Global Public M&A Guide - United States

Takeover Tactics

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# 6. Takeover Tactics

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**6.1 Tender offer procedures**

*Application of US Tender Offer Rules* – Section 14(d) and Section 14(e) of the Exchange Act and SEC Regulations 14D and 14E generally regulate US tender offers by a third party.  A tender offer for registered equity securities may also be subject to Rule 13e-3 under the Exchange Act if it is made by the issuer or its affiliate and would result in the issuer going private, which can include offers by non-controlling shareholders or offers where the target’s senior management is “engaged in” the transaction. Although Section 14(e) of the Exchange Act, as well as the rules promulgated thereunder, contain anti-fraud and anti-manipulation provisions that specifically apply in the context of tender offers, the general anti-fraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 under the Exchange Act also apply to tender offers.

Whether, and the extent to which, these laws and regulations apply is a function of (i) whether a specified transaction qualifies as a tender offer under available US judicial guidance, (ii) whether the target company qualifies as an FPI, (iii) whether a target security in the tender offer is an equity security registered under the Exchange Act, and (iv) whether the holders of the target security are US residents.

Somewhat counterintuitively, tender offers principally conducted outside the US involving the securities of a non-US target company that seemingly has little or no connection with the US may nonetheless implicate US federal securities laws if at least 10% of target securityholders are US residents.

*Tender Offer Definition* – “Tender offers” are not formally defined by federal statute or SEC rule or regulation. Rather, the SEC and practitioners have come to rely on two different judicial tests to determine whether a particular transaction constitutes a tender offer. While the details of those judicial tests are beyond the scope of this chapter, acquirer offers made to all shareholders of a target company to purchase target company shares, whether on a hostile basis or in a two-step merger, are considered to qualify as tender offers under those tests.

*FPI Definition* – Key exemptions from US tender offer procedures as described further below depend on whether the target company qualifies as an FPI. An FPI is defined as any issuer (other than a foreign government) that is a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country EXCEPT an issuer meeting both of the following conditions:

*US shareholder test* – More than 50% of the issuer's outstanding voting securities are directly or indirectly held of record by US residents; and

*US business contacts tests* – Any one of the following is true:

the majority of the executive officers or directors are US citizens or residents;

more than 50% of the issuer's assets are located in the US; or

the issuer's business is administered principally in the US.

*US Registration* – If a target company has any class of equity securities registered in the US under the Exchange Act, which will be the case if, for example, a target company has a class of shares listed on a national US exchange, such registration will generally trigger applicable US tender offer disclosure requirements under Section 14(d) of the Exchange Act and SEC Regulation 14D, along with certain procedural requirements like the all holders / best price rules summarized below, unless an exemption is available based on the target company shareholders’ level of US residency as described below.

*Location of Target Company Shareholders and FPIs* – US tender rules provide two key exemptions from various disclosure and procedural rules based on securityholder residency for target companies that qualify as FPIs. Those exemptions are as follows:

*Tier I* – Under the so-called Tier I exemption, if

US holders hold 10% or less of the target securities;

US holders of the target securities are permitted to participate in the tender offer on terms at least as favorable as those offered to other holders of the target securities, subject to certain exceptions;

Bidder provides informational documents to holders of the target securities in the US, in English, on a basis comparable to that provided to holders of the subject securities in its home jurisdiction; and

The target company is not an “investment company” or registered or required to be registered under the under the US Investment Company Act of 1940, other than a registered closed-end investment company,

then the bidder, the target company and applicable tender offer qualify for broad relief from most US tender offer rules.  These exemptions include:

No minimum offer period requirement;

No prescribed advanced notice required for an offer extension;

No prescribed timing requirement to pay consideration or return tendered securities;

No specific form of response required from the target company;

Purchases may be made outside the tender offer, subject to certain further conditions noted generally below; and

Even if the target equity securities are registered under the Exchange Act, there is no requirement for the bidder or target company to file offer materials or responses with the SEC (though SEC filings might still be required to satisfy the informational document condition noted immediately above), nor do procedural requirements, like the all holders / best price rules summarized below, apply.

*Tier II* – More limited relief from US tender rules is available under the so-called Tier II exemption.That exemption provides that, if

US holders hold 40% or less of the target securities;

The target company is not an “investment company” or registered or required to be registered under the US Investment Company Act of 1940, other than a registered closed-end investment company;

The target company is an FPI; and

The bidder otherwise complies with all applicable US tender offer laws and regulations other than those for which the Tier II exemption applies,

then the bidder, the target company and the tender offer would qualify for certain selective relief from US tender rules, with the key provisions summarized generally as follows:

A bidder may split its offer into multiple separate offers, one to US holders and the other(s) to non-US holders, so long as US holders are treated as favorably as any other holder;

A bidder may provide notice of extensions of its offer under the requirements of the target company's home jurisdiction, rather than comply strictly with the requirements noted below under US tender rules in connection with offer duration;

A bidder may suspend back-end withdrawal rights before offers are accepted while tendered securities are counted;

A bidder may pay for securities tendered under the law or practice of the target company's home jurisdiction rather than promptly as required by US tender rules noted below on payment;

A bidder may early terminate an offer period before scheduled expiration without a potential delay for material amendment as might be required under US tender rules if certain conditions to such early termination are satisfied, including that a minimum 20 business day offer period has already elapsed;

Purchases outside the tender offer are permitted subject to certain conditions as noted generally below but which conditions are more restrictive than under Tier I (e.g., such purchases cannot be made in the US under Tier II);

If the target equity securities are registered under the Exchange Act, there is no relief from a bidder and target company’s obligations to file SEC-compliant offer documents, including a target position statement as described below, but there is more limited relief available from various technical procedural aspects generally tied to registered equity securities (including the ability make separate US and non-US offers subject to certain conditions).

Calculating US Holders – To determine the number of US holders of a target security and confirm the application of a Tier I or a Tier II exemption, a bidder must conduct the following analysis:

*Look-Through Analysis* – A bidder must look not only at the residency of security holders of record but also must “look through” record holders that are brokers, dealers and banks (and their nominees) as of a certain date (generally, no more than 60 days before, and no more than 30 days after, the public announcement of the transaction) to determine the US residency of the underlying account holders. Such look-through analysis must be conducted in the US, the subject company’s jurisdiction of organization and the jurisdiction that is the primary trading market for the target securities if different from the jurisdiction of organization. The inquiry need only confirm the aggregate amount of the nominee's holding that corresponds to US accounts, but the obligation to look through requires that reasonable inquiry be made of nominees to determine the residency of their account holder customers. If, after reasonable inquiry, the bidder is unable to determine the beneficiary, it may assume that the owners are residents in the jurisdiction of the nominee’s principal place of business. If the tender offer is friendly, the bidder should send or request that the subject company send letters to brokers, dealers, banks, and other nominee holders inquiring about the aggregate amount of their holdings that correspond to US accounts.

*Analysis Timing* – US ownership may be calculated in negotiated transactions at any date up to 60 days before and 30 days after the public announcement of the business combination. Where a bidder cannot perform the look-through analysis in the prescribed 90-day period, it may do so as of the most recent practicable date before public announcement, but not earlier than 120 days before public announcement. The calculation should, in any case, be conducted before commencement of the tender offer.

*Alternative Test* – SEC rules provide that a bidder may presume the application of the Tier I or Tier II exemptions if (i) the bidder cannot conduct the requisite look-through analysis (typically in the context of hostile tender offers) and there is a primary trading market for the subject securities outside the US or (ii) the bidder is not an affiliate of the target company and proposes to conduct a business combination other than under an agreement with the subject company (i.e., a non-negotiated transaction or hostile takeover). In these cases, the bidder may presume application of such exemptions unless:

The average daily trading volume (“**ADTV**”) of the target securities in the US exceeds 10% or 40%, as applicable, of the worldwide ADTV during a recent 12-month period ending no more than 60 days before the public announcement of the business combination;

Any filing with the SEC, the target company's home regulator, or the jurisdiction of the targets primary trading market, indicates that US holders hold more than 10% or 40%, as applicable, of the target securities; or

The bidder knows or has reason to know, before the public announcement of the tender offer, that the level of US ownership exceeds 10% or 40%, as applicable.

*Procedural Requirements* – Under Section 14(d) of the Exchange Act and SEC Regulations 14D and 14E, tender offers in the US must generally be conducted in accordance with the following requirements (in addition to applicable disclosure requirements and certain additional technical procedural requirements):

*Duration* – The offer must initially be held open for at least 20 business days. In addition, the offer must remain open for a minimum of (i) 10 business days (pursuant to an extension, if necessary) following any increase or decrease in the percentage of the target company shares sought in the offer, the consideration offered, or the soliciting dealer's fee, or (ii) a minimum of 5 business days following any other material change in the terms of the tender offer (including any material waiver of any material terms). Offer extensions must be announced by press release issued by the earlier of 9:00 a.m. Eastern time and the opening of trading on the exchange where the securities are listed on the day following the scheduled expiration date.

*All holders; best price* – The offer must be made to all holders of the class of securities subject to the offer, and all tendering holders, including those who tendered prior to an increase in the offered consideration, must receive the same consideration per share.

*Withdrawal rights; subsequent offering period* – Tendered securities may be withdrawn at any time while the offer remains open. After termination of the offer period and acceptance of tendered shares, the acquirer may continue to accept shares for a "subsequent offering period" of from three to 20 business days. Statutory withdrawal rights are not available for shares tendered during a subsequent offering period.

*Purchases outside the offer* – Subject to certain exceptions, from the time the offer is first announced to the expiration date, the acquirer and its affiliates, the acquirer's dealer-manager and its affiliates, and a financial advisor to any of them if the advisor's compensation depends on the successful completion of the tender offer, may not purchase or arrange to purchase securities in the target public company subject to the offer, or securities convertible into or exchangeable for such securities, other than pursuant to the tender offer. The exceptions include purchases outside the offer in certain tender offers for the shares of FPIs in accordance with the target's home country law, subject to compliance with specified conditions, including disclosure.

*Pro rata acceptance* – In an offer for less than all outstanding securities of the class being sought, if a greater number of securities than the maximum number sought are tendered, acceptance of tendered shares must be pro rata.

*Prompt payment or return* – The tender offer consideration must be paid, or tendered securities must be returned, promptly after termination or withdrawal of the offer.

*Target company position* – The target public company must take a formal position regarding the tender offer within 10 business days after commencement of the offer by filing and distributing a Schedule 14D-9. In a friendly transaction, the target public company's Schedule 14D-9 is usually filed contemporaneously with the acquirer's Schedule TO, which includes the offer to purchase that is provided to the target public company shareholders, and the Schedule 14D-9 is distributed to the target public company shareholders together with the offer to purchase.

**6.2 Deal protection**

In a negotiated transaction, the executed transaction between an acquirer and a target public company is subject to topping bids by interloping bidders, until the shareholder approval is obtained (or the tender offer is closed). In light of this, the acquirer can enter into agreements with the target public company and its shareholders to protect the deal from competing offers. The availability of such measures will depend upon the applicable state corporate law, but such measures may include:

*Agreements with shareholders* – An acquirer can enter into agreements with one or more significant shareholders in which they agree to tender their shares into the acquirer's tender offer or vote in favor of the proposed merger, as the case may be. Depending on the jurisdiction, an irrevocable proxy may be used to enforce the tender/voting agreement. Acquirers should bear in mind that an agreement that grants an acquirer the right to acquire the shares or to direct the voting of the shares may constitute the acquirer as the beneficial owner of the shares covered by the agreement under Section 13(d) of the Exchange Act and obligate the acquirer to file a Schedule 13D prior to the actual purchase or other acquisition of the subject shares.

*"No-shop" clauses* – A "no-shop" provision in a merger agreement limits the target public company's ability to seek or facilitate competing bids, subject only to the fiduciary duties of the target public company's directors. As noted above, a target public company may insist on the ability to conduct an "active" market check of the merger terms through a "go-shop" clause permitting the target public company to solicit other bids for a negotiated period of time or a "passive" market check allowing the target public company to entertain a superior, competing offer made after public announcement of the merger agreement but without solicitation of other bids. An acquirer may also negotiate for the right to match any such superior offer.

*Break-up fees* – A break-up fee is a termination fee paid by a target public company to compensate an acquirer for termination of the merger agreement in favor of a competing bidder. It is necessary that a balance be struck between the amount necessary to compensate the buyer and a fee so high that the cost of bearing the break-up fee discourages competing bidders. Also, state corporate laws limit the amount of such fees, generally to below 5% of the transaction value, typically measured based on equity value. Alternatively, in some cases, bidders will agree to pay a reverse break-up fee, i.e., a fee payable by the bidder to the target public company upon termination, as consideration for the right to terminate the merger agreement upon specified conditions.

*Shareholder rights plans* – An acquirer can enter into an agreement with the target public company requiring the target public company to adopt a shareholder rights plan to discourage third parties from accumulating shares in the open market sufficient to maintain a "blocking position".

In US public company acquisition transactions, representations and warranties by a target public company do not survive the closing of the transaction, and post-closing indemnification rights and/or escrow of a portion of the merger consideration (which are customary in private company acquisitions) as well as representation and warranty insurance (increasingly common in private company acquisitions) are generally not practicable to the acquirer or customary.

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