwise have been entitled are sold, with the proceeds of sale being remitted to them instead.

This exemption is now more difficult to rely on because Article 5.1 of the European Takeovers Directive, which was required to be implemented in Europe on May 20, 2006, requires that an offer be made to "all holders of securities," and Article 3.1(a) requires that "all holders of the securities of an offeree company must be afforded equal treatment." In order to avoid compliance issues arising in relation to a jurisdiction that are disproportionate to the level of voting securities held in such jurisdiction, the City Code on Takeovers and Mergers (the "Takeover Code") contains a general derogation from these requirements. This derogation applies only to jurisdictions outside the European Economic Area and has two limbs. First, there must be a significant risk to the bidder of civil, regulatory or, particularly, criminal exposure, and second, less than 3 percent of the target company shares must be held by the shareholders in the relevant jurisdiction. If this general derogation does not apply, a specific derogation must be sought from the Takeover Panel.[2]

However, even where an exemption might exist under English company law or the Takeover Code, if U.S. tender offer rules apply, there might be a requirement that securities be offered to U.S. shareholders, and so another exemption will need to be relied on to avoid the registration requirements of the 1933 Act. There are three main exemptions available.

Tier I and Tier II Exemptions. Conflicts between U.S. and other takeover rules tend to arise because of the broad application of U.S. requirements. The Williams Act of 1968 (which amended the U.S. Securities Exchange Act of 1934 (the "1934 Act") to provide for the regulation of tender offers) states that it applies to all offers made in the U.S. or to U.S. security holders, regardless of where the target is incorporated. U.K. takeover rules, however, apply to offers for a U.K.-incorporated public company (and, in some situations, to companies incorporated in other states in the European Economic Area and whose shares are traded on a regulated market in the U.K.), wherever such offers are made. Therefore, circumstances can arise where both sets of rules apply.

In some situations, the filing, disclosure, and procedural provisions of the 1934 Act can be avoided where the foreign company has a sufficiently small U.S. shareholder base. Certain exemptions from the 1933 Act and the 1934 Act that have been put in place since 2000 can ease these conflicts. These exemptions follow a phased three-tier approach. Where more than 40 percent of the shareholders of the target company are in the U.S., no exemption applies, and the same rules apply as for domestic U.S. offers. If the U.S. shareholding is less than 10 percent of the total, the offer will be exempt from most registration and specific disclosure requirements under the "Tier 1" exemption. Offers involving U.S. shareholdings between these two parameters have the limited "Tier 2" exemption from some filing requirements. These exemptions are available only where the same conditions are offered to U.S. and non-U.S. shareholders, subject to certain exemptions where the conditions are not suitable in the U.S. (For example, the offering of a loan note alternative to cash is common in England to allow the target shareholder to defer the crystallization of its capital gains but would not be suitable for a U.S. shareholder.)

Although these exemptions provide some relief, the bidder is generally required to determine the nationality of the beneficial owners of the target's share capital in order to decide whether they are applicable. This can be a difficult task in some countries, although the implementation of the Transparency Directive, which was required to be implemented throughout the European Union by January 21, 2007, is expected to make the disclosure of the interests of major shareholders more consistent across the EU. In a hostile offer situation, the exercise is simpler, as bidders are allowed to use trading volume by location instead.

2. The Takeover Panel may grant a dispensation where it would be proportionate in the circumstances having regard to the cost involved; any resulting delay to the transaction timetable; the number of registered shareholders in the relevant jurisdiction; the number of shares involved; and any other relevant factors raised by the offeror or the offeree company.

Rule 802. Rule 802, promulgated under the 1933 Act, provides an exemption from the registration requirements, but this is available only where U.S. shareholders hold no more than 10 percent of the shares in the target (or, in the case of an amalgamation, will hold no more than 10 percent of the shares in the entity resulting from the amalgamation). In general, reliance on this rule requires U.S. shareholders to be treated at least as favorably as target shareholders in other jurisdictions; however, the bidder may exclude U.S. investors from an offering when they reside in states that do not waive blue-sky registration requirements, so long as the bidder has made a good-faith attempt to clear the securities in those states and offers the same cash alternative to shareholders in these states that it has offered to shareholders in any other state or jurisdiction. This could potentially cause issues under the "best price" rule (contained in Rules 14d-10 and 13e-4 under the 1934 Act), which requires that consideration paid to any security holder for securities tendered in the tender offer must be the highest consideration paid to any other security holder for securities tendered in the tender offer, although the SEC has ruled (on individual applications) that such an offer will not violate this rule.

Section 3(a)(10) and Schemes of Arrangement. Section 3(a)(10) of the 1933 Act provides a useful exemption in circumstances where Rule 802 is not available. In the SEC Division of Corporation Finance's Revised Staff Legal Bulletin No. 3 (CF), the SEC stated that an issuer must satisfy the following criteria to claim a Section 3(a)(10) exemption:

(a) The securities must be issued in exchange for securities, claims, or property interests. They cannot be offered for cash;

(b) A court or authorized governmental entity must approve the fairness of the terms and conditions of the exchange;

(c) 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 issuer will rely upon the Section 3(a)(10) exemption based on the court's or authorized governmental entity's approval of the transaction;

(d) The court or authorized governmental entity must hold a hearing before approving the fairness of the terms and conditions of the transaction;

(e) The court or governmental entity must be expressly authorized by law to hold the hearing, although it is not necessary that the law require the hearing;

(f) The fairness hearing must be open to everyone to whom securities would be issued in the proposed exchange;

(g) Adequate notice of the hearing must be given to all those persons; and

(h) There cannot be any improper impediments to the appearance by those persons at the hearing.

In England, takeover offers can be implemented by the conventional offer and acceptance method or by a procedure known as a "scheme of arrangement." This procedure satisfies the criteria for the availability of the Section 3(a)(10) exemption.[3] A scheme must be approved by the court, which will opine on the fairness of the transaction at a hearing which all shareholders are entitled to attend and at which they may voice their opinions on the terms of the

3. When a scheme of arrangement is used, the following wording is used in the scheme document sent to target shareholders to satisfy (c)(ii) above:

> The [Bidder] shares to be issued to the holders of [Target] shares under the Scheme will be issued in reliance upon the exemption from the registration requirements of the 1933 Act provided by section 3(a)(10) thereof and, as a consequence, will not be registered thereunder or under the securities laws of any state of other jurisdiction of the United States. For the purpose of qualifying the exemption from the registration requirements of the 1933 Act (as described above), [Bidder] and [Target] will advise the Court that its sanctioning of the Scheme will be relied upon by [Bidder] as an approval of the Scheme following a hearing on its fairness to [Target] shareholders, at which hearing all such holders are entitled to attend in person or through counsel to support or oppose the sanctioning of the Scheme and with respect to which notification has been given to all such holders.

transaction and its conduct. This court hearing will take place following a court-convened meeting of the shareholders. At that meeting, the scheme must be approved by a majority in number of those present and voting, representing at least 75 percent in value of the shares being voted. Once the scheme becomes effective, it is binding on all of the shareholders of the target company.

It should be noted, however, that where shareholders are considered to be of different classes (because they hold different classes of securities or because they are being treated differently under the terms of the offer, such as if they are management shareholders in an MBO and are rolling their holding over into the shares of the bidding entity), a meeting of each class of shareholder is required. Accordingly, if U.S. shareholders are excluded from receiving securities under the terms of an offer that is being implemented by way of a scheme of arrangement and are therefore at a disadvantage compared to other shareholders (such as because the value of the securities being issued is greater than the value of any cash consideration being offered as part of the offer), they might be considered a different class, with the result that a separate class consent will be required. The requirement to obtain the approval of a separate class of shareholders who might feel aggrieved at not being entitled to the same consideration as non-U.S. shareholders could jeopardize the success of the scheme. A scheme of arrangement should therefore not be seen as a method of excluding U.S. shareholders from any securities offer.

The offer by Celtic Pharma Development UK plc for Xenova Group plc ("Celtic Pharma"), in respect of which Jones Day acted for Celtic Pharma, provides an interesting illustration of the usefulness of the Section 3(a)(10) exemption.

Celtic Pharma's headline offer was a "paper" offer involving the issuance to target shareholders of secured payment-in-kind ("PIK") notes in exchange for the shares in the target. A cash alternative was also made available, but the nominal value of the PIK notes was greater than the value of the cash because the bidder wanted to provide an incentive to target shareholders to accept the PIK notes, thereby preserving its cash resources. Although the English Companies Act would have permitted Celtic Pharma to exclude U.S. persons from receiving PIK notes, since Xenova had ADRs listed on NASDAQ, the U.S. "all-holders" rule (contained in Rules 14d-10 and 13e-4 under the 1934 Act) did not permit such exclusion, with the consequence that PIK notes had to be made available to U.S. persons. This in turn would have required the PIK notes to be registered under the 1933 Act. However, for various reasons, a deal had to be concluded in a time frame that was not compatible with the registration process. The costs of registration would also have been prohibitive. Accordingly, the offer was implemented by way of a scheme of arrangement and in reliance on the Section 3(a)(10) exemption, thereby avoiding the need for registration and satisfying the "all-holders" rule.

WITHDRAWAL RIGHTS

Under Rule 10 of the Takeover Code, all offers are required to be conditional upon the bidder acquiring or agreeing to acquire (either pursuant to the offer or otherwise) shares in the target carrying more than 50 percent of the voting rights. Usually the bidder will set its acceptance condition at the higher level of 90 percent of the shares to which the offer relates but will reserve the right to waive it down to a lower level (provided that level satisfies the Rule 10 requirement). Attaining both 90 percent of the shares that are the subject of the offer and 90 percent of the target's voting rights enables a bidder to invoke the compulsory acquisition procedures under English law to squeeze out the outstanding minority.

Save in the circumstances described below, from the moment that he submits his acceptance of the offer of a takeover made under the Takeover Code, a shareholder is, under English law, bound and may not withdraw his acceptance. Under U.S. tender offer rules, U.S. shareholders are, broadly speaking, bound by acceptances only when the offer has become wholly unconditional. (U.S. tender offer rules will not apply if U.S. security holders hold 10 percent or less of the subject securities, the offer is made in the U.S. on the same terms as in the foreign jurisdiction, and an English-language version of the offering documents is made available to U.S. security holders.)

This is problematic because the ability of U.S. shareholders to withdraw their acceptances means that, until all conditions have been satisfied, a bidder cannot ascertain what level of acceptances has been achieved and whether or not its acceptance condition has been fulfilled. This creates difficulties because, to ensure that target shareholders are not locked in for an unduly long period, the Takeover Code requires the acceptance condition to be satisfied within 60 days of the making of the offer, failing which the offer will lapse.[4] Following the satisfaction of the acceptance condition, accepting shareholders are then locked in for a further 21 days during which the bidder must fulfill all of the other conditions to the offer. If it does not, the offer will lapse. In other words, the Takeover Code timetable allows an offeror a maximum of 81 days in which to declare its offer wholly unconditional. An important consideration for a bidder, however, is that a shareholder who accepts an offer is entitled to withdraw his acceptance once 42 days have elapsed from the making of the offer if the acceptance condition has not been satisfied by then. The bidder therefore will want the acceptance condition to be satisfied prior to the expiration of the 42-day period. However, it will want the acceptance condition to be satisfied only when it has every reason to believe that the other conditions to the offer will be satisfied within 21 days. This can lead to a conundrum where such conditions as antitrust or other clearance might take a significant period to be satisfied: if satisfaction of such conditions will take longer than 42 or 60 days, general withdrawal rights will commence or the offer will lapse, respectively. With this in mind, the bidder would ordinarily want to declare its offer unconditional as to acceptances before Day 42 (or, if necessary, Day 60), in order to prevent the offer from lapsing and to lock shareholders in for another 21 days, to allow it to satisfy the other conditions to the offer. However, where there is a significant U.S. shareholder base, it cannot declare the acceptance condition satisfied because, unless the offer has become wholly unconditional, U.S. shareholders will have withdrawal rights.

This problem is generally resolved by drafting the offer conditions so as to specify that the offer will not, other than with the consent of the Takeover Panel, become unconditional as to acceptances until all other conditions have been fulfilled. (Normally the acceptance condition would be one of the first conditions to be satisfied.) This means that the offer becomes wholly unconditional without first going through a period where it is unconditional as to acceptances but is subject to other conditions. However, it also means that, rather than having 81 days to satisfy all of its offer conditions, an offeror will have only 60 days (with Day 60, as mentioned, serving as the deadline for satisfaction of the acceptance condition). However, where the offer becomes unconditional on or after Day 42, the bidder still runs the risk that withdrawal rights will be available to all shareholders from that point onward.

PURCHASES DURING THE OFFER PERIOD

Another conflict that arises between U.S. and English rules relates to the acquisition by the bidder of securities subject to the offer other than through the offer itself. Although it is common practice in England and many other European jurisdictions for bidders to acquire target shares outside the offer (subject to disclosure requirements and potential effects on the nature and amount of the consideration that must be offered to the shareholders under the offer), it is prohibited in the U.S. under 1934 Act Rule 14e-5. If the target qualifies for the Tier I exemption, the offer will be exempt from Rule 14e-5, subject to certain disclosure and other conditions.

Notwithstanding the availability of the exemption, in many cross-border offers bidders will decide to conduct separate but simultaneous U.S. and non-U.S. offers in an effort to balance the competing regulatory requirements, tax concerns, and other structural considerations. A rigid interpretation of Rule 14e-5 would prohibit such a dual-offer structure, since the non-U.S. offer could be construed as an arrangement to purchase securities outside the U.S. offer. Bidders often seek a specific SEC exemption from the provisions of Rule 14e-5 to overcome this, and such exemptions have frequently been granted under no-action letters from the SEC.

The SEC's review of the proposed exchange offer by Mittal Steel for Arcelor eliminated the need to seek individual approval by granting a classwide exemption from Rule 14e-5. Under this classwide exemption, a bidder may offer to purchase securities pursuant to multiple simultaneous offers, so long as the consolidated transaction meets the following conditions:

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4. If a competing offer is made, Day 60 will be extended so that it coincides with Day 60 of the competing offer.

(a) The company that is the subject of the offers is a foreign private issuer as defined in Rule 3b-4(c) of the Exchange Act;

(b) The multiple offer must qualify for the Tier II exemption under Rule 14d-1(d);

(c) The economic terms and consideration of the offers must be the same, except that cash consideration to U.S. security holders may be paid in U.S. dollars in the U.S. offer at the exchange rate disclosed in the U.S.-offer documents;

(d) The procedural terms of the U.S. offer must be at least as favorable as the terms of the non-U.S. offer;

(e) The intention of the bidder to make purchases pursuant to the non-U.S. offer must be disclosed in the U.S.-offer documents to security holders participating in the U.S. offer; and

(f) Purchases by the bidder in the non-U.S. offer must be made solely under the non-U.S. offer and not as part of any open-market or private transaction.

Bidders that satisfy these requirements no longer will be required to seek an SEC exemption from Rule 14e-5. Nonetheless, in granting classwide relief, the SEC cautioned that the antifraud and antimanipulation provisions of the federal securities laws would continue to apply even to transactions exempt from Rule 14e-5.

TACTICAL LITIGATION

Tactical litigation to prevent or delay a takeover is effectively prohibited by the English courts following the case of *R v Panel on Takeovers and Mergers ex parte Datafin PLC and another (Norton Opax PLC and another intervening) 1987,* which concluded that decisions of the UK Takeover Panel, which regulates U.K. takeovers and adjudicates on all questions relating to the interpretation of the Takeover Code, could not be reviewed by the courts during the course of the takeover itself and thus delay the transaction. In this case, it was held that the Panel's decisions should be allowed to take their course while a transaction is underway and that the court should intervene, if at all, only at a later stage by making declarations to establish the position for the future, but which should not apply retroactively.

The U.S. courts, however, are notably more receptive to shareholder litigation, which may or may not be a tactical mechanism to delay or defend against the transaction, and litigation is a common feature of takeovers. Where an offer is being made into the U.S., the possibility that a U.S. shareholder will make an application to the U.S. courts is always present and increases the risk that the transaction will be delayed.

SEC APPROACH

The SEC has been concerned for some time that the U.S. takeover and securities laws have led bidders for non-U.S. companies to exclude U.S. shareholders from their offers. The introduction of the Tier I and Tier II exemptions in 2000 was the first major step in attempting to rectify this. The granting of the exemption in the Arcelor/Mittal Steel transaction represents the first major classwide exemption under the cross-border rules, and the SEC continues to take an interest in improving these rules. For example, it has been focusing on the cross-border rules for measuring ownership by U.S. security holders, which currently require a 30-day look-back period and a look-through to the accounts of certain banks, brokers, and nominees to determine beneficial ownership. Compliance with current share ownership rules is often difficult because they frequently conflict with local law and practice in many jurisdictions outside the U.S.

CONCLUSION

Despite the recent efforts of the SEC to encourage offers for foreign companies to be made to U.S. shareholders, substantial challenges remain when structuring an offer for a non-U.S. company with a significant U.S. shareholder base. Finding an appropriate exemption from registration remains a driving factor in the structuring of an exchange offer.

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