
**OFFICE OF ECONOMIC ANALYSIS
MEMORANDUM**

TO: OFFICE OF MERGERS & ACQUISITIONS, DIVISION OF CORPORATION FINANCE

FROM: OFFICE OF ECONOMIC ANALYSIS

SUBJECT: EVALUATION OF ADTV RATIO AS AN ALTERNATIVE TO US BENEFICIAL OWNERSHIP IN DETERMINING CROSS-BORDER EXEMPTION ELIGIBILITY

DATE: JUNE 17, 2008

Background

In 1999, the Commission adopted rule provisions (the “cross-border exemptions”) intended to facilitate the inclusion of US shareholders in cross-border business transactions involving foreign private issuers. The 1999 cross-border exemptions achieve this by exempting certain qualifying transactions from most of the US rules, not including the anti-fraud provisions. In other instances, the exemptions provide targeted relief from certain US rules, where they conflict with applicable foreign rules to facilitate cross-border transactions. Eligibility to rely on the exemptions in negotiated business combination transactions is determined by reference to the percentage of the target company’s shares beneficially held by persons resident in the United States. The exemption from the registration requirements of Section 5 for rights offerings by foreign private issuers is similarly available where US persons beneficially own no more than a certain percentage (10%) of the total shares of the relevant class.

On May 6, 2008, the Commission proposed changes to the existing cross-border exemptions. Although the proposed changes would modify in several respects the calculation of US ownership for purposes of the threshold eligibility determination, the proposed rules continue to rely on US beneficial ownership as the benchmark for that determination. However, the proposing release solicits comment on several alternate eligibility tests. One such possible alternative would be a test based on the average daily trading volume of the relevant securities in the United States as a fraction of worldwide trading over a relevant period ending before the relevant cross-border transaction (the “ADTV ratio”).

As part of the economic analysis of the alternatives under consideration, we have identified several criteria for comparing different measures that may be used in testing for cross-border exemption eligibility. These include (1) the ease of public access to information related to the measure; (2) the difficulty of manipulation of the measure; and (3) the alignment of the measure with the percentage of target securities beneficially held by US investors.

In the remainder of this memo, we present the third criterion and apply it to the evaluation of ADTV ratio as an alternative to US beneficial ownership in testing for eligibility. The alignment is weak according to our analysis of the available data.

Analysis

Alignment with percentage beneficial holdings of US investors

Our suggestion that the staff consider alignment with US beneficial holdings (in percentage) as a criterion in evaluating alternative eligibility tests for the cross-border exemptions reflects the following two considerations. First, under the current cross-border exemptions, cross-border business combinations and rights offerings may be exempted from the registration requirements of Section 5 of the Securities Act of 1933 and the procedural, disclosure and dissemination requirements of the Williams Act when the percentage of target securities held by US investors (“US beneficial ownership”) is relatively small (no more than 10% of the relevant class of securities). Second, in such cases, these requirements are relatively more likely to impose unintended opportunity costs on US investors of being excluded from potentially beneficial offers. This is because when US investors make up a relatively small percentage of the target shareholder base, their participation may not be necessary to the success of the transaction and the bidder or issuer may therefore choose to exclude US shareholders in order to avoid the cost and expense of complying with US rules. This was the staff’s experience in analyzing cross-border transactions in which US investors were excluded before the adoption of the 1999 cross-border exemptions.

ADTV and its alignment with US beneficial ownership

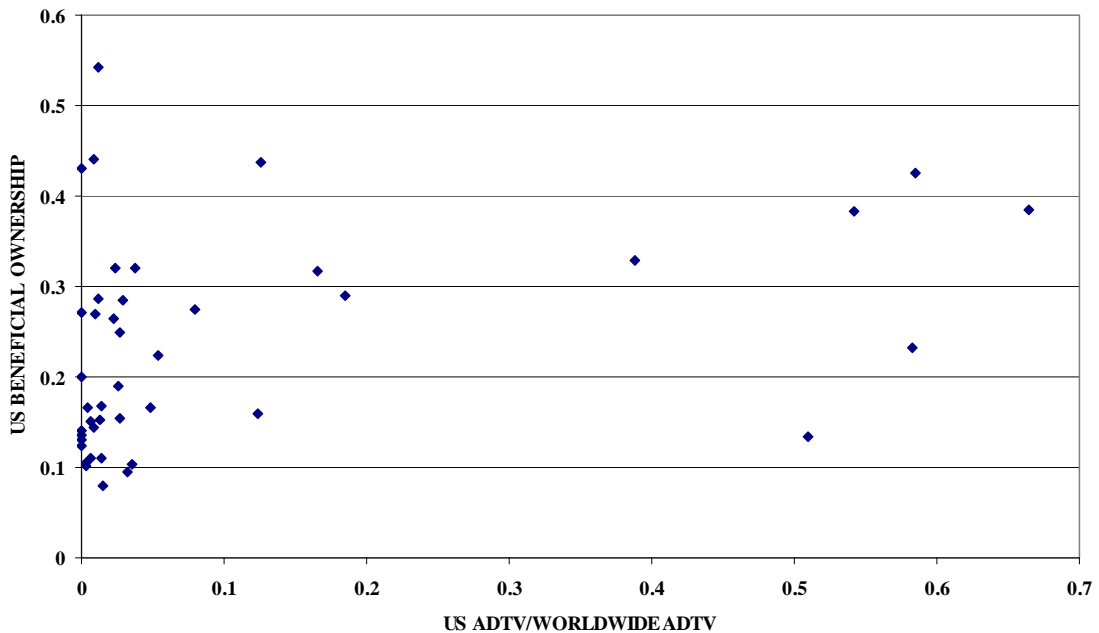
We examined the alignment between the percentage of US beneficial ownership of the subject securities and the ADTV ratio using correlation as our measure of alignment. We base our analysis on a data sample drawn from requests for cross-border no-action and exemptive letters submitted to the staff. The caption accompanying the chart describes our sample.

In the available data, the correlation between ADTV ratio and US beneficial ownership is 0.34. In order to consider whether imposing low threshold cut-offs based on ADTV ratio can effectively capture firms with low US beneficial ownership, we also considered the correlation among firms with low ADTV ratios. The correlation is even lower among firms with ADTV ratios less than 10% than among other firms, as the figure indicates; among firms with ADTV ratios less than 10%, the correlation is 0.096. To check whether our results were driven by outliers, we also computed correlation using the ranking of the firms in the sample based on ADTV ratio and the ranking of the firms based on US beneficial ownership. The results were qualitatively similar.

Because the available data comes from cross-border no-action and exemptive letters, it comprises only those transactions in which the acquirer sought exemptive or no-action relief from the staff. Most of these letters deal with cross-border transactions in which

US beneficial ownership in the target exceeds 10%, and the transaction is thus not automatically exempt from US registration and other rules. The letters also include some instances where US ownership is less than 10%, but the transaction is not within the category of transactions covered by the current cross-border exemptions.

US BENEFICIAL OWNERSHIP versus US ADTV/WORLDWIDEADTV



The sample includes the following observations. We reviewed 47 no-action request letters submitted to the Division of Corporation Finance dated between March 2002 and October 2007 and posted on the Commission's website. We also reviewed seven no-action request letters from Westlaw dated between 2000 and March 2002. We found 29 additional observations on U.S. beneficial ownership from no-action requests seeking relief from Rule 14e-5 submitted to the Division of Trading and Markets and posted on the Commission's website. Forty-three of these letters reveal their best estimates of U.S. beneficial ownership (with specified dates). We used DataStream to calculate U.S. ADTV as a fraction of worldwide ADTV for the 12 months preceding the specified date.