SIMPSON THACHER & BARTLETT
THE SEC'S M&A RELEASE: PROPOSED CHANGES IN THE REGULATION OF TAKEOVERS AND SECURITY HOLDER COMMUNICATIONS

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The U.S. Securities and Exchange Commission (the "SEC") has proposed a number of significant changes in the U.S. securities laws aimed at updating and simplifying the rules and regulations applicable to business combinations (including tender offers, mergers, acquisition and similar extraordinary transactions) (the "Proposals").[1] The Proposals were released concurrently with the SEC's "aircraft carrier" release, which proposes a series of significant changes in the regulation of securities offerings in the United States.[2] The SEC has indicated that the proposals set forth in the M&A Release and companion Aircraft Carrier Release will be subject to change after the customary comment process and are not likely to become effective until the year 2000. The SEC has also indicated that while it expects both sets of proposals to move toward adoption on the same track, it may adopt the proposals in either release without adopting those in the companion release.

EXECUTIVE SUMMARY

The M&A Release proposes the following significant changes to existing SEC rules and regulations under the U.S. Securities Act of 1933 (the "Securities Act") and the U.S. Securities Exchange Act of 1934 (the "Exchange Act") in connection with business combinations:

- Ease the current restrictions on communications to provide investors and the marketplace with more deal-related information on a timely basis;

- Reduce the disparity in the regulatory treatment of stock and cash tender offers by permitting exchange offers to commence upon the filing of a Securities Act registration statement;

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1 SEC Release No. 33-7607; 34-40633; IC-23520 (November 3, 1998) (the "M&A Release").

2 SEC Release No. 33-7606; 34-40632; IC-23519 (November 3, 1998) (the "Aircraft Carrier Release"). The Aircraft Carrier Release is the subject of a separate memorandum of our firm.

- Simplify the regulatory scheme by integrating the disclosure requirements for tender offers, going-private transactions and other extraordinary transactions and combining Schedules 13E-4 and 14D-1 into a single "Schedule TO";

- Require a "plain English" summary term sheet in all cash tender offers and mergers and in going-private transactions;

- Update the financial statement requirements for business combination transactions;

- Permit a subsequent offering period during which security holders can tender shares for a limited period after completion of certain tender offers;

- Clarify the rule that requires issuers to report any intended repurchases of their securities after a third-party tender offer has commenced, and such require information to be disseminated on a timely basis; and

- Clarify the rule that prohibits purchases by an offeror outside a tender offer.

The Proposals are the SEC's response to the increased use of securities as consideration in business combinations, the increase in hostile transactions involving proxy or consent solicitations, and the advent of major technological advances in communications which have made frequent, timely and direct communication with security holders more likely than in the past.

COMMUNICATIONS WITH SECURITY HOLDERS AND THE MARKETPLACE

One goal of the Proposals is to improve the current regulatory scheme by easing the restrictions the law currently imposes on communications by companies involved in business combinations. In the M&A Release, the SEC acknowledges that such companies typically have economic and other business reasons, and under certain circumstances may face legal duties, to disclose information at an early point in a contemplated transaction. The current rules, however, restrict deal-related disclosure prior to filing of a registration, proxy or tender offer statement. The Proposals would permit free communications, either oral or written, for many transactions at a much earlier point in the process than the current rules allow. The liberalized rules not only take into account the business and legal needs of companies involved in business combination transactions, but would also, in the SEC's view, help to provide full and fair disclosure to all investors.

Communications Under the Securities Act. The Proposals would eliminate certain of the existing restrictions on communications about a proposed business combination transaction before the registration, proxy or tender offer statement relating to the transaction is filed. Under

current law, in the case of a business combination involving securities as consideration, Section 5(c) of the Securities Act forbids offers for such securities unless a registration statement is on file.

Proposed Rule 166(b) would provide a safe harbor exemption from Section 5(c).[3] Given the goal of permitting widespread dissemination of deal-related information, including forward-looking information, there would be no content restrictions on exempted communications (other than applicable antifraud rules). All written communications during these periods would, however, need to be filed upon first use as pre-filing prospectus supplements.[4] The filing requirement is to assure, among other things, that the communication is available to all interested parties in the marketplace at the same time. The SEC is considering whether this proposed free-communication period should be limited in duration (*e.g.*, 48 hours following the public announcement of a transaction) or, alternatively, whether it would be practicable in takeover situations to require a minimum 30-day "quiet" period after the free-communication period and the filing of the registration statement, proxy statement or tender offer material to cure any conditioning effect the communications may have had for the offered securities.

Communications Under the Proxy Rules. Although substantially expanded in 1992 to permit certain security holder communications without the need to furnish a proxy statement prior to such communications, the proxy rules currently restrict pre-proxy statement solicitations by companies of their shareholders except in connection with (i) election contests under Rule 14a-11 under the Exchange Act or (ii) pursuant to Rule 14a-12 in response to solicitations or certain other publicized activities opposed by the company. As part of the Proposals, the narrow safe harbor currently provided in Rule 14a-12 would be expanded to permit solicitations before filing and delivery of a proxy statement without the requirement of a prior opposing solicitation or other activity.[5] The other provisions of the Rule 14a-12 safe harbor, including the requirements that (i) any written solicitation made pursuant to the Rule be filed with the SEC when made, (ii) no form of proxy be furnished to security holders prior to delivery of a proxy statement, (iii) disclosure of "participant" information be included as part of

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[3] A corresponding new rule, Rule 165, is also proposed to exempt communications during the waiting period and post-effectiveness periods from Section 5(b)(1) of the Securities Act.

[4] Under the Proposals, in both friendly and contested transactions these pre-filing prospectus supplements, as well as any oral communications made in the pre-filing period, would be subject to civil liability under Section 12(a)(2) of the Securities Act. In addition, while the SEC believes that Section 12(a)(2) liability would adequately protect investors while not chilling parties' willingness to make pre-filing communications, it is requesting comment on whether all written communications related to the transaction should be incorporated into the registration statement and subject to Section 11 liability under the Securities Act.

[5] The antifraud provisions of Rule 14a-9 under the Exchange Act would apply to all communications made in the expanded Rule 14a-12 safe harbor.

any solicitation made pursuant to the Rule and (iv) a proxy statement be delivered to solicited security holders at the earliest practicable date, would be retained.

Significantly, the proposed expansion of Rule 14a-12 would not be limited to solicitations in the business combination context. As proposed, companies could obtain their investors' views on other matters, such as governance items or executive compensation issues, prior to mailing a proxy statement for a vote on such matters. The continuing requirements of Rule 14a-12 noted above would also apply to non-business combination solicitations in reliance on the safe harbor. The SEC has asked for comment on a broader exemption from the proxy rules that (unlike the proposed Rule 14a-12) would not require delivery of a proxy statement or, in the case of written solicitations, contemporaneous filing with the SEC. Instead, written and oral "test the waters" solicitations would be permitted so long as no proxy card is requested from the solicited security holders.

As part of the Proposals, in light of the policy of encouraging companies to make early disclosure of deal-related information, the availability of filing merger proxies on a confidential basis with the SEC would be eliminated.

Communications Under the Tender Offer Rules. Consistent with the proposed new Rule 166(b) and modified Rule 14a-12, the SEC has also proposed eliminating the "five business day rule" applicable to third-party cash tender offers. This rule requires a bidder, within five business days of disclosure of certain information about an offer, either to (i) file a tender offer statement with the SEC and disseminate tender offer materials to security holders or (ii) withdraw the offer. Failure to take one of these steps within the five-business day period results in filing and disclosure violations under the tender offer rules. The five-business day rule does not apply to exchange offers for stock. However, the announcement of an exchange offer does constitute commencement of the offer unless a registration statement with respect to the securities offered is promptly filed. The SEC has also proposed eliminating the prompt filing requirement in the case of exchange offers.

Previously, the five business day rule and the prompt filing requirement were thought to limit the period during which investors could make investment decisions about a pending tender or exchange offer on the basis of incomplete information. The SEC now believes that unrestricted pre-filing communications will result in greater information about business combinations being made available to security holders on a more timely basis. Under the Proposals, bidders in both stock and cash tender offers would be required to satisfy the filing and dissemination requirements under the tender offer rules when tenders are first requested (*i.e.*, when transmittal forms are first sent or instructions on how to tender into the offer are first made available). The 20-business day period during which the offer must remain open would commence at this time.

The Proposals would also amend the current tender offer rules to permit target companies the same freedom to make pre-commencement communications as bidders without triggering the obligation to file a Schedule 14D-9 on the same date that it makes a

recommendation regarding the offer. The requirement that a target company must respond to a tender offer by communicating a position on the offer no later than ten business days from the date the offer is disseminated would remain in place.

In connection with its proposed revisions to the tender offer rules, the SEC has requested comment on, among other things, whether dissemination by summary advertisement alone (without the use of stockholder lists) should be eliminated in order to make the cash tender offer regulations more comparable to other business combination methods, which require disclosure documents to be sent to security holders. This would make the current practice of third-party bidders of supplementing the solicitation of tenders with a request for a stockholder list under Rule 14d-5 of the Exchange Act a requirement. The Proposals also would eliminate long form publication as a means of disseminating a tender offer, as such method is rarely used by bidders. Finally, the SEC is requesting commenters' views on the possible role of other means of disseminating tender offer material (*e.g.*, on the Internet).

EARLY COMMENCEMENT OF EXCHANGE OFFERS

In 1979, the SEC adopted a requirement that a registration statement be effective before commencing an exchange offer involving the securities to be registered. Cash tender offers, on the other hand, can commence upon filing of required information with the SEC and dissemination of this information to security holders. No prior review by the SEC of cash tender offer materials is required. In cases where the SEC staff elects to review a registration statement filed in connection with an exchange offer, the delay between filing and commencement can be substantial. In a competitive bidding situation, this delay can make a stock offer less attractive and less likely to be successful than a cash offer, even in when the stock offer has a higher stated value than the competing cash offer. To address this disparity, the tender offer rules are proposed to be revised to allow exchange offers (other than issuer exchange offers) to commence, at a bidder's option, upon the filing of the registration statement covering the offered securities rather than when the registration statement is effective. Under the Proposals, to commence an exchange offer, the bidder would be required to (i) file a registration statement relating to the securities offered, including a preliminary prospectus having all information necessary to allow security holders to make an informed decision regarding the exchange offer, (ii) disseminate the prospectus to all security holders and (iii) file a related tender offer statement with the SEC. The bidder would not be permitted to accept securities tendered for exchange until the registration statement was declared effective.

"Early commencement" of an exchange offer, as proposed, would be limited to third party exchange offers. Going private and roll-up transactions involving exchange offers, which the SEC believes involve material disclosure issues, and issuer exchange offers, would not be permitted to commence until the related registration statement is effective.

Even under the tender offer rules as proposed to be modified in the M&A Release, exchange offers would still be disadvantaged from a timing perspective to some extent. Cash tender offers are permitted to be completed after the minimum 20-business day tender period; purchases of securities in an exchange offer, however, could not be made until the related registration statement becomes effective. The SEC has solicited comment on whether expedited staff review of registration statements in connection with exchange offers, or possibly allowing such registration statements to be immediately effective upon filing with the SEC, would be necessary to harmonize the treatment of cash tender offers and exchange offers.

As part of the early commencement rule change envisioned by the Proposals, the SEC would specify minimum time periods for which an exchange offer would be required to remain open following the dissemination and disclosure of any material changes (whether as a result of SEC staff review or otherwise). This proposal largely codifies existing SEC guidelines with respect to the disclosure and dissemination of material changes in tender offer materials.[6]

INTEGRATION/STREAMLINING OF DISCLOSURE REQUIREMENTS

Regulation M-A and Schedule TO. Under current law, there is a different disclosure schedule for issuer tender offers, third party tender offers and going-private transactions. The Proposals have attempted to decrease the burdens of regulatory compliance by integrating the disclosure requirements applicable to these transactions into one set of uniform regulations. These regulations would also eliminate unnecessary differences among the various line-item disclosure requirements currently applicable to issuer and third party tender offers, tender offer recommendations and going private transactions. The new regulations would be known as "Regulation M-A" and would be included as a new 1000 series of Regulation S-K. The M&A Release also proposes combining the current tender offer schedules, Schedule 13E-4 and Schedule 14D-1, for issuer and third-party tender offers into a single schedule called "Schedule TO". The Proposals would also allow parties to use a combined disclosure filing for both tender offer and going private transactions.

Plain English Summary Term Sheet; Other Disclosure Changes. The Proposals include numerous other changes to the rules and regulations designed to streamline and improve disclosure in business combinations. Some of the more significant changes are discussed below:

- The Proposals provide for a "plain English" summary term sheet for all cash tender offer, cash merger and going-private transactions which would highlight the transaction's critical features and cross-reference more detailed discussions.

[6] SEC Release No. 34-24296 (April 3, 1987).

- Item 14 of Schedule 14A would modify financial statements requirements to (i) clarify that financial statement and other information about the acquiror in a cash merger is needed only if material to the evaluation of the transaction, (ii) where financial statements of the acquiror are required, require two (instead of three) year data and (iii) eliminate the need for financial information about a target in a cash merger (other than in going-private or roll-up transactions) when the acquiror's security holders are not voting on the transaction.

- In the Aircraft Carrier Release, the SEC has proposed to replace Forms S-4 and F-4 with Form C (Form SB-3 for small business issuers). Forms C and SB-3 would be the only ones available for registered exchange offers, mergers and other business combinations, and all issuers would be eligible to use Form C. There would be no distinctions based on size or seasoning of the issuer as is proposed in the Aircraft Carrier Release. In addition, the rules that currently require that the prospectus be delivered at least 20 business days before the date of the vote on the expiration of the exchange offer when incorporation by reference is used would be eliminated

UPDATE OF TENDER OFFER RULES

Subsequent Offering Period. The Proposals would allow a subsequent offering period, similar to that available in many United Kingdom tender offers, in new proposed Rule 14d-11 under the Exchange Act. In this subsequent offering period, security holders would be allowed to tender their shares after completion of a tender offer. This subsequent offering period would be at the bidder's option and would be for a fixed ten-business day period beginning after the tender offer has been open at least 20 business days. This subsequent offering period would be available only for tender offers for all outstanding shares and withdrawal rights would not be available during the subsequent offering period.

Bidder's Financial Statements and Source of Funds. Under the current tender offer rules, a bidder's financial statements must be disclosed if such information is "material." The Proposals attempt to clarify this materiality standard by providing specific guidance in an instruction in new Schedule TO as to when a bidder's financial statements are not required.[7] When the financial statements of a bidder are material, the Proposals would require only two years of historical financial information, as opposed to three years. The Proposals would also revise and update the type of financial information required to be included in third-party and issuer tender offers and going private transactions. Finally, the Proposals would expand the "Source of Funds" item requirement in the tender offer and going private rules to require disclosure of

[7] Under the Proposals, a bidder's financial statements would not be material when only cash is offered, there is no financing condition and either (i) the bidder is a public reporting company or (ii) the offer is for all outstanding securities of the target company.

the specific sources of financing, any conditions to the financing, and the bidder's ability to finance the offer if the primary source of financing falls through.

Pro Forma Financial Information in Two-Step Transactions. In transactions involving a cash tender offer followed by a back-end merger where securities are offered as consideration for shares of the target company, the Proposals would require pro forma financial information regarding the combined entity to be included in the first-step cash tender offer statement. The SEC believes this information is necessary for investors to evaluate the transaction as a whole and to determine whether to tender for cash in the front-end tender offer or retain their securities to receive the offered securities in the second step of the transaction.

Update of Rule 13e-1. Rule 13e-1 prohibits an issuer whose securities are the subject of a third party tender offer from repurchasing securities until information about the issuer's acquisition is filed with the Commission and sent to security holders. Under the current rule, an issuer can disseminate the required information to its security holders as early as six months before making any repurchases, long before they become the target of a tender offer. The revised rule would require issuers to file this information only after a tender offer is made in order to prevent early issuer filing from frustrating the rule's aim of providing information about the pending tender offer to the issuer's security holders.

Stockholder Lists. The Proposals would revise Rule 14d-5 under the Exchange Act (relating to dissemination of certain tender offers by use of stockholder lists and security position listings) to more closely align it with the 1992 amendments to Rule 14a-7 (the parallel rule relating to proxy materials). Specifically, Rule 14d-5 would be amended to require target companies to include in their stockholder lists a reasonably current list of non-objecting beneficial owners, as well as record owners, if the target company has obtained or obtains a list of beneficial owners for its own use before the meeting or security holder action. Similarly, a company that elects to provide a bidder with a stockholder list instead of mailing the bidder's materials would need to disclose recent information regarding non-objecting beneficial owners that the target company has in its possession or subsequently obtains.

Rule 10b-13. The Proposals would amend Rule 10b-13 under the Exchange Act (which prohibits a person making a cash or stock tender offer from purchasing a security that is the subject of the offer other than as part of the offer) and re-designate it as Rule 14e-5. The new rule 14e-5 would simplify the language but not alter the basic terms of the old Rule 10b-13 as it is currently interpreted by the SEC.

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The M&A Release sets forth a number of highly technical Proposals and the SEC has requested commenters' views on several other variations of these Proposals. This Memorandum is intended to constitute only an overview of certain key aspects of the M&A Release that are likely to be of interest to our clients at large. This Memorandum does not purport to discuss all of the Proposals. We invite recipients of this Memorandum who are

interested in discussing the M&A Release, or who have questions concerning any particular aspect of the M&A Release, to contact William E. Curbow of our New York Office (212) 455-2000.

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