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U.S. Legal Considerations Affecting Global Offerings of Shares in Foreign Companies

*Daniel A. Braverman**

I. INTRODUCTION

The 1980s witnessed the emergence of so-called “global” equity offerings as part of the increasing internationalization of the world’s capital markets. An equity offering can be said to be “global” when it involves simultaneous offerings of shares in a number of countries, one or more of which may be made to the public in accordance with the regulations of national markets. The capital markets of the United States can be included in a global equity offering in one of two ways: (1) shares may be offered to the public in accordance with the registration and disclosure requirements of the U.S. Securities Act of 1933¹ (Securities Act) and the regulations of the Securities and Exchange Commission (SEC) thereunder; or (2) shares may be offered on a more limited basis in accordance with Rule 144A² under the Securities Act or pursuant to traditional private placement procedures.

When a public offering or private placement is made in the United States as part of a global offering, the structure of the offering as a whole will be significantly affected both because of the requirements that will apply in the United States, with which the require-

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¹ 15 Securities Act of 1933, U.S.C. § 77a *et seq.* (1994) [hereinafter Securities Act].

² 17 C.F.R. § 230.144A (1996).

ments of other countries will have to be coordinated, and because of the extraterritorial effect of U.S. laws and regulations on the activities of the participants in the portion of the offering being made outside the United States. This article first outlines the most important laws and regulations that apply to public offerings and private placements in the United States and then analyzes how these laws and regulations can affect the structure and conduct of the offering outside the United States. While the focus of the article is on global offerings of shares in foreign companies, the rules applicable to U.S. companies are also noted where they differ in substance.

It must be stressed at the outset that the U.S. regulatory regime has evolved significantly in recent years in order to facilitate global offerings, and further changes can be expected. In the early 1980s, the SEC attempted to encourage U.S. public offerings of shares in foreign companies by tailoring the disclosure requirements more closely to home country requirements. In 1990, the SEC adopted Rule 144A under the Securities Act, which simplifies the procedures for making private placements to large U.S. institutions,³ and Regulation S⁴ under the Securities Act, which ensures that offerings can be made outside the United States without registration under the Securities Act.⁵ Throughout the 1980s and into the 1990s, the SEC also took steps to limit the extraterritorial application of its restrictions on market activities by participants in an offering while a U.S. distribution is under way, thereby reducing the impact of a U.S. tranche on the activities of foreign underwriters in foreign markets in a global offering. Other measures, such as allowing a foreign securities broker or dealer to solicit business in the United States in certain circumstances without having to register with the SEC as a broker or dealer and permitting a foreign bank or insurance company to offer its securities to the U.S. public without having to register with the SEC as an investment company were also part of the SEC's multifaceted response to internationalization. Finally, in a move that bears little on this article, the SEC adopted a bilateral, multijurisdictional disclosure system with Canada permitting certain large issuers to use the offering documents of their home country when making a public offering of securities in the other country.

In the light of these developments, it is important to recognize the protean character of the U.S. regulatory system as it applies to

³ *Id.*

⁴ 17 C.F.R. § 230.901-.904 (1996).

⁵ *Id.*

global offerings. Of necessity, this article can represent only a snapshot of a dynamic system that is ever changing in order to better accommodate the ebb and flow of capital across borders and to better integrate the U.S. capital markets with those of the rest of the world.

II. U.S. LAWS AND REGULATIONS

The Securities Act is the principal statute governing the distribution of securities in the United States. Any offer or sale of securities in the United States must be registered with the SEC under the Securities Act,⁶ unless an exemption is available.⁷ In the context of a global equity offering, the only relevant exemption for offers and sales in the United States is the one for a private placement that is made either under Rule 144A or on the basis of traditional private placement procedures.

Before proceeding to discuss registered public offerings and private placements, a word should be said about what is not treated here. This article does not discuss the requirements for obtaining a listing on a major U.S. stock exchange, such as the New York Stock Exchange or the American Stock Exchange, or a quotation on the National Association of Securities Dealers' Automated Quotation System (NASDAQ). These requirements are generally easy to meet in the context of a public offering since the information required by the relevant application will, for the most part, be contained in the filings made with the SEC under the Securities Act (and are irrelevant in private placements since the securities being offered will not be listed on a U.S. exchange or quoted on NASDAQ). As a technical matter, when securities are listed on a U.S. exchange or quoted on NASDAQ, they are also required to be registered under the Securities Exchange Act of 1934⁸ (Exchange Act), but that is also a routine procedure in the context of a public offering.

Secondly, this article does not discuss American Depositary Shares (ADSs) or the American Depositary Receipts (ADRs) that evidence them. Shares of foreign companies are usually offered to the public in the United States in the form of ADSs and ADRs. An ADR is a negotiable certificate in registered form that evidences one or more ADSs, which, in turn, represent the underlying foreign shares on

⁶ See Securities Act § 77e.

⁷ See Securities Act § 77c (exempted securities); Securities Act § 77d (1994) (exempted transactions).

⁸ Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1994) [hereinafter Exchange Act].

a share-for-share or multiple-share basis. ADRs are usually issued by a U.S. commercial bank (Depository) whose foreign correspondent (Custodian) deposits the underlying shares pursuant to a Deposit Agreement between the issuer and the Depository. ADRs can be submitted by the ADR holder to the Depository for cancellation and delivery of the underlying shares. Similarly, underlying shares can be deposited with the Custodian against issuance by the Depository of ADRs.

ADRs facilitate sales of ADSs between U.S. investors, since transfers may be registered on the books of the Depository in the same manner as transfers of shares in U.S. companies and the ADRs are eligible for clearance through The Depository Trust Company (DTC); accordingly, U.S. investors are not required to follow foreign transfer procedures or to send their certificates abroad.⁹ It is generally the case in a public offering that ADSs, rather than the underlying foreign shares, are quoted on a U.S. securities exchange or on NASDAQ so as to provide a U.S. dollar market once the public offering is launched. ADRs also permit U.S. investors to receive their dividends in dollars; dividends on the underlying shares paid in foreign currency

⁹ Privately placed ADSs of foreign companies may settle through DTC only if they are eligible for trading through PORTAL, a market for trading privately placed securities organized by the National Association of Securities Dealers, Inc. This market is, however, limited to securities that are eligible for resale under Rule 144A. Accordingly, private placements of shares that are not eligible for resale under Rule 144A generally may not settle through DTC.

Settlement mechanics vary considerably in global offerings, although simultaneous delivery against payment is a common element. The simplest case is when ADSs are offered and sold in the United States and ordinary shares are offered and sold abroad. In these circumstances, the ADSs would typically be evidenced by a single global ADR held by DTC and the ordinary shares would settle in accordance with customary practice in the issuer's home market. (This approach would also be followed in global offerings in which the U.S. investors are given the option of taking either ADSs or ordinary shares – if they choose to take ordinary shares, settlement would be in accordance with home market practice.)

If the ADSs – or global depository shares – are to be offered abroad, the situation gets more complicated. Euroclear and CEDEL, the principal European clearing systems, have decided not to hold ADRs that evidence ADSs offered and sold in the United States; they will, however, hold through DTC interests in ADRs that are held by DTC; and they also will hold ADRs that evidence ADSs offered outside the United States. Thus the possibilities are as follows: a single global ADR evidencing ADSs sold everywhere could be held by DTC, with the European clearing systems holding interests in this ADR through DTC; two global ADRs, one evidencing the ADSs offered and sold in the United States and the other evidencing the ADSs offered and sold abroad, could be held by DTC, with the European clearing systems holding interests in the latter through DTC; or DTC could hold one global ADR evidencing the ADSs offered and sold in the United States and the European clearing systems could hold through a common depository one global ADR evidencing the ADSs offered and sold abroad.

The decision as to which of these options to choose is likely to depend on whether the U.S. tranche is public or private and whether it is large or small relative to the size of the offering in the rest of the world.

are collected by the Custodian, converted into dollars and transmitted by the Depositary to the ADR holders.

For purposes of the Securities Act, an ADS is technically a separate security, the offer or sale of which must be registered with the SEC, as must the offer or sale of the underlying shares, unless an exemption is available.¹⁰ A simple registration form – Form F-6 under the Securities Act – may be used to register the ADSs.¹¹

Thirdly, this article does not discuss the securities laws of the fifty states – the so-called “blue sky” laws – which, in many cases, contain both registration requirements and anti-fraud protections. It is generally the task of U.S. underwriters’ counsel to ensure that all regulatory hurdles have been cleared in each state where the shares are to be offered or sold. In a public offering, the registration requirements of most states can be avoided by ensuring that the shares are approved for listing on a U.S. securities exchange or for quotation on NASDAQ before offers are made. Most blue sky laws also provide exemptions for private placements to institutional investors.

Finally, this article does not discuss the U.S. tax aspects of global offerings. Among the most significant of these for the marketing of a global equity offering in the United States are the unfavorable tax rules that apply to U.S. purchasers of shares in companies deemed to be passive foreign investment companies (PFICs) for purposes of the U.S. Internal Revenue Code of 1986¹² (the Code).

A PFIC is a foreign company that is engaged predominantly in the making of passive investments. The United States has developed special rules to discourage U.S. investors from seeking to defer U.S. taxation of their investment income by moving it offshore through the acquisition of equity securities in a PFIC that does not distribute its earnings currently. The rules require U.S. investors in a PFIC to pay what amount to significant penalties upon the sale or other disposition of an equity interest in the PFIC and on certain distributions by the PFIC. Alternatively, a U.S. investor in a PFIC may elect to report its *pro rata* share of the PFIC’s earnings annually, without regard to whether those earnings have been distributed as dividends, by electing to treat the PFIC as a “qualified electing fund” for tax purposes; such

¹⁰ The offer and sale of ADSs in a private placement in the United States is not required to be registered. The deposit agreement for one of these so-called “restricted ADR programs” would contain restrictions on deposit and withdrawal to ensure on a continuing basis that the ADSs and underlying shares are offered and sold only to investors who are permitted to buy them in private placements that are exempt from registration under the Securities Act.

¹¹ Securities Act, *supra* note 1.

¹² Internal Revenue Code of 1986, 26 U.S.C. §§ 1-9722 (1994) .

an election is only available, however, if the PFIC has agreed to comply with potentially burdensome reporting requirements and has the additional disadvantage of requiring payment of taxes on income not yet realized.

A foreign company will be classified as a PFIC if, during any taxable year, seventy-five percent or more of its gross income is passive income within the meaning of the applicable rules, or fifty percent or more of its assets are held for the production of passive income. Under the rules, an offshore mutual fund will generally be classified as a PFIC. Moreover, because the rules are drafted broadly, they may sometimes apply to foreign banks, insurance companies, property holding companies, start-up companies and other companies that would appear to be genuine operating companies.

If the PFIC rules apply, the tax consequences can have a significant adverse impact on the marketing of a global offering in the United States. Indeed, to my knowledge, there has not been a single U.S. public offering of shares in a PFIC, and the rules have imposed significant limitations on the marketing of shares in U.S. private placements as well.¹³

A. Public Offerings in the United States

A U.S. public offering with a U.S. stock exchange listing or NASDAQ quotation is the route usually followed when a foreign private issuer¹⁴ wishes to gain the widest access to the U.S. capital markets, to build a stable shareholder base in the United States and to encourage the emergence of a secondary trading market there. The U.S. regulatory regime is, however, extremely rigorous when securities are being

¹³ One solution in private placements has been to limit sales to entities that are exempt from U.S. taxation. Many of these entities, however, are pension plans subject to the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.* (1994) [hereinafter ERISA], which imposes a number of restrictions, one of the most significant being that if pension plans, whether or not subject to ERISA (and whether or not located in the United States), hold more than 25 percent of the shares of a non-operating company, any pension plan subject to ERISA must treat the assets of the company as assets of the plan, a result that will generally cause the ERISA plan manager to be in violation of ERISA rules (this is the so-called "plan asset" problem).

¹⁴ A foreign private issuer is any company incorporated under the laws of a foreign country, except for a company that meets the following conditions: (1) more than 50 percent of its outstanding voting securities are held of record by U.S. residents; and (2) any of the following: (a) the majority of its executive officers or directors are U.S. citizens or residents, (b) more than 50 percent of its assets are located in the United States, or (c) its business is administered principally in the United States. 17 C.F.R. § 240.3b-4(c) (1996). If a foreign company is not a foreign private issuer, it is treated as a U.S. issuer and certain of the disclosure and other requirements discussed below are more extensive.

offered to the public. The most significant requirements are those imposed by: (1) the registration and related requirements of the Securities Act, which cover disclosure and publicity; (2) Rules 10b-6,¹⁵ 10b-7¹⁶ and 10b-8¹⁷ under the Exchange Act (collectively, the Trading Rules), which regulate the market activities of the issuer and the underwriters while a distribution of securities is under way; and (3) the rules of the National Association of Securities Dealers, Inc. (the NASD), which are designed to ensure that members of the public are treated no less favorably than institutional investors and other institutional participants in the capital markets. Other restrictions, such as those imposed by section 7(d) of the Investment Company Act of 1940¹⁸ (the Investment Company Act), which prevents a foreign "investment company" from offering its shares to the public in the United States without registering with the SEC as an investment company,¹⁹ and by section 15(a)(1) of the Exchange Act,²⁰ which prevents any securities broker or dealer that has not registered as such with the SEC from offering securities in the United States, are also relevant.²¹

1. Registration and Related Requirements

The purpose of the registration requirements of the Securities Act, broadly speaking, is to ensure that investment decisions in a U.S. public offering are made on the basis of disclosures mandated by the SEC and are not influenced by unwarranted publicity. Under § 5 of the Securities Act, it is unlawful for any person:

- to offer any security for sale unless a registration statement in a prescribed form (including a preliminary prospectus) has first been filed with the SEC;²²
- to use any written information that offers any security for sale (*i.e.*, a statutory "prospectus"²³) unless it meets the disclosure requirements of the Securities Act (as a practical matter, this ensures that the only written information made available in connection with a U.S. public

¹⁵ 17 C.F.R. § 240.10b-6 (1996).

¹⁶ 17 C.F.R. § 240.10b-7 (1996).

¹⁷ 17 C.F.R. § 240.10b-8 (1996).

¹⁸ Investment Company Act of 1940, 15 U.S.C. § 80a-7(d) (1994) [hereinafter Investment Company Act].

¹⁹ *Id.*

²⁰ 17 C.F.R. § 240.15(a)(1) (1996).

²¹ *Id.*

²² Securities Act § 77e.

²³ The definition of "prospectus" is contained in section 2(10) of the Securities Act, 15 U.S.C. § 77b(1), and generally covers "any prospectus, notice, circular, advertisement, letter or communication, written or by radio or television, which offers any security for sale . . .". *Id.*

offering is the preliminary prospectus included in the registration statement),²⁴

- to confirm the sale of any security until the registration statement has been declared “effective” by the SEC;²⁵ and
- to deliver any security (or any written confirmation of sale) until a final prospectus meeting the disclosure requirements of the Security Act have been furnished to the purchaser (as a practical matter, this requires the prospectus that is included in the registration statement when it is declared effective to be delivered to the purchaser together with or prior to the confirmation of sale).²⁶

The effect of these rules is generally to prohibit marketing efforts in connection with a public offering until a registration statement has been filed, to limit the use of written materials in connection with any marketing efforts to the preliminary prospectus that is included in the registration statement, and to prevent sales from being confirmed until the registration statement has been declared effective and the final prospectus prepared, typically after review by the SEC to ensure that the disclosure requirements have been met. Generally, the underwriting agreement is signed and the securities are priced when the registration statement is declared effective or shortly thereafter.

a. Disclosure Requirements

The disclosure requirements for the prospectus included in a registration statement are set out in detailed SEC regulations and forms. The information called for is extensive – going well beyond what is required by regulators in most other countries – and only those requirements that are generally thought to be most significant for foreign issuers can be touched on here.

The relevant forms for a foreign company wishing to offer its shares to the U.S. public are Forms F-1, F-2 and F-3 under the Securi-

²⁴ Securities Act § 77e. Rule 430A under the Securities Act, 17 C.F.R. § 230.430A (1996), provides that in most cases the preliminary prospectus included in the registration statement will be deemed to meet the disclosure requirements of section 5(b)(1) of the Securities Act, 15 U.S.C. § 77e(b)(1).

²⁵ Securities Act § 77e.

²⁶ *Id.* Note, however, that Rule 430A under the Securities Act, 17 C.F.R. § 230.430A, provides that certain information relating to the pricing of the securities and the composition of the underwriting syndicate will be deemed to be contained in the prospectus included in the registration statement when it is declared effective, even if such information is omitted from that prospectus; the final prospectus delivered to investors is required to contain this information. *Id.* In addition, Rule 424(b) under the Securities Act, 17 C.F.R. § 230.424(b)(1996), allows certain changes, even substantive ones, to be made in the final prospectus after the registration statement is declared effective. *Id.*

ties Act.²⁷ Form F-1 is for an issuer that is not subject to the periodic reporting requirements of the Exchange Act²⁸ or that is subject to those requirements but is not otherwise eligible to use Forms F-2 or F-3. Forms F-2 and F-3 are available to an issuer that is subject to the periodic reporting requirements of the Exchange Act, provided certain other conditions are met. A foreign issuer will be eligible to use Form F-3 if:

- it has been subject to the periodic reporting requirements of the Exchange Act for at least twelve months, has filed at least one annual report on Form 20-F and has filed all required reports in the last twelve months on a timely basis;²⁹
- in the case of primary offerings of shares for cash, its voting stock held by non-affiliates has an aggregate worldwide market value (the so-called "float") of at least \$75 million;³⁰ and
- it has not defaulted on certain payments.³¹

An issuer that satisfies the float requirement but that has not been subject to the periodic reporting requirements for at least twelve months will be eligible to use Form F-2, so long as it has filed at least

²⁷ 17 C.F.R. §§ 239.31-33 (1996). These forms, adopted in 1982, represent an effort by the SEC to tailor the disclosure requirements for a U.S. public offering more closely to the requirements of the issuer's home country. The accommodations, however, are rather limited in scope. For a discussion of these forms, see generally Edward F. Greene & Eric D. Ram, *Securities Law Developments Affecting Foreign Private Issuers*, INT'L FIN. L. REV. 4 (1983). For U.S. issuers, the comparable forms are Form S-1, 17 C.F.R. § 239.11 (1996), Form S-2, 17 C.F.R. § 239.12, and Form S-3, 17 C.F.R. § 239.13.

²⁸ A foreign company can become subject to the periodic reporting requirements of the Exchange Act, set out in section 13 of the Exchange Act, 15 U.S.C. § 78m, by making a public offering in the United States, see Exchange Act § 78o(d), or by registering a class of its securities under the Exchange Act. A foreign company is required to register a class of its securities under the Exchange Act if it obtains a listing or quotation for that class on a U.S. securities exchange or on NASDAQ, Exchange Act § 78l(b), or, in the case of a class of equity securities, if there are 300 or more U.S. resident beneficial owners of shares in that class, 17 C.F.R. § 240.12g3-2(a) (1996). Rule 12g3-2(b) under the Exchange Act provides an exemption from Rule 12g3-2(a)'s requirement to register so long as the issuer agrees to furnish to the SEC the significant information it makes public in its home country, files with a stock exchange on which its securities are listed or distributes to its security holders. For a critique of Rule 12g3-2(b) in the current environment, see Edward F. Greene et al., *Hegemony or Deference: U.S. Disclosure Requirements in the International Capital Markets*, 50 BUS. LAW. 413 (1995) [hereinafter *Hegemony or Deference*].

A foreign company that is subject to the periodic reporting requirements of the Exchange Act must file an Annual Report on Form 20-F, 17 C.F.R. § 239.33 (1996), within six months of the end of its financial year, including audited financial statements reconciled to U.S. generally accepted accounting principles (U.S. GAAP) and Reports on Form 6-K, which must contain significant information the company makes public in its home country, files with a securities exchange or distributes to security holders.

²⁹ 17 C.F.R. § 239.33(a)(1)-(2).

³⁰ 17 C.F.R. § 239.33(b)(1).

³¹ 17 C.F.R. § 239.33(a)(3).

one annual report on Form 20-F and has filed all other required reports on a timely basis.³² If the issuer does not meet the float requirement, it will be eligible to use Form F-2 only if it has been subject to the periodic reporting requirements of the Exchange Act for at least thirty-six months and has filed all required reports on a timely basis.

The forms differ mainly in the extent to which they permit information about the issuer to be incorporated in the prospectus by reference to previous reports filed under the Exchange Act, Form F-3 being the most permissive in this regard. All the forms refer to Regulation S-X³³ under the Securities Act for the requirements regarding financial statements and to Form 20-F for the other disclosure requirements.

The prospectus to be used in a public offering must contain financial statements that have been audited on the basis of auditing *standards* that are generally accepted in the United States.³⁴ While these standards are in certain respects more rigorous than those applied elsewhere,³⁵ audits conducted by major international accounting firms generally will meet the U.S. requirements, as will audits conducted in accordance with the auditing standards of the United Kingdom.³⁶ The financial statements may be presented in accordance with accounting *principles* that are generally accepted in the issuer's home country, so long as the main differences between those principles and generally accepted accounting principles in the United States (U.S. GAAP) are explained and numerical reconciliations to U.S. GAAP of the principal income statement and balance sheet items are provided.³⁷

Although the financial statements may be prepared on the basis of other accounting principles, they must be similar in scope to those prepared in accordance with U.S. GAAP and therefore must include audited balance sheets as of the end of each of the issuer's two most

³² 17 C.F.R. § 239.32(b)(1)-(2) (1996).

³³ 17 C.F.R. § 239.32(b)(1)(i).

³⁴ 17 C.F.R. § 210 *et seq.* (1996).

³⁵ Rule 2-02(b) of Regulation S-X, 17 C.F.R. § 210.2-02(b), under the Securities Act requires the audit report to state that the audit was conducted in accordance with U.S. generally accepted auditing standards. While the rule contemplates that exceptions may be taken, it goes on to state that "nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit," *id.*, and the SEC has taken a hard line on this issue.

³⁶ Some procedures required by U.S. auditing standards, such as observation of physical inventory and other fieldwork, may not be customary in certain countries.

³⁷ The audit report contained in a registration statement for a U.K. company would typically state that the audit was "conducted in accordance with auditing standards generally accepted in the United Kingdom, which do not differ in any material respect from those in the United States."

recent financial years and audited statements of income, cash flows and changes in stockholders' equity for each of its three most recent financial years.³⁸ The financial statements must have an informational content substantially similar to that required by U.S. GAAP;³⁹ accord-

³⁸ 17 C.F.R. § 249.220f [Item 18(c)]. Numerical reconciliations generally are required for each year and for any interim periods for which a balance sheet, income statement and statement of cash flows is required (see the discussion below). Generally, this means that net income and cash flows must be reconciled for three years and shareholders' equity for two years. However, reconciliation of net income and cash flows for the earliest of the three years may be omitted if that information has not previously been included in a filing with the SEC. [Items 18(c)(2)(i)-(iii) of Form 20-F]. Moreover, if the statement of cash flows is prepared in accordance with International Accounting Standards No. 7, no reconciliation to U.S. GAAP is required. [Item 18(c)(2)(ii) of Form 20-F] Exceptions to the reconciliation requirement also apply in certain cases to financial statements that account for price level changes in certain ways or that are prepared for businesses acquired or to be acquired, for certain investee companies or for certain joint ventures. [Items 18(c)(2)(iv)-(vii) of Form 20-F].

The numerical reconciliations can reveal significant variations: for one U.K. company, BET, net income attributable to ordinary shareholders for the financial year ended March 31, 1991, was £150.0 million under generally accepted accounting principles in the United Kingdom (U.K. GAAP) but only £77.4 million under U.S. GAAP, while shareholders' equity at the financial year-end was only £472.8 million under U.K. GAAP but £1,585.4 million under U.S. GAAP; and for the first six months of the financial year ending March 31, 1992, net income attributable to ordinary shareholders under U.K. GAAP was £65.2 million, while there was a loss of £306.7 million under U.S. GAAP. The differences in these results were attributable principally to the treatment of goodwill arising as a result of acquisitions, which is written off against shareholders' reserves in the year of acquisition under U.K. GAAP but is recorded on the balance sheet as an intangible asset and amortized over its estimated useful life (at most forty years) under U.S. GAAP.

In the case of Daimler-Benz Aktiengesellschaft, net income for 1993 was DM 615 million under German GAAP while there was a net loss of DM 1,839 million under U.S. GAAP; stockholders' equity at December 31, 1993, was DM 18,145 million under German GAAP, but DM 26,281 million under U.S. GAAP. These differences resulted mainly from variances in the accounting treatment of provisions, reserves and valuation differences and, to a lesser extent, variances in accounting for business acquisitions, financial instruments, foreign currency translation and pensions and other postretirement benefits.

Little evidence exists to show that reconciliations to U.S. GAAP, even when they reveal differences of this magnitude, have any impact on the price at which securities are bought and sold in the market. In the absence of such an effect, it is unclear what purpose is being served by this requirement, compliance with which can be time consuming and costly. For a critique, see generally *Hegemony or Deference*, *supra* note 28.

³⁹ 17 C.F.R. § 210.3-19(a). Rule 3-19(b) of Regulation S-X, 17 C.F.R. § 210.3-19(b), under the Securities Act allows an issuer to provide audited financial statements as of the end of only the two financial years preceding the most recent financial year if (1) the audited balance sheet for the most recent financial year is not yet available; and (2) interim financial statements, which may be unaudited, as of a date within ten months of the effective date are provided. More stringent rules apply to U.S. companies. See 17 C.F.R. § 210.3-01(b)-(c).

Separate financial statements of certain businesses that have recently been acquired or that are to be acquired, and pro forma financial statements taking account of such acquisitions (and certain dispositions), are also required to be included in certain circumstances. See 17 C.F.R. §§ 210.3-05, .11-01. In addition, separate financial statements may also be required for certain unconsolidated subsidiaries and certain entities in which the company has a 50 percent or lesser interest. 17 C.F.R. § 210.3-09.

ingly, "segment" financial data must be provided – i.e., information with respect to revenues, operating profits, assets and capital expenditures broken down by industry segment and geographic area.⁴⁰ If a registration statement is declared effective more than ten months after the end of the issuer's most recent financial year, financial statements, which may be unaudited as of an interim date not more than ten months prior to the effective date of the registration statement, must be provided.⁴¹ Moreover, certain selected financial data must be included for each of the last five financial years, showing significant trends relating to revenues, income, liquidity, assets, liabilities, capital resources and dividends per common share.⁴²

In addition to the financial data, the prospectus must include a complete description of the issuer's business, an analysis by management of the issuer's financial condition, results of operations, or sources of liquidity and, where appropriate, a discussion of the most significant risks associated with an investment in the securities.

The description of the business must highlight, *inter alia*, any special characteristics of the issuer's operations or industry that could have a material impact on future performance and must identify any material country risks.⁴³ Examples of factors which might be discussed include dependence on one or a few major customers or suppliers (including suppliers of raw materials or providers of financing); existing or probable governmental regulation; expiration of material labor contracts, patents, trademarks, licenses, franchises, concessions or royalty agreements; unusual competitive conditions in the industry; the cyclic nature of the industry; and anticipated raw material or energy shortages to the extent management may not be able to secure a continuing source of supply.⁴⁴ The description must also explain any material variations between the percentage of revenues contributed by each industry segment and geographic area on the one hand and

If a foreign company's financial statements are prepared on the basis of U.S. GAAP, information for the earliest of these three years need not be provided for its initial U.S. public offering.

⁴⁰ 17 C.F.R. § 249.220f-18(b) (1996).

⁴¹ 17 C.F.R. § 249.220f-18(c)(3). See also FINANCIAL ACCOUNTING FOR SEGMENTS OF A BUSINESS ENTERPRISE, Statement of Financial Accounting Standards No. 14 (Fin. Accounting Standards Bd. 1976). The requirement to prepare full segment data does not apply to *pro rata* rights offerings to shareholders.

⁴² 17 C.F.R. § 210.3-19(c). Again, the requirements are more stringent for U.S. companies. See 17 C.F.R. § 210.3-01(e).

⁴³ 17 C.F.R. § 249.220f-8.

⁴⁴ 17 C.F.R. § 249.220f-1.

the corresponding percentages of operating profit contributed by the same segments on the other.⁴⁵

The management's discussion and analysis of financial condition and results of operations (MD&A) is intended to help investors understand the financial statements contained in the prospectus and to assess the sources, and probability of recurrence, of earnings or losses.⁴⁶ The discussion is generally divided into two parts. In the first part, the issuer must describe any unusual events or significant economic changes that materially affected the level of income and any trends or uncertainties that have had, or that the issuer reasonably expects will have, a material impact on net sales or revenues or on income from continuing operations.⁴⁷ If the financial statements show material changes in net sales or revenues, the issuer must indicate the extent to which such changes are attributable to changes in prices or to changes in the quantities of goods or services being sold. The issuer also must discuss the impact of inflation on its sales, revenues and income for the three most recent financial years. Where its consolidated financial statements reveal material changes from one year to the next in any line item, the issuer must explain the changes to the extent necessary to understand its business as a whole. In the second part, the issuer is required to describe material commitments for capital expenditures (and any material trends in such expenditure) and to identify its financial resources (and any deficiencies in them).⁴⁸ Any trends that are reasonably likely to result in material changes in the issuer's ability to finance its operations and capital expenditures also must be discussed.⁴⁹

Where appropriate, the prospectus also is required to contain, under an appropriate caption following the cover page or the summary (if included), a discussion of the principal factors that make the offering speculative or one of high risk. These factors may include, among other things, such matters as the absence of an operating history of the issuer, the absence of profitable operations in recent periods, the uncertain financial position of the issuer, the nature of the business in which the issuer is engaged or proposes to engage or the absence of a previous market for the shares. Material country risks

⁴⁵ 17 C.F.R. § 249.220f-1(b).

⁴⁶ 17 C.F.R. § 249.220f-1(a)(4).

⁴⁷ 17 C.F.R. § 249.220f-9.

⁴⁸ *Id.*

⁴⁹ 17 C.F.R. § 249.220f-9(a)-(b).

and other areas of vulnerability required to be disclosed in the business section are also generally highlighted in this discussion as well.⁵⁰

For an issuer that has not previously offered securities to the U.S. public, at least two months should be allowed for the preparation of a registration statement for filing with the SEC. The SEC staff generally will take one month to review the filing and to comment on the disclosure. During this period, offers may be made on the basis of the preliminary prospectus. Unless the SEC's comments are unusually extensive, one week should be allowed to prepare a response. After that, the registration statement can be declared effective, the underwriting agreement signed, the securities priced on the basis of indications of interest (or circles) obtained from investors during the marketing period, and sales confirmed. There is usually a period of three business days between pricing and closing. So approximately three and one-half months should be allowed from the time preparation of a registration statement begins until the closing date. Significantly less time is required for issuers that have previously offered securities to the public in the United States and have been filing periodic reports with the SEC under the Exchange Act. The registration fee is 1/29th of one percent of the aggregate public offering price of the shares.⁵¹

The SEC staff has been very helpful and flexible in assisting foreign issuers through the registration process. When necessary, the staff will review registration statements on an expedited basis and, when appropriate, will commence the review process in advance of a formal filing by accepting an informal, confidential submission, even if the registration statement is not yet complete. This practice emerged in the context of offerings where the timing was dictated by foreign requirements but is now available for most offerings by foreign companies.

⁵⁰ In addition to requiring the disclosure of material trends, the SEC encourages the inclusion of projections in the prospectus, provided that the assumptions on which they are based are disclosed and the projections themselves have a reasonable basis. 17 C.F.R. § 229.10(b) (1996). Moreover, Rule 175 under the Securities Act, 17 C.F.R. § 230.175, and Rule 3b-6 under the Exchange Act, 17 C.F.R. § 240.3b-6, provide safe harbors from the liability provisions of those acts for certain projections made in good faith. Nonetheless, issuers are generally advised not to include projections in their SEC filings, since in hindsight their reasonable basis may be challenged too readily. On October 19, 1994, the SEC issued a concept release soliciting comments on whether the safe harbor provisions are effective and, if not, whether they should be revised and how. Securities Act Release No. 7101, 59 Fed. Reg. 52,723 (1994).

⁵¹ 17 C.F.R. § 229.503(c).

b. Civil Liability and Due Diligence

The disclosure requirements are given their sting by the civil liabilities imposed by the securities laws, which give investors the right to rescind their purchases or to recover damages in certain circumstances. Section 11 of the Securities Act imposes strict liability on issuers for material misstatements or omissions in registration statements and liability, subject to a "due diligence" defense, on the directors, certain officers of the issuer and on the underwriters (or placement agents). Certain others, including auditors and other experts who consent to being named in the registration statement, also have section 11 liability.⁵² In addition, section 12(2) of the Securities Act⁵³ imposes liability, subject to a "reasonable care" defense, on any-

⁵² Securities Act § 77f.

⁵³ Section 11(a) of the Securities Act, 15 U.S.C. § 77k(a), states that any person who acquired a registered security may bring an action claiming that "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." *Id.* By its terms, section 11 of the Securities Act applies only in the context of a registered offering, and the plaintiff need not prove reliance (or even that he or she had received or read the prospectus), unless he or she bought the security after the issuer had made generally available to its security holders an earning statement covering a period of at least one year beginning after the effective date, but even then "reliance may be established without proof of the reading of the registration statement by such person."

The "due diligence" defense is contained in section 11(b)(3) of the Securities Act, 15 U.S.C. § 77k(b)(3), which provides that a defendant will not be liable for a material misstatement or omission under section 11 if he or she demonstrates that he or she had, after reasonable investigation, reasonable ground to believe and did believe that the statements contained in the registration statement were true and did not omit any facts required to make the statements not misleading. With respect to those statements in the registration statement that are made on the authority of a named expert who has consented to the mention of his name, the defendant need only establish that he or she had no reasonable ground to believe, and did not believe, that the statements were untrue or omitted facts required to make the statements not misleading. This more relaxed standard, which does not require a reasonable investigation, applies to the audited financial statements of the issuer, which are included in the registration statement on the authority of the issuer's independent accountants. A similar standard applies to statements made on the authority of a government official with responsibility for the matter in question, and to copies of or extracts from public official documents.

Section 11(f) of the Securities Act, 15 U.S.C. § 77k(f), provides that each person found liable under section 11 is jointly and severally liable with the others who could be found liable, but also provides that each may recover contribution from any person who, if sued separately, would also have been liable (except that contribution may not be recovered by a person guilty of fraudulent misrepresentation from a person not guilty of fraudulent misrepresentation).

Actions must be brought under section 11 within one (1) year after the discovery of the untrue statement or omission or after such discovery should have been made by the exercise of reasonable diligence. In no event may any action be brought more than three years after the security was first offered to the public. *See* Securities Act § 77m.

In addition, controlling shareholders (or other controlling persons) of anyone liable under section 11 of the Securities Act have liability under section 15 of the Securities Act, 15 U.S.C.

one who sells a security through any prospectus or oral communication containing a material misstatement or omission (the purchaser not knowing of such misstatement or omission).⁵⁴ Finally, Rule 10b-5⁵⁵ under the Exchange Act imposes liability on anyone who knowingly or recklessly makes an untrue statement of a material fact or omits to state a material fact in connection with the purchase or sale of a security.⁵⁶ The litigious nature of American society, the relative ease with which class actions can be brought on behalf of similarly-situated shareholders and the prevalence of contingent-fee arrangements combine to ensure that the threat of civil liability is an effective means of keeping U.S. disclosure standards high.⁵⁷

In order to establish a defense to claims under these liability provisions, the underwriters in a U.S. public offering engage in a "due

§ 77o, subject to a defense similar to, but more easily established than, the "due diligence" defense under section 11.

⁵⁴ Securities Act § 77l(2).

⁵⁵ Section 12(2) of the Securities Act, 15 U.S.C. § 77l(2), refers to a prospectus or oral communication that "includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements [therein], in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission)." *Id.* The U.S. Supreme Court has recently held that section 12(2) of the Securities Act only applies to public offerings. See *infra* Part II.B.3.a.

The courts have interpreted the word "seller" very broadly for purposes of section 12(2) of the Securities Act. In addition to embracing those who actually own and sell the security in question, the term has been construed to cover others with a financial interest in the sale who actively participate in its solicitation. Thus, investment banks acting as placement agents may be liable under section 12(2) of the Securities Act, as may directors, officers and principal shareholders who authorize the promotional efforts of the underwriters or placement agents, help prepare the offering documents or participate in meetings with salesmen or investors. See, e.g., *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 636 (3d Cir. 1989); *Wilson v. Saintine Exploration and Drilling Corp.*, 872 F.2d 1124 (2d Cir. 1989); *Crawford v. Glennis, Inc.*, 876 F.2d 507 (5th Cir. 1989).

Section 15 of the Securities Act, 15 U.S.C. § 77o, can also reach persons controlling those liable under section 12(2). The statute of limitations in actions under section 12(2) of the Securities Act is substantially the same as under section 11 of the Securities Act.

⁵⁶ 17 C.F.R. § 240.10b-5.

⁵⁷ Rule 10b-5, 17 C.F.R. § 240.10b-5, states that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

- (1) To employ any device, scheme or artifice to defraud,
- (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 17(a) of the Securities Act, 15 C.F.R. § 77q(a), and the state Blue Sky laws also provide for liability based on material misstatements or omissions in offering documents. These liability provisions are discussed briefly in Part II.B.3.a.

diligence" exercise, with the assistance of their legal advisors. Among other things, this generally involves (1) meetings with the principal executive and financial officers of the issuer to assess operating and financial results, identify any vulnerabilities and discuss prospects; (2) a review of all the issuer's significant documents, including minutes of the meetings of its shareholders and of its board of directors (and the board's more significant committees) for the past five years, and the issuer's material contracts; (3) independently checking the issuer's relationships with its principal suppliers and principal customers; (4) reviewing with the issuer's independent auditors the adequacy of the issuer's systems of accounting and control; and (5) visits to the issuer's principal facilities. It is generally a condition to the closing of a U.S. public offering that the legal advisors to the issuer and to the underwriters give letters to the underwriters confirming that nothing has come to their attention to cause them to believe that the registration statement or final prospectus contains a material misstatement or omission. To be in a position to give these letters, the legal advisors participate closely in the preparation of the prospectus and in the due diligence meetings with top management and, of course, do the bulk of the review of the issuer's significant documents. It is also customary for the company's independent auditors to deliver to the underwriters "cold comfort letters" in standard form when the underwriting agreement is signed and at closing.

The due diligence process is generally considered by foreign issuers to be burdensome, intrusive, time-consuming and expensive, but it is also acknowledged to be thorough and, perhaps, more likely to identify areas of business risk than the comparable exercises in other countries.

c. Restrictions on Publicity

The registration process and disclosure requirements are intended to ensure that potential investors are provided complete and accurate information about the issuer and to ensure that investment decisions are made on the basis of that information and are not influenced by advertising campaigns or other forms of publicity. The requirement that no "offer to sell" can be made until a registration statement has been filed prevents so-called "gun-jumping," which are efforts to "condition the market" in anticipation of an offering, and the prohibition on the use of written materials other than the preliminary prospectus after a registration statement has been filed precludes most forms of advertising, including newspaper, radio and television

campaigns, which are common in some countries. The only marketing efforts permitted in connection with a U.S. public offering, other than the distribution of the preliminary prospectus, are so-called "road shows," in which executive officers of the issuer and representatives of the managing underwriter meet potential investors and give oral presentations, perhaps with slides, about the issuer and the offering, and respond to questions.

The restrictions on publicity apply to the issuer at least from the time it "reaches an understanding" with the managing underwriter with respect to the offering, and may reach back to the time the issuer decides to proceed with a public offering. The investment bank selected to be the managing underwriter becomes subject to the restrictions when it begins to participate in the preparation of a registration statement or otherwise "reaches an understanding" with the issuer that it will become the managing underwriter. Other investment banks become subject to the restrictions when they are invited by the issuer or managing underwriter to participate, or when they seek to participate, in the offering. The restrictions on the issuer end when the distribution is over and securities dealers, whether or not they are participating in the distribution, are no longer required by the Securities Act to deliver prospectuses to purchasers. The restrictions on an individual securities dealer end when it has sold its allotment and is no longer required to deliver a prospectus.⁵⁸ The period during which a prospectus is required by the Securities Act to be delivered by securities dealers varies depending on a number of factors. If the issuer was subject to the periodic reporting requirements of the Exchange Act

⁵⁸ The SEC has resisted efforts by directors and officers to shift the risk of liability under the securities laws away from themselves and onto issuers through indemnification provisions. In the context of registered public offerings, the SEC has argued, and courts have agreed, that indemnification by an issuer of its directors and officers for violations of the securities laws is against public policy and thus unenforceable. See 17 C.F.R. § 229.512(h); *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F.2d 672, 676 (9th Cir. 1980), *cert. denied*, 452 U.S. 963 (1981); *In re Professional Fin. Management, Ltd.*, 683 F. Supp. 1283, 1285 (D. Minn. 1988); *Kilmartin v. H.C. Wainwright & Co.*, 637 F. Supp. 938, 940 (D. Mass. 1986); *Odette v. Shearson, Hammill & Co.*, 394 F. Supp. 946 (S.D.N.Y. 1975). While the SEC has not extended this position to indemnities given by an issuer to its underwriters for material misstatements or omissions in information not provided by the underwriters, several courts have held that standard indemnification provisions in underwriting agreements that do just this are also against public policy and unenforceable. See, e.g., *Eichenholtz v. Brennan*, 52 F.3d 478, 484 (3d Cir. 1995); *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970). On the other hand, a company may buy insurance for its directors and officers and underwriters may also insure themselves against securities law liabilities; these arrangements have not been effectively challenged. A company is required, however, to disclose in the registration statement for a public offering the premiums it pays for its directors and officers' insurance with respect to liabilities that could arise in connection with the registration.

prior to the filing of the registration statement, the period lasts until the dealer has distributed its allotment. If not, the period lasts until the later of the time when the dealer has disposed of its allotment and a time that varies as follows:

- if arrangements are made to have the shares listed on a U.S. securities exchange or quoted on NASDAQ when the offering commences, twenty-five days thereafter; and
- if no such arrangements are made, generally ninety days thereafter.⁵⁹

The SEC has recognized that conservative interpretations of the restrictions on publicity in connection with a U.S. public offering could have adverse effects on the quality of information that flows into the market, since the issuer and the underwriters may fear that press releases and research reports could be viewed as unlawful "offers to sell" the securities being distributed or as "prospectuses" that do not meet the disclosure requirements. To reconcile the conflicting objectives of restricting the "hype" surrounding an offering while at the same time encouraging the flow of important information into the market, the SEC has issued a number of releases and rules providing guidance.

In the releases, the SEC has encouraged issuers to continue to make factual information available to the public. The SEC has stated that issuers should:

- continue to advertise products and services;
- continue to send out customary quarterly, annual and other periodic reports to security holders;
- continue to publish proxy statements and send out dividend notices;
- continue to make announcements to the press with respect to factual business and financial developments; *i.e.*, receipt of a contract, the settlement of a strike, the opening of a plant or similar events of interest to the community in which the business operates;
- answer unsolicited telephone inquiries from security holders, financial analysts, the press and others concerning factual information;
- observe an "open door" policy in responding to unsolicited inquiries concerning factual matters from securities analysts, financial analysts, security holders and participants in the communications field who have a legitimate interest in the corporation's affairs; and
- continue to hold previously scheduled shareholder meetings and to answer shareholders' inquiries at shareholder meetings relating to factual matters.

The SEC has warned, however, that the issuance of forecasts, projections, predictions or opinions concerning value should be avoided.⁶⁰

⁵⁹ Securities Act Release No. 5009, 34 Fed. Reg. 16,870, at 16,870-71 (Oct. 7, 1969).

⁶⁰ The general requirement that securities dealers, whether or not they are participating in the offering, deliver prospectuses to purchasers for a certain period is contained in sections 4(3)

While the releases generally deal with corporate communications that are not related to an offering, the SEC also has recognized that the intention to make a public offering is itself an important item of information which the issuer should be permitted to announce. Rule 135 under the Securities Act permits such an announcement before the filing of a registration statement if the announcement is limited to certain specified information, including the name of the issuer, the title, the amount and basic terms of the securities, the anticipated time of the offering and the manner and purpose of the offering. Rule 134 under the Securities Act permits a post-filing announcement if it is limited to certain specified information, including the name of the issuer, the title and amount of the securities being offered, the general nature of the issuer's business and the names of the managing underwriters.

Research reports published by a broker-dealer that is participating in an offering are dealt with in Rule 138⁶¹ and Rule 139⁶² under the Securities Act. Rule 138 permits the distribution by a broker-dealer in the regular course of its business of information, opinions or recommendations as to an issuer's common stock if non-convertible preferred stock or debt securities are being offered and *vice versa*, but only if the issuer is eligible to file a registration statement on Forms F-2 or S-2 or Forms F-3 or S-3 and proposes to file, has filed or has an effective registration statement under the Securities Act relating to the securities being offered.

Rule 139(b) applies to industry-wide research reports and permits the distribution by a broker-dealer of any information, opinion or rec-

and 5(b) of the Securities Act, 15 U.S.C. §§ 77d(3), e(b). Rule 174 under the Securities Act, 17 C.F.R. § 230.174 (1996), contains the specific rules regarding the length of the period. The requirement that securities dealers deliver prospectuses even after a distribution is completed derives from a Congressional desire to draw a bright and certain line between distributions and secondary trading and to prevent securities dealers from claiming that securities acquired in the process of distribution were acquired after such process had ended. See LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION*, at 388-89 (3d ed. 1989).

An offering is deemed to commence for purposes of determining the period in question when sales can be confirmed (*i.e.*, after the registration statement is declared effective, the securities are priced and the underwriting agreement is signed).

It must be kept in mind that restrictions on publicity also apply under Rule 10b-6 under the Exchange Act, 17 C.F.R. § 240.10b-6, but for a slightly different period. For the discussion of Rule 10b-6, see *infra* Part II.A.2.a.

⁶¹ Securities Act Release No. 5180, 36 Fed. Reg. 16,506, at 16,507 (Aug. 16, 1971). Other releases covering similar ground include Securities Act Release No. 3844, 22 Fed. Reg. 8,359 (Oct. 8, 1957), Securities Act Release No. 4697, 29 Fed. Reg. 7,317 (May 28, 1964) and Securities Act Release No. 5009, 34 Fed. Reg. 16,870 (Oct. 7, 1969).

⁶² 17 C.F.R. § 230.138 (1996).

ommendation about an issuer that is subject to the periodic reporting requirements of the Exchange Act and proposes to file, has filed or has an effective registration statement under the Securities Act, if the information, opinion or recommendation:

- is contained in a publication which is distributed with reasonable regularity in the normal course of the broker-dealer's business and includes similar information, opinions or recommendations with respect to a substantial number of companies in the issuer's industry, or contains a comprehensive list of securities currently recommended by such broker-dealer;
- is given no materially greater space or prominence in such publication than that given to other securities or issuers; and
- in the case of an opinion or recommendation, is not more favorable with respect to the issuer or any class of its securities than the opinion or recommendation published by the broker-dealer in its last publication relating to the issuer or its securities prior to the commencement of the broker-dealer's participation in the distribution.⁶³

Rules 139(a)(1) and (2) relate to company-specific research reports. Rule 139(a)(1) permits the distribution by a broker-dealer of any information, opinion or recommendation about an issuer that is eligible to use Forms F-3 or S-3 and proposes to file, has filed or has an effective registration statement under the Securities Act, so long as the information, opinion or recommendation is contained in a publication that is distributed with reasonable regularity in the normal course of the broker-dealer's business. Recently adopted Rule 139(a)(2) provides a similar safe harbor for publications relating to a foreign private issuer that meets the eligibility requirements of Form F-3 (except for the periodic reporting requirements), so long as the issuer's securities have been traded on a "designated offshore securities market"⁶⁴ for at least twelve months and the publication is distributed with reasonable regularity in the normal course of the broker-dealer's business. The effect of this new rule is to permit the distribution in the United States of research reports relating to many foreign companies, including, in particular, those that are not yet subject to the periodic reporting re-

⁶³ 17 C.F.R. § 230.139 (1996).

⁶⁴ Special rules apply to projections for purposes of Rule 139(b), 17 C.F.R. § 230.139(b). For projections to be included in a publication, they must have been published previously on a regular basis, they must be included with respect to either a substantial number of companies in the issuer's industry or all companies in a comprehensive list which is contained in the publication (and must cover the same periods with respect to such companies as with respect to the issuer), and they must be no more favorable to the issuer than those contained in the most recent publication in which projections were included. See 17 C.F.R. § 230.139(2).

quirements of the Exchange Act, notwithstanding their intention to conduct a public offering in the United States.⁶⁵

2. Restrictions on Market Activities

The SEC has promulgated a number of detailed rules intended to prevent those with an interest in the success of a distribution from manipulating, through their activities in the market, the price of the securities being distributed. Rules 10b-6, 10b-7 and 10b-8 under the Exchange Act are the most significant of these rules when the effect of U.S. laws and regulations on the structure and conduct of a global equity offering is being considered.

a. Rule 10b-6

Under Rule 10b-6⁶⁶ of the Exchange Act, it is unlawful for an issuer, a selling stockholder, an underwriter or a prospective underwriter in a U.S. distribution, or a broker, dealer or other person who

⁶⁵ As specified in Regulation S under the Securities Act, 17 C.F.R. § 230.901-904, "designated offshore securities markets" are the Eurobond market regulated by the Association of International Bond Dealers, the Amsterdam Stock Exchange, the Australian Stock Exchange Limited, the Bourse de Bruxelles, the Frankfurt Stock Exchange, the Stock Exchange of Hong Kong Limited, the International Stock Exchange of the United Kingdom and the Republic of Ireland, the Johannesburg Stock Exchange, the Bourse de Luxembourg, the Borsa Valori di Milano, the Montreal Stock Exchange, the Bourse de Paris, the Stockholm Stock Exchange, the Tokyo Stock Exchange, the Toronto Stock Exchange, the Vancouver Stock Exchange and the Zurich Stock Exchange. See 17 C.F.R. § 230.902(a)(1).

Regulation S under the Securities Act also confers authority on the SEC to designate such other offshore securities markets as it considers appropriate. The attributes to be considered by the SEC when deciding whether to designate a market include organization under foreign law, association with a generally recognized community of financial intermediaries, oversight by a governmental or self-regulatory body, oversight standards set by an existing body of law, reporting of securities transactions on a regular basis to a governmental or self-regulatory body, a system for exchange of price quotations through common communications media and an organized clearance and settlement system. 17 C.F.R. § 230.902(a)(2). Thus far, the SEC has designated SEAQ International (June 14, 1990), the Helsinki Stock Exchange (July 7, 1990), the Mexican Stock Exchange (February 15, 1991), the Oslo Stock Exchange (December 13, 1991), the Alberta Stock Exchange (March 9, 1993) and the Istanbul Stock Exchange (October 26, 1993).

⁶⁶ For purposes of Rule 139(a) under the Securities Act, 17 C.F.R. § 230.139(1), a research report has not been distributed with "reasonable regularity" if it contains information, an opinion or a recommendation concerning a company with respect to which a broker or dealer currently is not publishing research. *Id.* No similar caveat is made with respect to Rule 139(b) under the Securities Act, 17 C.F.R. § 230.139(b).

The SEC has indicated that, for purposes of Rule 10b-6 under the Exchange Act, 17 C.F.R. § 240.10b-6, a research report that otherwise meets the requirements of Rule 139(a) under the Securities Act will generally not be permitted if it contains an opinion or recommendation more favorable to the issuer (or the securities in question) than the one contained in the broker or dealer's previous report. See *infra* note 68.

has agreed to participate, or is participating in, a U.S. distribution (or certain of their affiliates), to bid for or purchase any security which is the subject of the distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right, until after it has completed its participation in the distribution. In order to avoid the need for difficult case-by-case line-drawing exercises, Rule 10b-6 prohibits all bids for and purchases of the relevant securities, without regard to whether such bids or purchases are made for manipulative purposes. The flexibility to continue ordinary trading activities, to the extent considered appropriate by the SEC, is provided by a number of exceptions to these prohibitions.

Rule 10b-6's prohibition on attempts to induce purchases of securities has the effect of restricting publicity in connection with a distribution, including the dissemination of information by issuers and the publishing of research reports by broker-dealers. While Rule 10b-6 does not itself contain any exceptions to this restriction, the activities permitted by the SEC's releases on corporate communications, by Rules 134 and 135 under the Securities Act and, in most cases, by Rules 138 and 139 under the Securities Act should be permitted.⁶⁷

The period during which the restrictions of Rule 10b-6 apply is set out, somewhat obliquely, in the definitions. A securities dealer becomes subject to the restrictions: (1) as an "underwriter" when it has agreed with the issuer or selling stockholder to purchase securities for distribution, to distribute securities for or on behalf of the issuer or selling stockholder or to manage or supervise a distribution for or on behalf of the issuer or selling stockholder;⁶⁸ and (2) as a "prospective underwriter" when it has decided to submit a bid to become an under-

⁶⁷ 17 C.F.R. § 240.10b-6.

⁶⁸ Some caution is warranted here. Although one might expect the rules on publicity that apply to public offerings of securities under the Securities Act to be carried over into 17 C.F.R. § 240.10b-6 [hereinafter Rule 10b-6], which was designed mainly for public offerings, that is not entirely the case. When the SEC adopted amendments to 17 C.F.R. § 230.139 [hereinafter Rule 139], in 1984, it highlighted the differences between the purposes of the registration requirements of the Securities Act and Rule 10b-6:

Rule 139 and Rule 10b-6 are designed to serve different purposes. Rule 139 provides a safe harbor from the strict liability provisions of the Securities Act, which assure that investors receive prospectus disclosure. In contrast, Rule 10b-6 is intended to assure that distributions of securities are free of the market effects of bids, purchases or inducements to purchase by those who have an interest in the success of a distribution. The prohibition on inducements to purchase is an essential element of Rule 10b-6. Because inducements to purchase, such as improved recommendations, can be an effective and inexpensive method of facilitating the distribution of securities, the [SEC] staff is taking a no-action position that . . . is narrower than the safe harbor provided by Rule 139.

writer (pursuant to an invitation for bids) or when it has reached an understanding with an issuer or selling stockholder that it will become an underwriter.⁶⁹ The issuer or selling stockholder becomes subject to the restrictions when it decides to go forward with the distribution, even if it has yet to retain underwriters.⁷⁰ The restrictions end when the person in question has completed its participation in the distribution. In the case of an issuer or selling stockholder, this is deemed to occur when the distribution as a whole has been completed; in the case of an underwriter, when it has distributed its allotment, including all other securities of the same class acquired in connection with the distribution, and any stabilization arrangements and trading restrictions with respect to the distribution have been terminated; and in the case of any other person (such as a securities dealer acting not as an underwriter but as a member of a selling group), when it has distributed its allotment.⁷¹ The period during which publicity and other activities are restricted under Rule 10b-6 is thus not quite coextensive with the period during which publicity is restricted by virtue of the registration requirements of the Securities Act.

Rule 10b-6 contains a number of exceptions for activities that are not engaged in for the purpose of creating actual, or apparent, active trading in any security (or raising its price). Of these, the most significant is the exception that permits an underwriter, prospective underwriter or securities dealer to bid for or purchase shares, or rights to acquire shares, prior to a "cooling-off" period that begins two (or in some cases nine) business days before the commencement of offers or sales of the securities being distributed.⁷² For this purpose, the com-

Accordingly, the SEC staff announced that it would not recommend that the SEC take enforcement action under Rule 10b-6 "with respect to a research report that is (1) within Rule 138 or paragraph (b) of Rule 139 or (2) within paragraph (a) of Rule 139 and does not contain a recommendation or earnings forecast more favorable than that previously disseminated by the firm." Exchange Act Release No. 21332, 49 Fed. Reg. 37,569, at 37,572 (1984). (The SEC staff noted, however, that on "infrequent occasions" a favorable revision of earnings forecasts might not be an inappropriate inducement if based on newly released information regarding the issuer. Whether such a revision is permissible "requires an analysis of all of the facts and circumstances surrounding the distribution." *Id.* at 37,572 n. 25.) Moreover, when the SEC adopted amendments to Rule 10b-6 in 1987 it stated that even these permissible research reports could constitute solicitations of brokerage transactions (*e.g.*, if the research report is focused on the issuer whose securities are being distributed and is directed at particular customers by a broker-dealer's sales personnel) and thus concluded that the distribution of such reports by a broker, if made after the "cooling-off" period discussed below in this Part II.A.2(a), could violate Rule 10b-6. Exchange Act Release No. 24003, 52 Fed. Reg. 2,994, at 2,995 n.17 (Jan. 16, 1987).

⁶⁹ 17 C.F.R. § 240.10b-6(c)(1).

⁷⁰ 17 C.F.R. § 240.10b-6(c)(2).

⁷¹ Exchange Act Release No. 22510, 50 Fed. Reg. 42,716, at 42,721 n.44 (Oct. 10, 1985).

⁷² 17 C.F.R. § 240.10b-6(c).

mencement of offers or sales is considered to occur when the underwriters are permitted to confirm sales (*i.e.*, after the registration statement is declared effective, the underwriting agreement is signed and the securities are priced). The rationale for this exception is that the effect of any bids or purchases on the price of the security being distributed should be dissipated during the cooling-off period. It is important to recognize that this exception applies only to bids and purchases and not to attempts to induce purchases, since the effect of publicity cannot be expected to dissipate during the cooling-off period.

Other significant exceptions include:

- offers to sell or the solicitations of offers to buy the securities being distributed, or securities or rights offered as principal by the person making the offer to sell or the solicitation of the offers to buy;⁷³
- transactions with the issuer or among participants in the distribution effected otherwise than on a securities exchange;⁷⁴
- unsolicited privately negotiated purchases, each involving at least a block of the securities in question, that are not effected from or through a broker or dealer;⁷⁵ and
- brokerage transactions not involving solicitation of the customer's order (or involving the solicitation of the customer's order prior to the commencement of the applicable cooling-off period).⁷⁶

These exceptions are designed either to facilitate transactions that are essential to the smooth conduct of the offering, or to permit transactions that, in the absence of willful misconduct, cannot be expected to affect the price of the security being distributed.

b. Rule 10b-7

Another important exception to the restrictions of Rule 10b-6 under the Exchange Act is that permitting stabilizing transactions conducted in accordance with Rule 10b-7⁷⁷ under the Exchange Act. Stabilization means placing a bid or making a purchase for the purpose of

⁷³ 17 C.F.R. § 240.10b-6(a)(xi). The "cooling-off" period will be two business days if the shares in question have a price of \$5.00 per share or more and if there is a public float of 400,000 or more shares; in other cases the cooling-off period will be nine days. 17 C.F.R. § 240.10b-6(a)(xii). contains a similar exception for bids and purchases by the issuer.

⁷⁴ 17 C.F.R. § 240.10b-6(a)(vi). This permits the underwriters to offer and sell the securities being distributed and also allows them to offer and sell any other securities they own or acquire as principal.

⁷⁵ 17 C.F.R. § 240.10b-6(a)(i). This allows the underwriters to transfer shares among themselves, for example pursuant to the orderly marketing arrangements discussed in Part III.A.3.a and to purchase shares from the issuer pursuant to the underwriting agreement (including pursuant to the exercise of any "over-allotment option" discussed in Part II.A.2.b).

⁷⁶ 17 C.F.R. § 240.10b-6(a)(ii).

⁷⁷ 17 C.F.R. § 240.10b-6(a)(v).

pegging, fixing or stabilizing the price of any security.⁷⁸ The purpose of stabilization in a distribution of securities is to give comfort to potential purchasers in the offering that the price of the security in the after-market will not be significantly below the public offering price, thereby facilitating a smooth transition from the primary phase of the distribution to orderly secondary market trading. Since stabilization involves almost by definition the creation of a somewhat false market, it is subject to detailed regulation.

The general requirement of Rule 10b-7 is that no stabilizing bid or purchase may be made "except for the purpose of preventing or retarding a decline in the open market price of a security."⁷⁹ This general requirement is implemented through a number of detailed rules:

(1) Except as provided in paragraphs (2), (3) and (4) of this section, no person shall (a) begin to stabilize a security at a price higher than the highest current independent bid price for the security being distributed exists at the time stabilizing is initiated, stabilizing may be initiated at a price not in excess of the public offering price.⁸⁰

(2) If the principal market for a security is a securities exchange and stabilizing is initiated on such exchange, the initial stabilizing bid or purchase may be made at a price not in excess of the last independent sale price on such exchange, even if it is above the highest current independent bid price.⁸¹

(3) If a stabilizing bid or purchase is made before the initial public offering price of the security to be distributed is determined, and such offering price is higher than such stabilizing bid or purchase price, then stabilizing may be resumed after determination of such public offering price at the price at which it could then be initiated.⁸²

(4) A stabilizing bid lawful when made may be continuously maintained or reduced irrespective of changes in the independent bid, asked price or sale price of the security.⁸³

(5) No person shall stabilize a security at a price above the price at which such security is currently being distributed.⁸⁴

⁷⁸ 17 C.F.R. § 240.10b-7.

⁷⁹ 17 C.F.R. § 240.10b-7(b)(3) (permitting stabilizing to facilitate a distribution).

⁸⁰ 17 C.F.R. § 240.10b-7(c).

⁸¹ 17 C.F.R. § 240.10b-7(j)(1). The stabilizing price may be raised, however, if no stabilizing purchases are made for three consecutive business days, in which case a stabilizing bid may be entered at the price at which stabilizing could then be initiated, even if it is higher than that of the last stabilizing bid. *See* 17 C.F.R. § 240.10b-7(j)(4).

⁸² 17 C.F.R. § 240.10b-7(j)(2).

⁸³ 17 C.F.R. § 240.10b-7(j)(3).

⁸⁴ 17 C.F.R. § 240.10b-7(j)(4). No stabilizing may be conducted, however, at a price higher than the price at which stabilizing is being conducted in the principal market for the security.

Two other highly technical rules are of particular significance in the context of a global equity offering. The first provides that, when a security is traded in more than one market, stabilizing may not be initiated at a price that would be unlawful in the market which is the principal market for the security in the United States open for trading when stabilizing is initiated. Moreover, if the principal market for the security in the United States is a securities exchange, stabilizing may be initiated in any market after the close of such exchange only at the price at which stabilizing could have been initiated on such exchange when it closed.⁸⁵

The second rule provides that a stabilizing bid may not be placed on a securities exchange before the opening quotations for the security on that exchange are available, unless stabilizing is already being conducted lawfully on that exchange at that price. A stabilizing bid may be placed, however, immediately prior to the opening of a securities exchange at a price no higher than the price at which stabilizing could have been initiated on that exchange at its previous close.⁸⁶

The general effect of these rules is to permit stabilizing bids to be initiated at a price no higher than the last independent bid or sale price. Once entered, a stabilizing bid may be maintained regardless of market developments but (subject to several limited exceptions) may not be raised and must be reduced if the price at which the security is then being distributed is lower. When determining the level at which stabilizing bids may be initiated, reference must be made to the latest prices quoted in the principal market for the securities in the United States.⁸⁷

It is customary in U.S. public offerings of shares for stabilization to be accompanied by "over-allotment." The managing underwriter in a U.S. public offering is typically given the authority to over-allot (*i.e.*, to offer and sell more shares than the underwriters have contracted to purchase from the issuer on a "firm" basis.) By over-allotting shares, the managing underwriter can ensure that there are purchasers ready to accept resales of shares that the underwriters purchase in the market as a result of stabilization. In order to protect the underwriters in circumstances where the shares purchased as a result of stabilization are not sufficient to cover the short position created through over-allotments, the issuer typically will grant them a so-called "over-allotment option." The over-allotment option generally

⁸⁵ 17 C.F.R. § 240.10b-7(j)(5).

⁸⁶ 17 C.F.R. § 240.10b-7(h).

⁸⁷ 17 C.F.R. § 240.10b-7(i).

allows the underwriters, for a period beginning with the execution of the underwriting agreement and ending thirty days after the closing date, to purchase from the issuer, at the public offering price less the commissions provided for in the underwriting agreement, up to fifteen percent of the shares being offered but solely for the purpose of covering any over-allotments that are made on behalf of the syndicate by the managing underwriter. If the offering is a success, and there are no stabilizing purchases in the market, the managing underwriter will exercise the option on behalf of the syndicate for that number of shares which have been over-allotted, and the syndicate will earn the same commissions on the additional shares as it earned on the so-called "firm shares." If, however, stabilizing activities result in purchases in the market, the over-allotment option will generally be exercised only to cover the syndicate's short position that remains after the shares purchased through stabilization have first been applied for that purpose. Of course, when shares purchased through stabilization are used to cover over-allotments, the commissions associated with the exercise of the over-allotment option are foregone since in most cases the shares will have been purchased in the market at, or slightly below, the public offering price and not, as would be the case if the over-allotment option were exercised, at the public offering price less the commissions. Any profits and losses arising out of stabilization activities are typically allocated among the underwriters *pro rata* to their underwriting commitments, subject to agreed limits.

c. Rule 10b-8

Rule 10b-8⁸⁸ under the Exchange Act applies when shares are being distributed in the United States in an underwritten rights offering. When a company offers shares through the *pro rata* distribution of negotiable rights to existing shareholders, it will often enter into an arrangement with one or more investment banks to eliminate its exposure to market movements during the subscription period. The issuer's exposure arises because holders of rights will generally exercise them, if at all, as close to the expiration date of the rights as possible. This results in a risk to the issuer: if the price of the underlying shares falls below the rights exercise price prior to the expiration date, the offering will fail. In order to eliminate this risk, an issuer may enter

⁸⁸ This general statement of the effect of the stabilization rules and the detailed description of the rules set forth above is subject to a number of exceptions that are beyond the scope of this article. In addition, there are a number of disclosure and record-keeping requirements. See 17 C.F.R. § 240.10b-7(k)-(l).

into a standby underwriting agreement in which one or more investment banks agree to purchase the shares underlying the rights at the exercise price if not all the rights are exercised. In order to manage the risk they assume through the standby underwriting agreement, the investment banks will typically sell shares short in the market and buy rights to cover their short position. Rule 10b-8 is designed to prevent these risk management activities from affecting the market price of the shares and the rights. The rule aims to maintain the integrity of the offering by setting an upper limit on the price at which the shares being offered may be sold and the price at which the rights may be purchased, in either case by any person participating in the distribution, in particular the standby underwriters.

The upper limit Rule 10b-8 imposes on the price for offers and sales of shares underlying the rights (Lay-Off Price) is the price set by the manager of the rights offering or derived from a formula to which the manager has agreed.⁸⁹ The Lay-Off Price may be raised only once during each day and is subject to limitations related to the market price of the shares.⁹⁰ If the principal market for the shares is a securities exchange, the Lay-Off Price, when set, may not exceed the higher of (1) the price at which the shares last traded on that exchange or (2) the current asked price on that exchange (in each case plus a commission).⁹¹ Otherwise, the Lay-Off Price, when set, may not exceed the highest price then being offered by a securities dealer not participating in the distribution to other securities dealers (plus a concession).⁹²

Rule 10b-8 also places restrictions on the ability of participants in the distribution to purchase rights, though only when the price of the underlying security is being stabilized, or when the participants have purchased more rights than they have sold shares short (*i.e.*, when they have a net "long" position). Under such circumstances, purchases of rights become subject to the following restrictions, which are similar in concept to the restrictions on stabilization contained in Rule 10b-7 and apply until the net long position has been eliminated.⁹³

⁸⁹ 17 C.F.R. § 240.10b-8.

⁹⁰ 17 C.F.R. § 240.10b-8(b) (imposing price restrictions on distributions through rights).

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* These restrictions do not apply to (i) privately negotiated transactions effected otherwise than on a securities exchange among persons participating in the distribution; (ii) odd-lot transactions and round-lot transactions that offset odd-lot transactions previously or simultaneously executed or reasonably anticipated in the usual course of business by a person who acts in the capacity of an odd-lot dealer; (iii) brokerage transactions not involving solicitation of the customer's order; (iv) offers and sales at the subscription price to holders of rights; (v) offers and

(1) Not more than one bid to purchase rights shall be maintained in any one market at the same price at the same time.⁹⁴

(2) No bid for, or purchase of, rights shall be made until an independent market for such rights has been established.⁹⁵

(3) The initial bid for, or purchase of, rights shall not be made at a price higher than the highest current independent bid price in the principal market for such rights in the United States open for trading at the time when such bid or purchase is made.⁹⁶

(4) A bid which is lawful when initiated may be continuously maintained or reduced irrespective of changes in the independent bid, asked price or sale price of such right.⁹⁷

sales to members of any group or class entitled to a special price; or (vi) offers and sales of securities owned beneficially on the record date for the rights or acquired through the exercise of rights issued in respect of securities so owned. 17 C.F.R. § 240.10b-8(c).

⁹⁴ 17 C.F.R. § 240.10b-8(d). These restrictions do not apply to the purchase of rights (i) by or through the manager of the distributing group in a privately negotiated transaction effected neither on a securities exchange nor from or through a broker or dealer not participating in the distribution; (ii) by an underwriter or dealer directly from a retail customer in an unsolicited privately negotiated transaction not effected on a securities exchange; (iii) in stabilizing transactions in the rights effected in compliance with Rule 10b-7, 17 C.F.R. § 240.10b-7; (iv) in a privately negotiated transaction, otherwise than on a securities exchange, between persons participating in the distribution acting as principal; (v) by a person registered as an odd-lot dealer in such rights on a national securities exchange who is acting in such capacity in effecting such transactions; (vi) to complete a sale of rights to a retail customer made under circumstances indicating the purchaser intends to exercise such rights; (vii) by the issuer of the rights from the security holder to whom they were originally issued if (1) such rights are not resold, (2) the securities which can be acquired with such rights are not sold by such issuer during the rights period and (3) such issuer has no agreement to sell the unsubscribed shares or to compensate, directly or indirectly, any person for obtaining exercises of rights except by a security holder to whom they were originally issued; (viii) by a dealer-manager, provided that: (1) such dealer-manager has no arrangement with the issuer of the rights to purchase any part of the securities remaining unsubscribed after the rights expire, (2) such dealer-manager purchases such rights for the purpose of supplying the rights or the security which can be acquired with such rights, to soliciting dealers (provided, however, that such dealer-manager may not purchase more rights than are necessary to acquire the securities or rights which he reasonably expects to be able to sell to soliciting dealers within five business days after the expiration of the rights) and (3) such dealer-manager purchases such rights in accordance with most of the restrictions set out in the text. The term "soliciting dealer" as used above means a person entitled to receive, directly or indirectly, from an issuer of rights, compensation for obtaining exercises of such rights; and the term "dealer-manager" means a person who manages a distribution involving soliciting dealers. 17 C.F.R. § 240.10b-8(d)(8).

⁹⁵ 17 C.F.R. § 240.10b-8(d)(1). However, more than one bid at the same price may be maintained otherwise than on a securities exchange.

⁹⁶ 17 C.F.R. § 240.10b-8(d)(2). However, if trading has not begun on the business day on which trading in the rights could lawfully have begun, and the theoretical value of such rights can be ascertained by a generally accepted mathematical formula, then the right may be purchased thereafter at a price not in excess of such theoretical value.

⁹⁷ 17 C.F.R. § 240.10b-8(d)(3). However, if the principal market for the rights is a securities exchange in the United States open for trading at such time, the initial bid or purchase may be made in any market at the last independent sale price on such exchange if such right has been traded on such exchange on such day or on the preceding business day, and the current asked

The price at which a bid for, or purchase of, rights is made may be increased only if (1) no rights have been purchased, as principal, for a full business day, by the distribution participants; or (2) the independent bid price in the principal market for the rights in the United States has exceeded such price for a full business day; *provided, however*, that the increased bid or purchase price in any such case shall meet the requirements which would be applicable if it were the initial bid or purchase (*i.e.*, the requirements set out above in paragraph 3).⁹⁸ Purchases of rights must be limited to those necessary to acquire that number of underlying shares which the distribution participants have previously sold and reasonably expect to be able to sell within five business days after the expiration of the rights.⁹⁹

These limitations on sales of shares and purchases of rights have been criticized as unnecessary and economically inefficient.¹⁰⁰ Underwriters of rights distributions, if they are risk averse, will want to stay "flat" with respect to the shares underlying the rights: they would ideally want to acquire a number of rights corresponding exactly to the number of shares they sell. Because of the dynamic quality of the securities trading markets, however, temporary deviations from a perfectly flat position are inevitable. The inability of the underwriters in a rights offering to go even slightly long on the rights without triggering these burdensome restrictions effectively forces them to favor a shorter position than would otherwise be the case. Consideration should thus be given to eliminating the rules that prevent underwriters that are long on the rights from following the market up when they purchase rights (*i.e.*, the underwriters should not have to be out of the market for a full business day or have to wait for a time when the independent bid price has exceeded for a full business day the price at which the underwriters had been purchasing rights). Consideration should also be given to eliminating the restriction that prevents the

price on such exchange is equal to or above such sale price. Moreover, if the initial bid or purchase is made after the close of such exchange, the initial bid or purchase may be made at the price at which such initial bid or purchase could have been made on such exchange at the close thereof unless the bidder or purchaser knows or has reason to know, that other persons have offered or sold such right at a lower price after such close.

Because this rule refers only to markets and securities exchanges in the United States, it has caused technical problems in global offerings of shares in foreign companies. *See infra* Part III.

⁹⁸ 17 C.F.R. § 240.10b-8(d)(4). If the bidding for and purchasing of rights is discontinued for any reason, bidding for or purchasing of rights may not be resumed except at a price not exceeding the lower of the two following prices: (i) the last price at which a lawful bid or purchase was made or (ii) the price which would be applicable if it were the initial bid or purchase.

⁹⁹ 17 C.F.R. § 240.10b-8(d).

¹⁰⁰ *See* Letter from the American Bar Association to the Securities and Exchange Commission (Oct. 20, 1994) (regarding File No. S7-14-94).

Lay-Off Price from being increased more than once a day; it is difficult to see what purpose this serves.

On April 11, 1996, the SEC issued a release proposing for public comment, Regulation M, which would govern market activities of issuers, selling securityholders, underwriters, and other participants in securities offerings in place of the Trading rules and certain related rules.¹⁰¹ The release posed over 68 specific questions and invited general comment; comments were required to be submitted to the SEC by June 17, 1996.

Proposed Regulation M consists of several new rules that would regulate the market activities currently regulated by the Trading Rules. Proposed Rules 101 and 102, together analogous to Rule 10b-6, would regulate bids for and purchases of securities in distribution and certain related securities by participants in the distribution and certain of their affiliates. Proposed Rule 101 would regulate bids and purchases by underwriters, prospective underwriters and other distribution participants, and affiliates of such persons that fall within the proposed definition of "affiliate purchaser." Proposed Rule 102 would regulate bids and purchases by issuers, selling securityholders and their affiliated purchasers. Proposed Rule 104, analogous to Rule 10b-7, would regulate stabilization to facilitate an offering. Rule 10b-8 would be rescinded and has no counterpart in Proposed Rule M. If Regulation M is adopted, exemptions granted and no-action positions taken by the SEC in connection with the Trading Rules would no longer be in effect.

Proposed Rules 101 and 102, unlike Rule 10b-6, would apply different restrictions to issuers, selling securityholders, and their affiliated purchasers, on the one hand, and underwriters, other distribution participants and their affiliated purchasers, on the other. In particular, a number of the exemptions proposed to be available to underwriters, other distribution participants and their affiliated purchasers would not be available to issuers, selling securityholders, and their affiliated purchasers. Moreover, under Regulation M, the more restrictive provisions imposed on issuers and selling securityholders would also apply in almost all cases to their affiliates that are dealers, brokers, or otherwise engaged in securities-related activities.

Among the principle changes to the existing regulatory scheme that Regulation M would effect are the following:

- Eliminating restrictions currently imposed by Rule 10b-6 on underwriters and other distribution participants in connection with distribu-

¹⁰¹ See SEC Release No. 33-7282; 34-37094 (April 11, 1996).

tions of actively-traded securities, which is a term given a precise definition in the proposed regulation. Issuers and selling securityholders, however, would remain subject to restrictions with respect to such securities.

- Reducing the duration of restrictions on bids for and purchases of securities subject to such restrictions and focusing the restricted period on the pricing of the offering.
- Eliminating restrictions currently imposed by Rule 10b-6 on derivative securities that are not used to determine the price of the security in distribution. However, derivative and other securities that are used to determine the price of the security in distribution would be subject to such regulation even if not currently regulated under Rule 10b-6.
- Narrowing restrictions currently imposed by Rule 10b-6 on distributions of debt securities.
- Allowing routine dissemination of certain research reports by underwriters and other distribution participants during a distribution.
- Eliminating restrictions on underwriters and other distribution participants in connection with distributions of securities of domestic, as well as foreign, issuers made in compliance with Rule 144A under the Securities Act.
- Creating a *de minimis* exception and an exception for basket transactions for underwriters and other distribution participants. No such exemptions are proposed, however, for issuers and selling securityholders.
- Creating a more flexible framework for stabilizing transactions.
- Imposing for the first time special disclosure and recordkeeping requirements for underwriters and other distribution participants with respect to "penalty bids" and purchases to cover a syndicate short position.
- Eliminating restrictions on transactions in connection with rights offerings currently imposed by Rule 10b-8.

Proposed Regulation M, if adopted, would represent a significant improvement over existing Trading Rules, especially if the distinction drawn in the proposed regulation between underwriters, other distribution participants, and related persons on the other side is eliminated when the regulation is adopted.

3. *The NASD Rules*

The Rules of Fair Practice of the NASD, and interpretations of these Rules by its Board of Governors, represent an attempt to codify the "high standards of commercial honor and just and equitable principles of trade" that are required of all securities dealers who are members.¹⁰² Two sets of rules are of particular importance in the context of a global equity offering. The first requires in effect that all

¹⁰² SECTION 1 OF THE RULES OF FAIR PRACTICE OF THE NASD.

potential investors in a public offering be offered the securities at the same public offering price, and the second ensures that the benefits of any rise in the price of a publicly offered security in the after-market flow to the investing community rather than being retained by participants in the distribution.

The so-called “Papilsky” rules, requiring that all investors be offered securities at the same price, operate by limiting the scope of permissible discounts. Section 24 of the Rules of Fair Practice, as interpreted by the Board of Governors, requires that selling concessions, discounts or other allowances in connection with a public offering of securities be paid only to brokers or dealers engaged in the investment banking or securities business and only as consideration for services rendered in distribution. Services will be considered to be rendered in distribution if the dealer in question is an underwriter of part of the offering, has made some selling effort with respect to the sale or has provided or agreed to provide *bona fide* research to the person to whom or at whose direction the sale is made. A broker or dealer who has received or retained a selling commission, discount or other allowance may not grant or otherwise reallow all or part of it to anyone other than a broker or dealer that is itself engaged in the investment banking or securities business and, again, only as consideration for services rendered in distribution.

The interpretation of the Board of Governors of the NASD on “Free Riding and Withholding” is based upon the premise that members of the NASD have an obligation in a public offering to make a *bona fide* public distribution at the public offering price of securities that trade at a premium in the secondary market (a so-called “hot issue”). Moreover, the Board considers that the failure to make a *bona fide* public distribution when there is demand for an issue can itself be a factor in artificially raising the price. Accordingly, the interpretation prohibits any member of the NASD from continuing to hold any security that is part of a hot issue or to sell any such security to related parties or to certain accounts where reciprocal benefits could be provided, except in accordance with previous investment practice and in immaterial amounts.

The Rules of Fair Practice require in certain circumstances that the foreign underwriters in a global equity offering agree to abide by these and related requirements of the NASD. This is considered in Part III.A.4 .

4. Other Restrictions

Both the Investment Company Act and the Exchange Act contain additional requirements that are relevant to a U.S. public offering of shares in a foreign company.

a. The Investment Company Act

Section 7(d) of the Investment Company Act¹⁰³ requires any foreign "investment company" that offers securities to the public in the United States to register as an investment company with the SEC;¹⁰⁴ as a practical matter, this prohibits the securities of any foreign "investment company" from being offered to the U.S. public unless an exemption is obtained. The definition of "investment company" is broader than might be expected, covering not only companies that engage primarily in the business of investing, reinvesting or trading in securities, but also, in certain circumstances, companies primarily engaged in other businesses if they own less than majority interests in their operating subsidiaries.¹⁰⁵ Because industrial companies in Europe and elsewhere outside the United States often control their subsidiaries through minority interests, they can become "inadvertent" investment companies and thus be denied access to the public capital markets in the United States. Until the autumn of 1991, foreign banks and insurance companies were considered investment companies as well, but Rule 3a-6¹⁰⁶ under the Investment Company Act now excepts them from the definition, provided, among other things, that they are regulated as commercial banks or insurance companies by the authorities in their home countries.¹⁰⁷ Rule 3a-6 also has the ef-

¹⁰³ Investment Company Act § 80a-7(d).

¹⁰⁴ Investment Company Act § 80a-7(d). The Investment Company Act applies more stringent restrictions to U.S. companies. Section 7(a) of the Investment Company Act, 15 U.S.C. § 80a-7(a), precludes any U.S. "investment company" from offering securities, whether in a private placement or public offering, through the use of the U.S. mails or the means of interstate commerce. However, Section 3(c)(1) of the Investment Company Act, 15 U.S.C. § 80a-3(c)(1), excepts from the definition of "investment company" any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons (subject to a complex attribution rule) and which is not making and does not presently propose to make a public offering of its securities. This exception thus permits limited U.S. private placements by U.S. companies that would otherwise be "investment companies." As discussed in Part II.B.3, the SEC has tried to impose similar limitations on private placements by foreign investment companies, notwithstanding that foreign investment companies are only precluded by the statute from offering their securities to the public. See *infra* Part II.B.3.

¹⁰⁵ Investment Company Act § 80a-3(a)(1)(3). See also 17 C.F.R. § 270.3a-1 (1996).

¹⁰⁶ 17 C.F.R. § 270.3a-6.

¹⁰⁷ 17 C.F.R. § 270.3a-6(b)(1)(i)(B) (in the case of banks); 17 C.F.R. § 270.3a-6(b)(3)(i) (in the case of insurance companies). To qualify for the exception under Rule 3a-6(b)(1), 17 C.F.R.

fect of excepting most bank holding companies from the definition of investment company.

b. Restrictions on Foreign Broker-Dealers

Section 15(a) of the Exchange Act makes it unlawful for any securities broker or dealer to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security through the use of the U.S. mails or of any means or instrumentality of interstate commerce, unless the broker or dealer is registered with the SEC. In order for a foreign broker-dealer to register, its employees, including senior management, are required to pass examinations and register with the NASD, and the broker-dealer is required to comply throughout the world with U.S. net capital and other rules (which are not consistent with the rules of a number of other countries). As a practical matter, therefore, section 15(a) has the effect of precluding foreign brokers or dealers from offering or selling securities in the United States except through their U.S. affiliates which have so registered. Accordingly, foreign brokers and dealers may not participate as underwriters in a U.S. public offering.¹⁰⁸

The impact of section 7(d) of the Investment Company Act and section 15(a) of the Exchange Act is less severe in the context of a U.S. private placement. This is discussed in Parts II.B.3.c. and II.B.3.d.

B. Private Placements in the United States

With the adoption by the SEC of Rule 144A¹⁰⁹ under the Securities Act in April 1990, a significant impetus was given to the underwritten private placement as an effective way of including the U.S.

§ 270.3a-6(b)(1)(i)(B), a foreign bank must also be "engaged substantially in commercial banking activity," which is defined to mean "engaged regularly in, and deriving a substantial portion of its business from, extending commercial and other types of credit and accepting demand and other types of deposits, that are customary for commercial banks in the country in which the head office of the banking institution is located." 17 C.F.R. § 270.3a-6(b)(iii)(2). In order for a foreign insurance company to qualify for the exception under Rule 3a-6(b)(3), 17 C.F.R. § 270.3a-6(b)(3)(i), it must be engaged primarily and predominantly in the writing of certain insurance agreements or the reinsurance of risks on such agreements. 17 C.F.R. § 270.3a-6(b)(3)(ii). Trust or loan companies incorporated in Canada and building societies in the United Kingdom are also excepted from the definition of "investment company" under Rule 3a-6. See 17 C.F.R. § 270.3a-6(b)(1)(ii).

¹⁰⁸ Foreign brokers or dealers may, however, join U.S. houses in a single underwriting syndicate in a global offering, so long as the right to offer and sell the shares in the United States is reserved to U.S. registered brokers or dealers.

¹⁰⁹ 17 C.F.R. § 230.144A.

capital markets in a global equity offering.¹¹⁰ As of December 31, 1993, 168 foreign companies had offered and sold common shares in the United States under Rule 144A in 157 offerings that raised approximately \$6.863 billion in aggregate. By contrast, only one U.S. issuer had sold \$250,000 of common shares in one offering under Rule 144A.¹¹¹

1. Rule 144A

Rule 144A provides that an offer or sale of eligible securities to a qualified institutional buyer, or a person reasonably believed by the seller to be a qualified institutional buyer, is exempt from the registration requirements of the Securities Act,¹¹² provided only that the seller takes reasonable steps to make the buyer aware that the offer or sale is being made pursuant to the rule.¹¹³ Any security sold under Rule 144A becomes a "restricted security" (as defined in Rule 144(a)(3) under the Securities Act), which means that resales are subject to limitations, discussed below, for a period of three years.¹¹⁴ The assumption underlying Rule 144A is that qualified institutional buyers can be expected to know, and abide by, the restrictions on resale that apply to restricted securities.

A "qualified institutional buyer," in general, is any institutional investor that owns and invests on a discretionary basis at least \$100 million in securities of companies that are not affiliated with that in-

¹¹⁰ For a detailed discussion of Rule 144A, as well as of traditional private placement procedures, see Edward F. Greene & Alan L. Beller, *Rule 144A: Keeping the U.S. Competitive in the International Financial Markets*, 4 INSIGHTS (June 1990); Edward F. Greene et al., *Private Offerings in the U.S. by Foreign Issuers*, in U.S. REGULATION OF THE INTERNATIONAL SECURITIES MARKETS (1992).

¹¹¹ SEC, Staff Report on Rule 144A (July 20, 1994). Notwithstanding the extensive use of Rule 144A, 17 C.F.R. § 230.144A, by foreign companies, public offerings remain the more prevalent route to the U.S. capital markets. From the time Rule 144A was adopted through December 31, 1993, foreign companies raised \$23.415 billion in 191 initial public offerings of common stock, and if subsequent offerings were taken into account, the figure would of course be much higher.

¹¹² 17 C.F.R. § 230.144A(d)(1). Rule 144A, 17 C.F.R. § 230.144A, applies only to resales of securities. *Id.* Accordingly, for a placement by an issuer to be made under Rule 144A, the shares must be sold through an underwriter acting as principal. It should be sufficient, however, for the underwriting commitment to be formulated as an obligation to procure investors to purchase and pay for the securities, failing which the underwriters themselves will be obliged to purchase and pay for them. Moreover, if offers and sales are limited to qualified institutional buyers and if the shares are eligible for resale under Rule 144A, a direct placement by an issuer that is made on the basis of the procedures set forth in Rule 144A should qualify as a traditional private placement without any additional restrictions, notwithstanding that Rule 144A would not apply by its terms to the sale by the issuer to the initial investors.

¹¹³ 17 C.F.R. § 230.144A(d)(2).

¹¹⁴ 17 C.F.R. § 230.144A(a)(3).

vestor. In the case of securities dealers, the threshold amount is reduced to \$10 million,¹¹⁵ and any bank or savings and loan association must, in addition to the \$100 million requirement, have an audited net worth of at least \$25 million.¹¹⁶ In forming a view as to whether a purchaser is a qualified institutional buyer, the seller is entitled to rely on certain publicly available information, or on a certificate of the chief financial officer (or other executive officer) of the purchaser specifying the amount of securities owned and invested on a discretionary basis as of a specified date at or since the close of the purchaser's most recent financial year.¹¹⁷ Standard & Poor's Corporation also publishes a list of qualified institutional buyers, and the SEC has stated that this list may be relied on by sellers.

Shares of a foreign company are eligible to be sold under Rule 144A, unless they are of the same class as shares that are listed on a securities exchange in the United States or quoted on NASDAQ.¹¹⁸ If the issuer is not subject to the periodic reporting requirements of the Exchange Act and has not obtained an exemption from those requirements under Rule 12g3-2(b) under the Exchange Act, it must agree, for the benefit of holders and prospective purchasers of the shares, to provide certain reasonably current general information upon request, including a very brief statement of the nature of its business and the products and services it offers, and its most recent balance sheet and profit and loss and retained earnings statements and similar financial statements for the two preceding financial years.¹¹⁹ Information will be considered to be "reasonably current" if it meets the timing requirements of the issuer's home country or principal trading markets.¹²⁰

The requirement to furnish information applies for so long as the shares being sold are "restricted securities" and are, thus, subject to resale restrictions. Under Rule 144, the restricted period is three years.¹²¹ During the first two years, restricted securities may not be offered or sold in the public secondary trading markets in the United

¹¹⁵ 17 C.F.R. § 230.144A(a)(i). Special rules apply to families of investment companies. 17 C.F.R. § 230.144A(a)(iv).

¹¹⁶ 17 C.F.R. § 230.144A(a)(vi).

¹¹⁷ 17 C.F.R. § 230.144A(d)(1)(i)-(iv).

¹¹⁸ 17 C.F.R. § 230.144A(d)(3)(i). ADRs and the underlying shares are considered to be the same class for this purpose.

¹¹⁹ 17 C.F.R. § 230.144A(d)(4)(i).

¹²⁰ 17 C.F.R. § 230.144A(d)(4)(ii)(c).

¹²¹ 17 C.F.R. § 230.144A(k). In the case of affiliates of the issuer, resales remain subject to the volume and manner of sale limitations referred to below even after the three-year period.

States,¹²² and, during the third year, they may only be offered or sold in those markets in accordance with certain limitations regarding volume and manner of sale.¹²³ Throughout the three-year period, however, the securities may be offered and sold in the United States on a private basis, for example to other qualified institutional buyers under Rule 144A (or in any other transaction that does not constitute a "distribution" for purposes of the Securities Act), or outside the United States in accordance with Regulation S, which is discussed in Part II.C.1. A security lawfully sold into the public secondary trading markets in the United States, or outside the United States, during the three-year restricted period generally will cease to be a restricted security.

Offers and sales of shares will be exempt from the registration requirements of the Securities Act under Rule 144A only if they are made without any form of "general solicitation or general advertising," which is the third source of restrictions on publicity we have encountered thus far. Rule 502(c) under the Securities Act states that this includes, but is not limited to, any advertisement, article, notice or other communication published in any newspaper, magazine or similar media, or broadcast over television or radio, and any seminar or meeting where participants have been invited by any general solicitation or general advertising.¹²⁴ It is uncertain whether the kind of corporate communications contemplated by the SEC releases discussed earlier would be general solicitation or general advertising. It is also not clear whether the publication by a broker or dealer participating in the placement of a research report of the kind contemplated by Rules 138 or 139 under the Securities Act would be general solicitation or general advertising.¹²⁵

¹²² 17 C.F.R. § 230.144A(d)(1).

¹²³ See 17 C.F.R. § 230.144A(e)-(f).

¹²⁴ 17 C.F.R. § 230.502(c) (1996).

¹²⁵ The issue here is whether the policy objective of ensuring that privately placed securities do not flow into the public trading markets in the United States requires that ordinary corporate communications and research reports that comply with the limitations contained in the rules and releases already discussed must cease while the placement is under way. So long as the shares are offered and sold only to qualified institutional buyers, who are presumed to know and to act in compliance with the rules regarding resales of restricted securities, or to other institutional investors on the basis of the traditional private placement procedures outlined below, which are designed to ensure that only certain limited kinds of resales can occur, the risk that the shares will be resold unlawfully to the U.S. public is relatively small and would be reduced only marginally, if at all, if ordinary corporate communications and research were prohibited. What is at best only a marginal reduction in a risk already remote would not appear to justify cutting off the normal flow of information about an issuer for the duration of a placement, which could deprive the market at large of information that would be useful in making investment decisions.

It is clear, however, that certain announcements of a private placement will not constitute general solicitation or general advertising. Under recently adopted Rule 135(c) under the Securities Act, a notice given by an issuer that is subject to the periodic reporting requirements of the Exchange Act, or exempt from those requirements pursuant to Rule 12g3-2(b) thereunder, that it proposes to make, is making or has made an offering of securities not registered or required to be registered under the Securities Act will not be deemed to offer any securities for sale so long as the information contained in the notice is limited generally to that which would be permitted by Rule 135 under the Securities Act (discussed above) and certain other conditions are met. In connection with the adoption of this new rule, Rule 502(c) under the Securities Act was amended to provide expressly that the publication by an issuer of a notice in accordance with Rule 135(c) would not be deemed to constitute general solicitation or general advertising. It is also clear that the conduct of "road shows" in connection with the placement will not constitute general solicitation or general advertising, so long as invitations are given solely to qualified institutional buyers. These "road show" meetings can be held in several locations over an extended period of time and can involve large numbers of potential investors. The road shows that have been conducted in large Rule 144A placements have been indistinguishable in many respects from those conducted in registered public offerings.

In an analogous context, where there is concern that securities initially offered and sold abroad would flow immediately into the United States as a result of secondary trading, the SEC has stated that ordinary corporate communications and research reports permitted by Rule 139(b), 17 C.F.R. § 230.139(b), need not cease during the offering. See *infra* Part II.C.1.a for the discussion of "directed selling efforts" as that term is used in Regulation S under the Securities Act.

The question whether research reports meeting the requirements of Rule 138, 17 C.F.R. § 230.138, or Rule 139(a)(1) or (b), 17 C.F.R. § 230.139(a)(1), (b), constitute general solicitation or general advertising is not likely to arise very often, since a reporting issuer (the only kind of issuer about which such research reports could be published) generally will choose to offer its shares to the U.S. public rather than to make a private placement. This is especially true when the issuer has become subject to the reporting requirements of the Exchange Act through a securities exchange listing or NASDAQ quotation for its shares, since Rule 144A would not then be available to it, leaving only the more restrictive traditional private placement procedures. On the other hand, questions about research reports that meet the requirements of Rule 139(a)(2), 17 C.F.R. § 230.139(a)(2), are more likely to arise, since that rule does not require the issuer to be subject to the periodic reporting requirements of the Exchange Act for the research report to qualify.

Research reports should not constitute general solicitation or general advertising if they are distributed in the United States only to investors who would be eligible to buy the shares being offered in the private placement (*i.e.*, QIBs in a Rule 144A placement and other sophisticated institutional investors in a traditional private placement).

2. *Traditional Private Placements*

If Rule 144A is not available, or if it is not attractive,¹²⁶ in the context of a particular global equity offering, a private placement can still be made on the basis of traditional procedures. These procedures, developed over decades of practice, are designed *inter alia* to ensure that the initial offers and sales are not made to the public¹²⁷ and to demonstrate that the issuer has exercised "reasonable care" to ensure that the purchasers of the privately placed securities are not buying them with a view to their public distribution, or for reoffer or resale in connection with a public distribution. Buying for those purposes could jeopardize the exemption from the registration requirements of the Securities Act.¹²⁸

In a traditional private placement, shares are usually offered to a limited number of sophisticated institutional investors in minimum amounts (generally \$250,000); and there can be no general solicitation or general advertising. Each purchaser is required to provide a so-called "non-distribution letter" in which, among other things, it confirms its status as an institutional investor and represents that it is not buying the shares with a view to their distribution, and agrees to abide by certain restrictions on resale for so long as the shares are restricted securities. These restrictions generally preclude resales except:

- to other sophisticated institutional investors who also provide non-distribution letters (or to qualified institutional buyers without such letters if the shares are eligible for resale under Rule 144A);
- outside the United States under Regulation S; or
- in other circumstances with an opinion of counsel that registration under the Securities Act is not required.

Finally, the shares are stamped with a legend notifying purchasers of the restrictions on resale (or custodial arrangements are put in place if legending the shares in this way is not feasible); and "stop-transfer" procedures are adopted in order to enforce the resale restrictions.

3. *Other Considerations*

Many of the laws and regulations that apply in a U.S. public offering do not apply, or are of less significance, in a private placement. Since the placement is by definition exempt from the registration re-

¹²⁶ 17 C.F.R. § 230.144A, might not be attractive if it is desired to expand the market for the shares to institutional investors other than qualified institutional buyers.

¹²⁷ See Securities Act § 77d.

¹²⁸ See 17 C.F.R. § 230.502(d) (containing the "reasonable care" requirement).

quirements of the Securities Act, a registration statement need not be filed with the SEC, offers can be made at any time, written offers may be made through a variety of different media, and the detailed disclosure requirements outlined above, including in particular those regarding financial statements,¹²⁹ need not be followed.

a. Civil Liability and Due Diligence

There is a considerably lower risk of litigation associated with offering and selling securities in a U.S. private placement than in a registered public offering. First, the sophisticated institutional investors to whom the shares are sold may be less likely to bring meritless claims than the plaintiff's bar, which often takes advantage of class action procedures and contingent fee arrangements to compel settlement. Secondly, the liability provisions of the securities laws that apply to U.S. private placements are less draconian than those that apply to public offerings. Section 11 of the Securities Act applies only to SEC registered offerings and, in an important recent decision, the U.S. Supreme Court held in *Gustafson v. Alloyd Co.* that section 12(2) of the Securities Act applies only to public offerings.¹³⁰ Prior to this decision, every U.S. court that had considered the question, participants in the U.S. capital markets and the U.S. securities bar had all believed that section 12(2) applied to private placements.¹³¹ Based on this be-

¹²⁹ It is generally not the practice to reconcile to U.S. GAAP the financial statements contained in the offering documents used in the United States for a global offering involving Rule 144A. However, in many cases a narrative discussion of the principal differences between U.S. GAAP and the accounting principles actually used will be provided.

¹³⁰ *Gustafson v. Alloyd Co.*, 115 S. Ct. 1061, 1071 (1995). The Supreme Court's holding was premised on the notion that the word "prospectus" as used in section 12(2) is a "term of art referring to a document that describes a public offering of securities by an issuer or controlling shareholder." *Id.* at 1073-74. Under the holding, the term "prospectus" does not include an offering document used in a private placement or written materials used in secondary market transactions.

¹³¹ The Court's decision in *Gustafson, id.*, was unexpected in that it upset 60 years of settled law and appears to apply to private placements that are readily distinguishable from the one at issue. The case involved the sale of an entire business to a small group of investors acting together, rather than a wider distribution to a significant number of independent placees; moreover, the misstatements, which involved projected earnings, were contained in a contract negotiated with the investors, not in an offering document, and the contract itself specified the remedy in the event that earnings were lower than anticipated. The Court also did not refer to Rule 144A (or Regulation D) or to the fact that many private placements today are conducted in a manner similar to public offerings. Nonetheless, the scope of the *Gustafson* holding mitigates against reading it as limited to its facts. See Edward F. Greene et al., "The Gustafson Case and Diligence and Disclosure in U.S. Private Placements," *European Financial Services Law* [hereinafter *European Financial Services Law*]. The *Gustafson* holding was less surprising insofar as it related to secondary market transactions, since there had previously existed a split of authority among U.S. courts as to the applicability of section 12(2) to secondary market trading.

lief and the view that the "reasonable care" defense available to a seller under section 12(2) required a "reasonable investigation" comparable to that required to establish a defense under section 11 of the Securities Act, due diligence investigations in connection with U.S. private placements typically were similar in scope to those undertaken for SEC-registered public offerings. The scope of the due diligence investigation that is appropriate for a U.S. private placement must now be reconsidered in light of the remaining sources of liability for misstatements or omissions in private placement offering documents.

The *Gustafson* decision left Rule 10b-5 under the Exchange Act as the principal U.S. federal standard for liability in a private placement. Although the disclosure standard for offering documents contained in Rule 10b-5 is identical to that of section 12(2),¹³² the conduct that is actionable under Rule 10b-5 and section 12(2) is not the same. In order to defend a claim brought under section 12(2), once the plaintiff proves that there was a material misstatement or omission, a defendant must establish that it acted with "reasonable care." By contrast, in pursuing a Rule 10b-5 claim, the plaintiff bears the burden of proving that the defendant acted with "scienter."¹³³ U.S. courts have held that scienter encompasses intent to defraud, as well as knowing misconduct, and have fairly consistently found recklessness to be sufficient;¹³⁴ mere negligence, however, is not enough.¹³⁵ Thus, the *Gustafson* decision should, at least, theoretically, reduce the risk of liability associated with offering and selling securities in a U.S. private placement.

Two other surviving sources of liability for offering documents are worth noting, however. First, issuers, selling stockholders, underwriters and placement agents may be found liable for material misstatements or omissions in offering documents used in private

¹³² Under both section 12(2) and Rule 10b-5, liability is predicated upon a misstatement or omission of a material fact that makes the statements in the document misleading.

¹³³ *Aaron v. SEC*, 446 U.S. 680, 695 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 205 (1976).

¹³⁴ See, e.g., *Citibank v. K-H Corp.*, 968 F.2d 1489, 1496 (2d Cir. 1992); *Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 525-26 (5th Cir. 1992).

¹³⁵ While the mere failure to conduct a due diligence review of an issuer's affairs would not generally be regarded as acting with scienter, it is possible that underwriters or placement agents could be found to be liable under Rule 10b-5's "shingle theory" where they know that their recommendations are false (or that the information upon which they are based is false) or disregard obvious inconsistencies or other negative information of which they are on notice. See, e.g., *Dannenberg v. PaineWebber Inc.*, 50 F.3d 615, 625-29 (9th Cir. 1995); *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989); *Cook v. Avien, Inc.*, 573 F.2d 685, 692-96 (1st Cir. 1978); *In re Asker*, 50 S.E.C. Docket 1385 (Feb. 14, 1992); *In re Kuznetz*, 48 S.E.C. 551 (1986).

placements under the broad anti-fraud provisions contained in section 17(a) of the 1933 Act, certain elements of which require only that the plaintiff show that the defendant acted negligently.¹³⁶ Currently, however, there is no express private right of action under section 17(a). Only the SEC can bring a civil action, and it would appear unlikely that the SEC would pursue such an action in connection with a U.S. private placement that is made only to sophisticated institutional investors, absent actual fraud – and even then the SEC might be inclined to let the institutions fend for themselves.

Secondly, state securities laws – the so-called “Blue Sky” laws – are also a possible source of liability in private placements. Nearly all U.S. states (other than New York) have statutes that allow investors to sue to rescind transactions or recover damages when securities are sold by means of materially misleading offering documents. In approximately 35 states, including a number of states with a significant number of institutional investors, the standard of actionable conduct is comparable to the reasonable care standard of section 12(2).

While participants in the capital markets and their advisers are now in the process of reassessing their due diligence procedures for U.S. private placements, it is unlikely that practices will change significantly. This is due to the desire of all participants in a placement to ensure that the offering documents are accurate and complete in all material respects and also due to the difficulty of defining, with either specificity or certainty, the minimum steps an issuer, selling stockholder, underwriter or placement agent must take to ensure that it is not found to be reckless for purposes of Rule 10b-5 or to have violated section 17(a) of the Securities Act or the Blue Sky laws of the various states. Thus, at least for the time being, it seems likely that private placements in the United States will continue to be made by

¹³⁶ Securities Act § 77q [hereinafter section 17(a)].

Section 17(a) provides that:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly:

- (1) To employ any device, scheme, or artifice to defraud, or
- (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

While actions brought under section 17(a)(1) require proof of the defendant's scienter, to prevail under section 17(a)(2) or (3), a plaintiff need only establish that the defendant acted negligently.

Aaron, *supra* note 134, at 697.

way of an offering document that is prepared to a very high standard and supported by extensive, but perhaps more focussed, due diligence.

b. Restrictions on Market Activities and the NASD Rules

The situation with regard to the restrictions on market activities imposed by Rules 10b-6, 10b-7 and 10b-8 under the Exchange Act is complicated in the case of a private placement and is dealt with in Part III.B.2. The Rules of Fair Practice of the NASD regarding limitations on discounts and free riding and withholding do not apply in a private placement.

c. The Investment Company Act

While section 7(d) of the Investment Company Act would seem to be irrelevant to a private placement in the United States by a foreign investment company, since that section applies by its terms only to a "public offering," the SEC staff has concluded that the Investment Company Act prevents a foreign investment company from making a private placement as well, if "as a result" of the placement there would be more than one hundred beneficial owners of any of the issuer's securities (other than short-term debt) in the United States.¹³⁷ In the release adopting Rule 144A, the SEC appeared to endorse the position of its staff, raising the question whether the resale under Rule 144A of securities of a foreign investment company that resulted in there being more than one hundred beneficial owners of the company's securities in the United States would constitute a violation of the Investment Company Act.¹³⁸

This doctrine has created enormous practical difficulties. First, it is unclear what the hundred-beneficial-owner test really means. Take, for example, the case of an issuer that has never sold securities in the United States but finds that there are fifty beneficial owners of its securities there when a private placement is to be made, the securities having flowed into the United States from foreign markets in secondary market trading. It seems fair to conclude that a placement with up to another fifty U.S. investors can be made and let us assume that a placement to twenty-five U.S. investors is in fact made. What happens if the privately placed shares are resold in the United States, resulting in there being more than 100 owners? What if the privately placed

¹³⁷ See Touche, Remnant & Co., SEC No-Action Letter (Aug. 27, 1984).

¹³⁸ Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Securities Act Release No. 6862, 55 Fed. Reg. 17,933, at 17,940-41 (Apr. 23, 1990).

shares are not sold, but other securities in the United States at the time of the placement are, resulting in there being more than one hundred owners? What if, after that, some of the privately placed shares are sold, increasing the number still further? What if, in that situation, the number of private placees is still below one hundred? What if additional securities flow into the United States from foreign markets after the placement? What if a combination of all these possibilities occurs? The SEC has provided no guidance here, and it is very difficult for U.S. legal advisers to give definitive advice in this area. Secondly, because many foreign companies issue securities in bearer form, it is often difficult to decide whether there is "room" for a U.S. placement, since the number of existing U.S. holders cannot be ascertained. Finally, the transfer restrictions that would have to be imposed on private placements in order to ensure that resales in the United States do not breach the hundred-beneficial owner limitation could add complexity and impair liquidity to a degree that would affect the marketability of the shares. It is worth noting that in a 1990 release requesting comment on how the Investment Company Act should be amended, the SEC raised for consideration the possibility of exempting from the definition of investment company any entity that sold its securities in the United States only to institutional investors.¹³⁹ If this sensible position were to be adopted, a foreign investment company would not be subject to limitations under the Investment Company Act when making a private placement of its shares in the United States.

d. Restrictions on Foreign Broker-Dealers

Rule 15a-6¹⁴⁰ under the Exchange Act, adopted in the summer of 1989, softens the impact of section 15(a) when a U.S. private placement is being made. Among other things, Rule 15a-6 permits a foreign broker or dealer to induce, or attempt to induce, the purchase or sale of any security by a U.S. institutional investor without registering with the SEC, so long as any resulting transaction with the institutional investor is effected through a registered broker or dealer (the "intermediary") with whom the foreign broker-dealer has a relationship, and a number of other conditions are met.¹⁴¹ The employees of a foreign broker-dealer must conduct their securities activities from

¹³⁹ Request for Comments on Reform of the Regulation of Investment Companies, Investment Company Act Release No. 17534, 55 Fed.Reg. 25,322, at 25,337 (June 15, 1990).

¹⁴⁰ 17 C.F.R. § 240.15a-6 (1996).

¹⁴¹ 17 C.F.R. § 240.15a-6(a)(3)(i).

outside the United States, except for promotional visits to U.S. institutional investors where they are accompanied by an employee of a registered broker-dealer that accepts responsibility for the foreign person's activities.¹⁴² The employees of a foreign broker-dealer may call so-called "major U.S. institutional investors" (*i.e.*, institutional investors with total assets of \$100 million) on the telephone, but an employee of a registered broker-dealer must participate if a call is made to any other kind of institutional investor.¹⁴³

The foreign broker-dealer and each of its employees who participates in the solicitation of a U.S. institutional investor must consent in writing to service of process in any civil action involving the SEC or a self-regulatory organization, and this consent must be obtained by the registered broker-dealer acting as intermediary.¹⁴⁴ The foreign broker-dealer must also provide to the SEC, upon request, information that relates to transactions by or through an intermediary.¹⁴⁵ In addition to being responsible for effecting transactions, the intermediary is responsible for issuing all required confirmations and related reports, maintaining adequate capital, receiving, delivering and safeguarding funds and securities on behalf of the U.S. institutional investor and maintaining in the United States all required books and records relating to the transactions.¹⁴⁶ In addition, as between the foreign broker-dealer and the intermediary, the intermediary is responsible for the extension of any credit to the U.S. institutional investor in connection with the transactions.¹⁴⁷

C. Offerings Outside the United States

Before turning to the effect on the structure and conduct of a global equity offering of the U.S. laws and regulations outlined above, a word should be said about Regulation S under the Securities Act, which provides that offers and sales of securities outside the United States are not subject to the registration requirements of the Securities Act.¹⁴⁸ The limitations imposed by section 4(3) of the Securities Act on the ability of foreign securities dealers to resell into the United

¹⁴² 17 C.F.R. § 240.15a-6(a)(3)(ii).

¹⁴³ 17 C.F.R. § 240.15a-6(a)(3)(iii)(B).

¹⁴⁴ 17 C.F.R. § 240.15a-6(a)(3)(iii)(D).

¹⁴⁵ 17 C.F.R. § 240.15a-6(a)(3)(i)(B).

¹⁴⁶ 17 C.F.R. § 240.15a-6(a)(3)(iii).

¹⁴⁷ 17 C.F.R. § 240.15a-6(a)(3)(iii)(A)(3).

¹⁴⁸ Securities Act Release No. 4708, 29 Fed. Reg. 9, 829 (July 9, 1964).

States shares that they purchase in foreign offerings are also relevant.¹⁴⁹

1. Regulation S

Regulation S was adopted by the SEC in April of 1990 to codify and rationalize the so-called "foreign offering exemption" from the registration requirements that had evolved out of the seminal Release 33-4708 and the no-action letters issued under it, initially in connection with Eurobond offerings by U.S. companies.¹⁵⁰ Regulation S, and the earlier release and no-action letters, were considered necessary because there is no exemption in the Securities Act itself for offerings outside the United States that make use in any way of the U.S. mail or the means or instrumentalities of interstate commerce. It is important to recognize that Regulation S relates only to the registration requirements of the Securities Act, and not to the various provisions of the securities laws that impose liability for misstatements or omissions in offering materials.¹⁵¹

Regulation S consists of a general statement and two safe harbors. The general statement provides simply that any offer or sale that is made outside the United States is not subject to the registration requirements of the Securities Act.¹⁵² While this standard seems clear, it is in fact fraught with uncertainty when: (1) important participants in an offering are in the United States; (2) negotiations or other activities relating to an offering take place in the United States; (3) some of the securities being distributed are sold in the United States; or (4) securities initially sold outside the United States are resold there within a short period of time. The safe harbors of Regulation S are intended to eliminate this uncertainty. The first applies to initial distributions,¹⁵³ the second to resales.¹⁵⁴

a. Initial Distributions

There are two conditions to the availability of the safe harbor for an initial distribution outside the United States of shares in most for-

¹⁴⁹ Securities Act § 77d(3).

¹⁵⁰ Securities Act Release No. 4708, 29 Fed. Reg. 9,828 (July 9, 1964). For a discussion of the practices developed on the basis of that release, see Alan L. Beller & Gail S. Berney, *Eurobonds*, 19 REV. OF SEC. & COMMODITIES REG. 39 (Feb. 19, 1986).

¹⁵¹ 17 C.F.R. § 230.901-.904.

¹⁵² 17 C.F.R. § 230.901.

¹⁵³ 17 C.F.R. § 230.903.

¹⁵⁴ 17 C.F.R. § 230.904.

eign companies.¹⁵⁵ First, no "directed selling efforts," can be made in the United States by the issuer or any underwriter, dealer or other person participating in the distribution pursuant to a contractual arrangement (each such person being referred to as a "distributor") or by any of their affiliates, or on behalf of any of them.¹⁵⁶ This prohibition on "directed selling efforts," the fourth source of limitations on publicity discussed in this article, applies to the issuer until the distribution is completed and applies to each distributor until it has disposed of its allotment.¹⁵⁷ The failure by the issuer or any distributor to abide by this restriction will result in the loss of the safe harbor for all the participants in the distribution.¹⁵⁸

"Directed selling efforts" are defined to mean any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the shares being offered under Regulation S.¹⁵⁹ The release adopting Regulation S states that mailing printed material to U.S. investors, conducting promotional seminars in the United States, or placing advertisements with radio or television stations broadcasting into the United States or in publications with a general circulation in the United States would constitute directed selling efforts.¹⁶⁰ Similarly, the publishing in the United States of a research report containing information, opinions or recommendations concerning the issuer or any class of its securities would also constitute directed selling efforts.¹⁶¹ A publication has a general circulation in the United States if it is printed primarily for distribution there or if it had, during the preceding twelve months, an average circulation there of 15,000 copies or more per issue.¹⁶² If a publication has both a U.S. and a foreign edition, the foreign edition may be disregarded entirely.¹⁶³

Regulation S and the adopting release specify a number of activities that do not constitute directed selling efforts. An advertisement

¹⁵⁵ 17 C.F.R. § 230.903(a)-(b). Additional restrictions apply in certain circumstances, as discussed below.

¹⁵⁶ 17 C.F.R. § 230.903(b). The definition of "distributor" is contained in 17 C.F.R. § 230.902(a).

¹⁵⁷ Securities Act Release No. 6863, 55 Fed. Reg. 18,306, at 18,311 (Apr. 24, 1990). If there is a "substantial U.S. market interest" in the issuer's shares, the prohibition on directed selling efforts applies for the "restricted period" as well. See *infra* notes 192-201, and the accompanying text.

¹⁵⁸ Securities Act Release No. 6863, 55 Fed. Reg. at 18319-18320.

¹⁵⁹ 17 C.F.R. § 230.902(a).

¹⁶⁰ Securities Act Release No. 6863, 55 Fed. Reg. at 18,311; 17 C.F.R. § 230.902(b)(1).

¹⁶¹ Securities Act Release No. 6863, 55 Fed. Reg. at 18,311.

¹⁶² Securities Act Release No. 6863, 55 Fed. Reg. at 18,311; 17 C.F.R. § 230.902(k)(1)(ii).

¹⁶³ 17 C.F.R. § 230.902(k).

will not be deemed to be a directed selling effort if it is required to be published under U.S. or foreign laws or regulations, contains no more information than is legally required, and includes a statement to the effect that the shares have not been registered under the Securities Act and may not be offered or sold in the United States unless an exemption is available.¹⁶⁴ Nor will a “tombstone” advertisement in a publication with a general circulation in the United States be deemed to be a directed selling effort, provided that the publication has less than twenty percent of its circulation in the United States (aggregating for this purpose the circulation of its U.S. and similar non-U.S. editions), the information is limited to certain basic facts about the issuer and the offering, and a statement of the kind referred to above is included.¹⁶⁵ Finally, the publication by the issuer of a notice meeting the requirements of Rule 135 or Rule 135(c) under the Securities Act will not be construed to be “directed selling efforts” for purposes of Regulation S.¹⁶⁶

The publishing in the United States of a research report containing information, opinions or recommendations concerning an issuer that is subject to the periodic reporting requirements of the Exchange Act (or any class of its securities) will not be deemed to be a directed selling effort if the publication meets requirements that are similar to those of Rule 139(b).¹⁶⁷ It is noteworthy in this regard that neither the publishing of a research report that meets the more relaxed requirements of Rule 139(a), nor the publishing of a report that meets the requirements of Rule 138, is excluded from the meaning of “directed selling efforts.” This inconsistency, which the SEC has not explained, appears to have no rationale, and U.S. legal advisers may be able to conclude, in a number of circumstances, that the publishing in the United States of a research report that meets the requirements of Rule 138 or Rule 139(a) should not be deemed to be a directed selling effort.¹⁶⁸

The dissemination by an issuer of routine corporate communications of the kind normally published by companies, such as press releases regarding financial results or the occurrence of material events,

¹⁶⁴ 17 C.F.R. § 230.902(b)(2).

¹⁶⁵ 17 C.F.R. § 230.902(b)(4). The information permitted to be included is similar to that allowed by 17 C.F.R. § 230.134.

¹⁶⁶ 17 C.F.R. § 230.902(b)(7).

¹⁶⁷ Securities Act Release No. 6863, 55 Fed. Reg. at 18,311-12.

¹⁶⁸ For a discussion of this question, see Joseph McLaughlin, “Directed Selling Efforts” Under Regulation S and the U.S. Securities Analyst, 24 REV. OF SEC. & COMMODITIES REG. 117 (June 12, 1991).

will also not be deemed to be a directed selling effort.¹⁶⁹ Similarly, the prohibition on directed selling efforts is not intended to interfere with news stories about foreign companies or other *bona fide* journalistic activities which are not intended to induce purchases of securities by persons in the United States.¹⁷⁰ Accordingly, access by journalists to general press conferences and meetings with company spokesmen, and the distribution of notices to the press generally need not be limited. This is true even when the journalists work for publications with a general circulation in the United States and when the foreign offering is being discussed, so long as the press conference or meetings are held and the notices are distributed outside the United States.¹⁷¹ In general, Regulation S is not intended to interfere with any lawful and customary activities, selling or otherwise, that are conducted outside the United States;¹⁷² it is therefore consistent with Regulation S for there to be advertising campaigns for an offering outside the United States, including on television and radio, as occurs regularly in privatizations.

Limited contacts with the United States, including limited activities directed at prospective investors which may even be unlawful offers under the Securities Act or unlawful solicitations under section 15(a) of the Exchange Act, generally will not constitute directed selling efforts for purposes of Regulation S, and, accordingly, will not result in the loss of the safe harbor for all participants in the offering.¹⁷³ Moreover, the distribution in the United States of a foreign broker-dealer's quotations by a third-party system that distributes such quotations primarily in foreign countries will not be deemed "directed selling efforts," if securities transactions cannot be executed between foreign broker-dealers and persons in the United States through the system and participants in the system do not initiate contacts with U.S. persons or persons within the United States beyond those permitted

¹⁶⁹ Securities Act Release No. 6863, 55 Fed. Reg. at 18,312.

¹⁷⁰ *Id.*

¹⁷¹ Preliminary Note 7 to Regulation S; Securities Act Release No. 6863, 55 Fed. Reg. at 18,312. The requirement that the information be made available to the press generally has proved particularly vexing, since it is common practice for underwriters to provide to Reuters details of an offering at the time of launch and for issuers to publicize an offering through one-on-one interviews with the *Financial Times*. Reuters has a general circulation in the United States, and the *Financial Times* generally refuses to exclude the interviews from its U.S. edition. Reconsideration of this requirement, in light of general Euro market practice, may be appropriate.

¹⁷² Securities Act Release No. 6863, 55 Fed. Reg. at 18,312.

¹⁷³ *Id.*

by Rule 15a-6 under the Exchange Act.¹⁷⁴ Also, legitimate selling efforts in the United States in connection with a U.S. public offering that is registered under the Securities Act or in connection with an offering that is exempt from registration will not constitute directed selling efforts with respect to a contemporaneous offering being made outside the United States under Regulation S.¹⁷⁵ Accordingly, the non-U.S. portions of a global equity offering can have the benefit of the safe harbor of Regulation S even when major selling efforts are made in the United States in connection with the U.S. tranche, whether it be public or private.

The second condition to the availability of this safe harbor is that the initial offers and sales be made in “offshore transactions.”¹⁷⁶ This means that the offer may not be made to a person in the United States and either (1) at the time the buy order is originated, the buyer must be outside the United States (or the seller must reasonably believe that the buyer is outside the United States), or (2) the transaction must be executed on the physical trading floor of an established foreign securities exchange.¹⁷⁷ A violation of the offshore transaction requirement will result in the safe harbor being lost for the person involved, but not for the other participants in the distribution.¹⁷⁸

The release adopting Regulation S sets out certain guidelines for determining whether a buyer is outside the United States when the buy order is originated.¹⁷⁹ The general rule is that the buyer itself, rather than its agent, must be outside the United States.¹⁸⁰ If, however, the buyer is a corporation, partnership or investment company, it is sufficient that an authorized employee of that entity, or, in the case of an investment company, an authorized employee of its investment adviser, be outside the United States, and there is no need to consider where the investment decision is taken.¹⁸¹ The release does not, however, provide any specific guidance as to whether U.S. pen-

¹⁷⁴ 17 C.F.R. § 230.902(b)(6).

¹⁷⁵ Securities Act Release No. 6863, 55 Fed. Reg. at 18,319-20. This is consistent with the SEC's view that offers and sales under Regulation S will not be integrated with contemporaneous SEC-registered public offerings or exempt private placements. *Id.* at 18,320.

¹⁷⁶ 17 C.F.R. § 230.902(a).

¹⁷⁷ 17 C.F.R. § 230.902(i). Not all foreign securities exchanges have or make significant use of, a physical trading floor. A noteworthy example of one that does not is The International Stock Exchange of the United Kingdom and the Republic of Ireland. The SEC has not explained the rationale for the “physical trading floor” requirement and chose not to apply it for purposes of the resale safe harbor discussed in Part II.C.1.b.

¹⁷⁸ Securities Act Release No. 6863, 55 Fed. Reg. at 18,319-20.

¹⁷⁹ *Id.* at 18,310.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

sion funds, which are typically organized as trusts, fall within the general or the specific rule. The question comes up when a distributor wishes to sell securities to accounts of U.S. pension funds that are managed by fiduciaries outside the United States. There seems to be little reason to distinguish for this purpose between the relationship an investment company has with its investment advisor on the one hand, and the relationship a pension fund has with its fiduciary on the other. Thus, when a fiduciary buys outside the United States for the account of a U.S. pension fund, the requirement that the buyer be outside the United States ought to be satisfied without regard to where, or by whom, the investment decision is taken. Nonetheless, in the absence of guidance from the SEC on the question, it may be prudent to limit sales to circumstances in which the offshore fiduciary for the U.S. pension fund is acting on a discretionary basis and is, thus, making the investment decisions.

Additional restrictions apply to certain foreign issuers and to U.S. issuers. Additional restrictions apply to a foreign issuer if there is a "substantial U.S. market interest" in the class of shares being distributed.¹⁸² There is a "substantial U.S. market interest" in a foreign company's shares if, in the company's last financial year: (1) the securities exchanges and inter-dealer quotation systems in the United States in the aggregate constituted the single largest market for shares; or (2) twenty percent or more of all trading in the shares took place on securities exchanges and inter-dealer quotation systems in the United States and less than fifty-five percent of such trading took place in the securities markets of a single foreign country.¹⁸³

If the foreign company reasonably believes at the commencement of the offering that there is no substantial U.S. market interest in its shares, there are no additional requirements.¹⁸⁴ Otherwise, there are three additional requirements. The first has the effect of prohibiting distributors from offering or selling in the United States or to U.S. persons, until the expiration of a forty-day "restricted period" commencing with the closing date for the offering,¹⁸⁵ any shares that are sold initially outside the United States and reacquired in foreign markets.¹⁸⁶ The second requires that "offering restrictions" be adopted, meaning that each distributor must agree that: (1) all offers and sales

¹⁸² 17 C.F.R. § 230.902(n).

¹⁸³ 17 C.F.R. § 230.902(n)(i)-(ii).

¹⁸⁴ 17 C.F.R. § 230.903(c)(i)(A).

¹⁸⁵ In certain instances, the restricted period would begin at commencement.

¹⁸⁶ 17 C.F.R. § 230.903(c)(2)(iii).

during the restricted period will be made either pursuant to Regulation S or pursuant to another exemption from the registration requirements of the Securities Act; and (2) the offering materials used during the restricted period, including advertisements relating to the offering, must contain statements to the effect that the securities have not been registered under the Securities Act and may not be sold in the United States or to U.S. persons unless an exemption from the registration requirements is available.¹⁸⁷ The final requirement is that each distributor selling securities during the restricted period to a securities dealer or a person receiving a selling concession, fee or other remuneration send a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to a distributor.¹⁸⁸

These three additional requirements also apply to offerings of shares in U.S. companies that are subject to the periodic reporting requirements of the Exchange Act.¹⁸⁹ More rigorous restrictions apply to offerings of shares in U.S. companies that are not subject to such reporting requirements.¹⁹⁰

A breach of the "offering restrictions" requirement will cause the safe harbor to be lost for all participants in the distribution, but a breach of either of the other two requirements will result in the safe harbor being lost only for the person who fails to comply.¹⁹¹

¹⁸⁷ 17 C.F.R. §§ 230.902(b), .903(c)(2)(ii).

¹⁸⁸ 17 C.F.R. § 230.903(c)(2)(iv). The "restricted period" and confirmation requirements should not be relevant when the "flow-back" of an appropriate number of shares is registered with the SEC, either as part of a global offering or otherwise. *See infra* Part III.A.2.

¹⁸⁹ 17 C.F.R. § 230.903(c)(2). There is much controversy over Regulation S offerings of shares in U.S. companies that are listed on a U.S. securities exchange or quoted on NASDAQ, especially when the shares are offered at a discount to the current market price. The concern is that the shares offered abroad will flow back immediately into the U.S. market, thus constituting an indirect, unregistered public distribution in the United States. *See, e.g.*, "Securities Public Policy Issues of Interest," Remarks of Richard Y. Roberts, Commissioner, U.S. Securities and Exchange Commission, *27th Annual Rocky Mountain State-Federal-Provincial Securities Conference*, Denver Co. (Oct. 14, 1994), pp. 3-6. Similar concerns have been expressed by members of the SEC staff with respect to derivative transactions entered into by foreign purchasers of Regulation S shares during the restricted period if such derivative transactions can reasonably be expected to lead to short selling in the U.S. market by counterparties engaged in hedging their positions. In the context of a global offering of shares in listed U.S. companies, however, these issues are unlikely to arise, since the flow-back will typically be covered by an effective registration statement.

¹⁹⁰ 17 C.F.R. § 230.903(c)(3). Among other things, the restricted period is extended to one year and the issuer is required to agree not to register any transfers in violation of the restrictions. These requirements also apply to non-reporting foreign issuers, if there is a "substantial U.S. market interest" for their shares. Very few, if any, foreign issuers will fall into this category.

¹⁹¹ Securities Act Release No. 6863, 55 Fed. Reg. at 18,319-20.

b. Resales

The second safe harbor of Regulation S is for resales.¹⁹² As in the case of an initial distribution, a resale will fall within the safe harbor if it is made without directed selling efforts and in an offshore transaction.¹⁹³ However, in contrast to the rules regarding directed selling efforts in an initial distribution, a violation of the requirement by one seller will not result in the resale safe harbor being lost for others.¹⁹⁴ The offshore transaction requirement also is cast somewhat differently, in that the provision regarding sales on the physical trading floor of a foreign securities exchange is replaced by a provision permitting resales in a number of offshore securities markets, including most of the major European and Asian securities exchanges, without regard to whether they have a physical trading floor.¹⁹⁵

The resale safe harbor of Regulation S is of particular significance in a global equity offering where a U.S. placement is made under Rule 144A or on the basis of traditional private placement procedures, since it permits the U.S. purchasers to resell the shares immediately into the principal trading market even though they are restricted securities (as that term is used in Rule 144). This ability to resell the shares immediately enhances their liquidity, and effectively integrates the U.S. private placement market with the capital markets of the rest of the world.

2. *Section 4(3) of the Securities Act*

Section 4(3) of the Securities Act¹⁹⁶ affords an exemption from the registration requirements for offers and sales of securities by securities dealers, subject to certain limitations. These limitations have the effect of prohibiting all U.S. and foreign securities dealers (whether or not they are participants in a distribution) from offering or selling unsold allotments in the United States at any time, and other securities included in the offering that they acquire in the market until forty days after the commencement of the offering. Thus, securities initially offered and sold outside the United States under Regulation S may not be reoffered or resold into the United States by

¹⁹² 17 C.F.R. § 230.904.

¹⁹³ 17 C.F.R. § 230.904(a)-(b). Certain additional requirements apply to resales by a securities dealer or other person receiving a selling concession, fee or other remuneration if there is a "substantial U.S. market interest" in the issuer's shares. *See supra* note 186; *see also* 17 C.F.R. § 230.904(c)(1).

¹⁹⁴ 17 C.F.R. § 230.904(b); Securities Act Release No. 6863, 55 Fed. Reg. at 18,320.

¹⁹⁵ 17 C.F.R. § 230.904(a). *See supra* note 83 (listing exchanges).

¹⁹⁶ Securities Act § 77e(3).

a foreign securities dealer until forty days after the offering commenced.¹⁹⁷

III. THE IMPACT ON A GLOBAL EQUITY OFFERING

We now turn to the effect of these U.S. laws and regulations on the structure and conduct of a global equity offering. The analysis begins with, what is from the U.S. perspective, the standard situation: a public offering in the United States combined with an international offering being made in the Euromarkets on the basis of the so-called "professionals exemption" that applies in one form or another in most countries.¹⁹⁸ The standard is then modified, first, to show the reduced level of complexity when the U.S. tranche is offered and sold on a private rather than a public basis and, secondly, to demonstrate by way of example the increased level of complexity when a public offering in the United States is combined with a regulated public offering in another country, such as the United Kingdom, France, Germany, Italy or Japan.

A. Standard Global Equity Offering

In the standard situation, the U.S. laws and regulations have a significant impact on the structure and conduct of the offering.

1. *Underwriting Arrangements*

Generally, the global distribution is divided in two, with one underwriting syndicate being formed for the public offering in the United States and a second for the international tranche. Each syndi-

¹⁹⁷ Because a research report with respect to a company's shares may be viewed as an offer of those shares, section 4(3), Securities Act § 77e(3), may prevent the distribution of research reports in the United States during the forty-day period by participants and non-participants in the offering. *Id.* Broker-dealers that are not participating in the offering generally ignore this risk. Broker-dealers that are participating in the offering generally refrain from distributing research reports in the United States during the forty-day period, except perhaps in circumstances where there was a significant pre-existing trading market for the shares and the report can thus be said to relate to the shares trading in that market. In these circumstances, the broker-dealer must take care to deliver only the pre-existing shares, rather than the shares sold in the offering, to satisfy any orders stimulated by the research report.

¹⁹⁸ A survey of relevant requirements was conducted in connection with the global offering of shares in British Telecommunications plc, completed in the summer of 1993. In that offering, shares were offered and sold to the public in the United Kingdom, Japan, the United States and Canada. Offers and sales in other countries were required to be made in compliance with the sales restrictions contained in Part 2 of the Fifth Schedule to the Orderly Marketing Agreement dated June 10, 1993. That schedule set out the requirements for offering securities to professionals (or otherwise in a manner exempt from detailed regulation) in more than thirty countries, including all the major European, South American and Asian capital markets.

cate is responsible for the conduct of the offering in its market. The underwriters in the international syndicate often allocate among themselves, sometimes in consultation with the issuer, the responsibility for making offers and sales in particular regions or countries. Each syndicate is led by one or more managing underwriters, while the offering as a whole is supervised by a global coordinator.

These arrangements are typically documented in underwriting agreements between each syndicate and the issuer, an orderly marketing agreement between the syndicates and separate agreements among the underwriters in each syndicate. Each underwriting agreement sets out the representations and covenants of the issuer, the indemnities given by the issuer to the underwriters as to the offering documents, the conditions to the offering, the number of shares to be sold and the combined managing, underwriting and selling commissions. The orderly marketing agreement divides up the markets between the syndicates, and generally gives the global coordinator responsibility for over-allotments, stabilization and publicity, and determining when sales of shares between syndicates should be permitted in response to the varying levels of demand in different markets, assuming that any sales generally are being made at the public offering price less the applicable selling concession. Each agreement among underwriters provides, among other things, for the allocation of selling commissions. The closings for the U.S. and international offerings generally occur at the same time, with each being conditioned on the other.

2. Registration and Related Requirements

The registration requirements of the Securities Act, including the prohibition on offers before a registration statement is filed, the limitation of written offers thereafter to the preliminary prospectus included in the registration statement, the requirements that no sale be made until the registration statement is declared effective and that a copy of the final prospectus be delivered to each purchaser at or prior to the confirmation of sale and the associated restrictions on publicity (as well as the restrictions on publicity imposed by Rule 10b-6) will, of course, apply to the public offering in the United States. They will not, however, apply to the international offering so long as it is made outside the United States in accordance with Regulation S.¹⁹⁹ None-

¹⁹⁹ The position is less certain in so far as the extraterritorial application of the restrictions on publicity of Rule 10b-6 is concerned. A consensus among U.S. legal advisers does seem to be emerging, however, that at least insofar as foreign issuers are concerned the distribution of re-

theless, for combined commercial and legal reasons, the registration requirements have a major influence on how the global offering is conducted.

First, as to timing, the U.S. syndicate is likely to insist that the international underwriters be prohibited from making offers or confirming sales until offers and sales are permitted in the United States. If offers could be made earlier outside the United States, the U.S. underwriters would be at some disadvantage since they would have less time to generate demand in their market, potentially causing an adverse effect on their ability to compete with the international syndicate for the allocation of shares from the issuer and on their relative ability to dispose of the shares allocated to them. Permitting sales to be made outside the United States before the registration statement is declared effective could be even more damaging, since "gray-market" trading of "when-issued" shares could occur at prices below the public offering price, which could have a disruptive effect on the marketing effort in the United States as U.S. investors would reach out to the foreign market to buy the shares at the lower price. In light of these considerations, the timing of offers and sales in the international offering is generally made subject to the constraints imposed by the registration process.

Secondly, the U.S. syndicate has an interest in restricting the offering materials that are to be used by the international underwriters to a prospectus that is substantially identical to the one required to be used in the United States in order, once again, to prevent the international syndicate from obtaining any marketing advantage. The issuer will generally insist on this as well, and the international underwriters are usually willing to go along, because the liability provisions of the U.S. securities laws may apply on an extraterritorial basis and discrepancies in disclosure attract attention and create risks that are best avoided.²⁰⁰

search reports outside the United States should not raise Rule 10b-6 problems. No such consensus has emerged with respect to research reports relating to U.S. issuers. The SEC staff would likely take the position that Rule 10b-6 applies in each case.

²⁰⁰ For one of a number of cases considering the extra-territorial application of the liability provisions of the U.S. securities laws, see *Bersch v. Drexel Firestone*, 519 F.2d 974 (2d Cir. 1975). Although the possibility cannot be ruled out, it is unlikely that a U.S. court would find subject matter jurisdiction over a claim brought against a foreign issuer or underwriter by a foreign person who purchased shares of the foreign issuer outside the United States, even if the U.S. telecommunications or postal systems were used in the offering (or another basis of jurisdiction could be established). In those circumstances, as Judge Friendly articulated the issue in *Bersch*, "when . . . a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United

The situation regarding research reports is more complicated, since it is common practice for the underwriters of a Euro-equity offering to publish research reports shortly before, and even during, a distribution. The U.S. syndicate may, in order to preserve a level playing field, wish to prevent the international underwriters from publishing research reports other than those that meet the requirements of Rule 138 or 139 under the Securities Act, but they do not always prevail in this. It is important, however, that steps be taken to ensure that any research report that does not comply with Rule 138 or 139 is not mailed into the United States, since distributing any such report there could constitute:

- an offer or a non-complying prospectus in violation of section 5 of the Securities Act, which could result, among other things, in the SEC requiring that the offering be delayed to allow the effect of the unlawful publicity to dissipate;
- an attempt to induce purchases in violation of Rule 10b-6, which could have similar consequences;²⁰¹ or
- directed selling efforts which could result in the safe harbor of Regulation S being lost for the issuer and the other participants in the international offering.

It should, however, be sufficient in this regard to limit the mailing of the research report to addresses outside the United States and to place on the cover a restrictive legend prohibiting the distribution of the report in the United States.

Finally, while the shares being offered and sold outside the United States are not required to be registered with the SEC, it is usually the case that between ten and fifteen percent of such shares are so registered in the case of a foreign issuer and all of them in the case of a U.S. issuer. This is done in order to permit transfers of shares from the international syndicate to the U.S. syndicate and their subsequent sale in the United States by the U.S. underwriters, pursuant to the orderly marketing arrangements and to permit immediate resales into the United States of shares initially sold abroad by securities dealers who purchase them in the market but would otherwise be

States courts and law enforcement agencies to be directed to them rather than leave the problem to foreign countries." *Id.* at 985. There is also some doubt as to whether a federal court is permitted by Article III of the U.S. Constitution to assert jurisdiction over a claim involving two non-U.S. parties. See U.S. CONST., art. III, § 2, cl. 1.

²⁰¹ See *supra* note 84. It is unclear whether it is permissible under Rule 10b-6, 17 C.F.R. § 240.10b-6, to distribute research that does not comply with Rule 138, 17 C.F.R. § 230.138, or Rule 139, 17 C.F.R. § 230.139, under the Securities Act even outside the United States.

subject to the forty-day restricted period of section 4(3)(a) of the Securities Act.²⁰²

3. Restrictions on Market Activities

The restrictions on the market activities of participants in a U.S. distribution set forth in the Trading Rules – *i.e.*, Rules 10b-6, 10b-7 and 10b-8 under the Exchange Act – apply in a global equity offering not only to the trading activities of the U.S. underwriters in the United States but also to the trading activities outside the United States of all participants in the offering, including the international underwriters. The rationale for the extraterritorial application of these U.S. regulations is that when shares of a foreign company are being distributed in the United States, trading activities in the principal markets for the shares outside the United States can be expected to have an effect on the U.S. investment community, since the attractiveness of the price at which the securities are being offered in the United States will be assessed in the light of the prices quoted in the foreign markets. The restrictions of the Trading Rules are thought appropriate in order to ensure that the U.S. investment community is not deceived by a false market, or confused about the significance of price fluctuations in foreign markets as a result of a lack of familiarity with the trading rules and practices there. However, the extraterritorial application of these regulations can cause significant difficulties, since the U.S. rules often conflict with the trading rules and customary practices in the foreign markets. These difficulties, and the steps the SEC has taken to ameliorate them, are outlined below. For convenience, the discussion covers global equity offerings that involve a public offering in a national market outside the United States as well as the standard situation.

a. General

The most significant difficulty created by the extraterritorial application of the Trading Rules results from the requirement that participants in the foreign distribution and their affiliates refrain not only from activities engaged in for the purpose of creating actual or apparent active trading in the securities being distributed in the United States (or of raising their price), but also from entirely legitimate trading activities as well, including those in connection with market-mak-

²⁰² If there is a “substantial U.S. market interest” in a foreign issuer’s shares, it would be prudent to register all the shares offered and sold abroad in light of the likelihood that they will trade immediately into the United States.

ing and risk management. Since, in many cases, the principal market-makers in the shares of a foreign company, or their affiliates, will be participating as underwriters in the global offerings of shares in that company, the strict application of the Trading Rules in the principal trading market would be severely disruptive. Moreover, in those circumstances where a market-maker is required by the rules of the trading market where it operates to hold itself out as a buyer of securities at all times, compliance with the Trading Rules could subject it to penalties. Finally, in rights offerings, the extraterritorial application of Rule 10b-8 needlessly interferes with economically rational and non-manipulative risk management activities.

The SEC staff has recognized these difficulties and has gone a long way towards resolving many of the most severe conflicts. In a very significant step taken in October 1993, the SEC exempted from the restrictions of the Trading Rules most activities of distribution participants conducted outside the United States in connection with offerings of equity securities of highly-capitalized German companies.²⁰³ In a policy statement released later the same year, the SEC announced its willingness to consider applications for similar exemptions on a country-by-country basis.²⁰⁴ Such exemptions were granted to French companies in June 1994 and to U.K. companies in January 1995.²⁰⁵

The German case illustrates the wide range of problems in the extraterritorial application of the Trading Rules. In the context of the German universal banking system, in which banks act as underwriters of securities, perform traditional broker/dealer functions and act as investment advisers (and, through affiliates, as fund managers), the application of the Trading Rules to the activities of distribution participants and their "affiliated purchasers" outside the United States could seriously jeopardize the success of any primary or secondary offering of shares in a German company. In particular, the applica-

²⁰³ Exemptions from Rules 10b-6, 10b-7, and 10b-8 During Distributions of Certain German Securities, Exchange Act Release Nos. 33-7021; 34-33022, 58 Fed.Reg. 53,220 (Nov. 15, 1993).

²⁰⁴ Application of Rules 10b-6, 10b-7, and 10b-8 During Distributions of Foreign Issuers, Exchange Act Release Nos. 33-7027; 34-33137, 58 Fed.Reg. 60,324 (Nov. 15, 1993).

²⁰⁵ Exemptions From Rules 10b-6, 10b-7, 10b-8 During Distributions of Certain French Securities, Exchange Act Release Nos. 33-7066; 34-34176, 59 Fed.Reg. 31,274 (June 17, 1994); Exemptions From Rules 10b-6, 10b-7, and 10b-8 During Distributions of Certain United Kingdom Securities Traded on SEAQ International, Exchange Act Release Nos. 33-7127; 34-35234, 60 Fed.Reg. 4,644 (Jan. 24, 1995). The exemption for U.K. issuers also applies to trading activities in the United Kingdom in connection with offerings of securities of German or French issuers that fall within the German and French exemptions or of any other issuers that fall within similar exemptions that may be obtained in the future.

tion of the Trading Rules outside the United States could have the following consequences:

- Distribution participants, including the underwriters (and in particular the lead underwriter), would be unable to maintain an orderly market by buying and selling the shares or rights to purchase shares ("affected securities") as principals during the offering, as is customary and expected in Germany. Moreover, distribution participants would be precluded from fulfilling their formal market-making obligations on the Deutsche Terminbörse with respect to listed options that are affected securities. Finally, and perhaps most important, the market in Germany for the shares of the company in question could simply collapse as a consequence of the application of the Trading Rules, in view of the high proportion of trading in the shares of German companies that is conducted by the larger German banks, and the likelihood that most (if not all) of them would act as distribution participants in any offering by a blue-chip German company.
- Distribution participants' risk management activities would be restricted to those permitted by Rule 10b-8, which would place limits on their ability to buy rights and sell shares short, and they would be precluded by Rule 10b-6 from hedging in derivatives or other affected securities.
- Distribution participants' customary proprietary trading activities, involving arbitrage and other trading strategies, would be curtailed.
- Accounts managed by distribution participants and their affiliates on a discretionary basis, investment funds for which affiliates of distribution participants act as investment advisors and other entities (*e.g.*, industrial companies) that may be viewed under U.S. law as affiliates of a distribution participant could be considered "affiliated purchasers" under Rule 10b-6. Such affiliated purchasers would be subject to the same restrictions under Rule 10b-6 as the relevant distribution participant and, thus, would not be permitted to bid for, or purchase, any affected security.

These consequences would be particularly harsh in the context of a rights offering, where the distribution period normally exceeds one month. They would, however, also be problematic in the context of a secondary offering, even if it is directed solely to the United States, because any halt in share trading in Germany by distribution participants could jeopardize the functioning of the entire market for the class of securities being distributed.

The SEC recognized that the application of the Trading Rules outside the United States in the context of offerings of equity securities of German companies could have severe consequences. Therefore, the SEC granted exemptions intended to permit customary activities outside the United States while at the same time preventing the abuses at which the Trading Rules are directed. The main features of the exemptions, which apply to offerings of equity (and equity-re-

lated) securities of German companies whose securities are included in the Deutscher Aktienindex (DAX), are as follows:

- The Trading Rules do not apply in Germany, subject to a requirement that distribution participants and affiliated purchasers provide to the Frankfurt Stock Exchange certain data regarding their principal trades and trades on behalf of customers (above a DM 500,000 threshold) in Germany. Generally speaking, this reporting requirement applies during the period commencing three business days before pricing and ending upon completion of the U.S. portion of the distribution. In the case of rights offerings, however, the reporting requirement only applies from the time when the rights exercise price represents a discount of less than 10% from the then-current market price of the security underlying the rights (the market price being the closing price on the floor of the Frankfurt Stock Exchange) until the earlier of (1) the completion of the distribution in the United States or (2) the time when the rights exercise price represents a discount of at least 12% from the then-current market price of the security underlying the rights. The identities of counterparties, other than underwriters and selling group members, need not be provided. Distribution participants and their affiliated purchasers are also required to effect principal trades in Germany on, or report information about such trades to, a German stock exchange.
- The Trading Rules also apply in "Significant Markets," defined as markets outside the United States and Germany that account for at least 10% of worldwide published trading volume over a defined reference period, but subject to any general exemptions that are available in that market. The Trading Rules will not apply in other markets outside the United States and Germany.
- A two business-day cooling-off period is available in the United States and Significant Markets (where the rules apply), subject to compliance in Significant Markets with certain record maintenance and production requirements, but only to the extent these requirements are consistent with bank secrecy laws.
- Disclosure to the effect that the Trading Rules do not apply in certain markets must be included in the prospectus.

It is possible that the exemptions granted to highly-capitalized German companies, and now to highly-capitalized French and U.K. companies, will eventually give rise to a general revision of Rule 10b-6 to exempt other highly-capitalized foreign companies and perhaps U.S. companies as well. This would be but one of a number of instances where problems emerging from the internationalization of the capital markets have caused the SEC to take a fresh look at its rules as they apply to U.S. companies.²⁰⁶

²⁰⁶ See Review of Antimanipulation Regulation of Securities Offerings, Exchange Act Release Nos. 33-7057, 34-33924, 59 Fed.Reg. 21,681 (Apr. 26, 1994). Another example is the adop-

b. Rule 10b-6

The SEC staff has granted both general and case-by-case relief from the extraterritorial application of Rule 10b-6. The most significant form of general relief permits so-called “passive” market-making on the International Stock Exchange of the United Kingdom and the Republic of Ireland (the “London Stock Exchange”).²⁰⁷ In granting this relief, the SEC staff recognized that Rules 10b-6 and 10b-7 would interfere with the rules of the London Stock Exchange intended to preserve the integrity of London’s trading market. These rules were designed to prohibit “fair-weather” market-making by preventing a member firm from resuming market-making activities in a security for three months after the firm ceased to make a market in that security. Market-makers in London would thus be penalized if they were to withdraw from the market when they or their affiliates participated in an offering, as would be required by Rule 10b-6.²⁰⁸

The passive market-making exemption permits participants in a distribution (and their affiliates) that are members of the London Stock Exchange to continue to make a market in shares of the same class as those being distributed, so long as they do not lead the market in terms of price or size. Specifically, they are permitted to enter bids for, and make purchases of, certain qualified shares quoted on the Stock Exchange Automated Quotation (SEAQ) and SEAQ International systems, but only at a price no higher than the highest bid currently being displayed on the SEAQ or SEAQ International system by an independent member of the London Stock Exchange, and for a quantity of shares that is no greater than the largest quoted size currently being so displayed, except in certain unsolicited transactions.²⁰⁹

tion of Rule 10b-6A under the Exchange Act, 17 C.F.R. § 240.10b-6, which was based on the concepts developed in the U.K. “passive” market-making exemptions discussed below.

²⁰⁷ Distributions of Certain SEAQ and SEAQ International Securities, SEC No-Action Letter [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,707 (July 15, 1993). The passive market-making exemptions were first granted in the late-1980’s. See International Stock Exchange of the United Kingdom and the Republic of Ireland, SEC No-Action Letter, 1988 WL 410137 (SEC) (Oct. 19, 1988), and London Stock Exchange, SEC No-Action Letter, 1992 WL 360094 (SEC) (Dec. 2, 1992). The 1993 letter restated and expanded the relief granted earlier.

²⁰⁸ Review of Antimanipulation Regulation of Securities Offerings, Exchange Act Release Nos. 33-7057, 34-33924, 59 Fed.Reg. at 21,681.

²⁰⁹ To be eligible for the exemption, securities quoted on SEAQ and SEAQ International must have a “Normal Market Size” (NMS) of 5,000 Shares or greater, as calculated by the London Stock Exchange on the basis of trading volume in the preceding twelve months and recalculated each quarter; otherwise, their eligibility must be agreed upon by the SEC’s Division of Market Regulation and the London Stock Exchange. To be eligible for the exemption, securities quoted on SEAQ International must have at least two designated SEAQ International market-makers (so-called “firm quote” securities) and must have “an average trading volume during

Prior notice to the London Stock Exchange must be given by the firm that intends to avail itself of the exemption. That firm must keep records of its trading activities during the distribution and make such records and its personnel available to the SEC. A similar general exemption has been granted to market-makers on the Toronto Stock Exchange in connection with offerings of securities eligible for the multijurisdictional disclosure system between the United States and Canada.²¹⁰

The second kind of general relief granted by the SEC staff relates to the availability of the two-day or nine-day cooling-off periods of Rule 10b-6. The SEC staff has taken the position that these cooling-off periods generally are not available when the principal trading market for the securities being distributed is outside the United States.²¹¹ After dealing with this problem on a case-by-case basis for many years, the staff stated in early 1993 that the two-day or nine-day cooling-off periods of Rule 10b-6 would be available if certain conditions were satisfied. For the nine-day cooling-off period to be available:

- written notice must be provided to the SEC;
- distribution participants and their affiliated purchasers must keep (and retain for two years) certain records of their transactions in the securities being distributed or in related securities during the period commencing on the later of: (1) the date one month prior to the commencement of the offers or sales in the United States or (2) the date on which the person becomes a participant in the distribution, and ending when the distribution in the United States is either completed or abandoned;
- distribution participants must make such information available to the SEC or its staff upon request through a specified method; and
- distribution participants and their affiliated purchasers may not, from the time they become a participant in the distribution until the completion of the distribution, effect any transactions in the security being distributed or related securities for the purpose of creating actual or apparent active trading in, or raising the price of, such securities.

For the two-day cooling-off period to be available, there are two additional requirements:

any twenty consecutive business day period within sixty consecutive calendar days prior to the commencement of the [applicable] cooling-off period that equals or exceeds the equivalent of \$250,000 as calculated from transactions reported to [and published by] a foreign financial regulatory authority . . . " *Id.*

²¹⁰ Division of Market Regulation, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,753 (Aug. 22, 1991). The multijurisdictional disclosure system is discussed in [JAMES G. DANNIS & DOUGLAS L. POLING, *THE NEW U.S./CANADIAN MULTIJURISDICTIONAL DISCLOSURE SYSTEM*, 5 *Insights* (Sept. 1991).]

²¹¹ See Sullivan & Cromwell, SEC No-Action Letter, 1991 WL 176892 (July 29, 1991), which restates the staff's position on this issue.

- the average daily trading volume in the security during any twenty consecutive business day period within sixty consecutive calendar days prior to the commencement of the applicable cooling-off period equals or exceeds the equivalent of U.S. \$250,000; and
- the market in which such exempted transactions are effected requires, at a minimum, contemporaneous trade reporting (which means reporting trades to a foreign financial regulatory authority within twenty-four hours).²¹²

The SEC staff has also granted case-by-case relief in a number of different areas. Among other things, it has: (1) permitted market-making to continue on a passive basis on the Copenhagen,²¹³ Montreal²¹⁴ and Oslo²¹⁵ stock exchanges; (2) accommodated the market-making activities of affiliates of certain issuers;²¹⁶ (3) permitted ordinary market-making by affiliates of the underwriters in a global offering to continue on the London Stock Exchange without regard to the passive market-making rules;²¹⁷ and (4) permitted distribution participants to trade with, and on behalf of, their customers in a U.K. rights offering.²¹⁸

c. Rule 10b-7

The SEC has also taken a number of steps to mitigate the effect of the extraterritorial application of the U.S. rules on stabilization, as well as to adapt the rules to the requirements of a global equity offering where the principal trading market for the shares is outside the United States.

²¹² Exchange Act Release No. 31943, Fed. Reg. 13,288, at 13,291 (Mar. 4, 1993). On April 4, 1994, the SEC staff modified this exemption to provide in effect that distribution participants would not have to provide to the SEC information about their customers to the extent that doing so was prohibited by applicable law. Notice of Modification of Class Exemption Letter Regarding Application of Cooling-Off Periods Under Rule 10b-6 to Distributions of Foreign Securities, Exchange Act Release No. 33-33862, 59 Fed. Reg. 17,125 (Apr. 11, 1994). The SEC staff also clarified in the Business Day Letter that the two-day or nine-day period must include two or nine full trading days in the foreign market before the commencement of offers and sales in the United States.

²¹³ Novo Norodisk A/S, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,735 (June 18, 1991).

²¹⁴ TransCanada Pipelines Limited, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,733 (June 10, 1991).

²¹⁵ Goldman, Sachs and Co., SEC No-Action Letter, 1988 WL 234328 (May 6, 1988).

²¹⁶ Banco de Santander, S.A., SEC No-Action Letter, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,523 (July 29, 1987).

²¹⁷ British Communications Public Limited Co., SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,062 (Dec. 4, 1991).

²¹⁸ Saatchi & Saatchi Co. PLC, SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,652 (May 21, 1993); [*British Airways Plc*, SEC No-Action Letter (May 21, 1993)].

Difficulties have arisen in this area for two principal reasons. First, the extraterritorial application of Rule 10b-7 requires the stabilizing underwriter to comply with at least two sets of regulations, those of the United States and those of the market in which stabilizing takes place. This has proved to be difficult.²¹⁹ Secondly, the requirement that stabilizing levels be determined by reference to prices in the principal market for the shares in the United States and, once set, that they not be raised, created technical problems. If the principal market in the United States for the security was a securities exchange and that exchange was closed when stabilizing was to commence, the price would have to be set by reference to the closing price on that exchange. For example, if the underwriters in an international offering for a security that was traded on both the London and New York stock exchanges wished to commence stabilizing during the day in London, but before the New York Stock Exchange opened, the underwriters would have to commence stabilizing at a price based on the prior closing price on the New York Stock Exchange, which is likely to have become stale as a result of morning and early afternoon trading in London. Moreover, once the U.S. stabilizing price was set in dollars, the rules prevented it from being raised if the dollar depreciated against the currency of the principal market where the shares were traded.

To overcome the difficulties resulting from the conflicts with local rules, the SEC proposed an amendment to Rule 10b-7 in January permitting stabilization to be conducted in compliance with foreign regulations that are determined by the SEC to be comparable to Rule 10b-7, as long as:

- no stabilization takes place in the United States;
- procedures exist to enable the SEC to obtain information concerning foreign stabilizing transactions; and
- no stabilizing transactions are effected at a price higher than the price at which the shares are then being distributed in the United States.

²¹⁹ For example, the rules on stabilization of the U.K. Securities Investment Board also provide that a stabilization bid may not exceed the offering price, but they afford greater latitude than Rule 10b-7 in permitting a stabilizing bid to be adjusted upward in response to market movements. *Stabilizing to Facilitate a Distribution*, Exchange Act Release No. 28,732, 56 Fed. Reg. 814, at 818 (Jan. 9, 1991). In France, Article 7 of Regulation No. 90-04 of the Commission des Opérations de Bourse (July 5, 1990), provides that stabilization may only be conducted for the purpose of ensuring liquidity or smoothing excessive variations in the market price. Stabilization will be presumptively valid if it is conducted against the trend of the last quoted price—*i.e.*, if the market price of the shares is going up, the person conducting stabilization may sell (and vice versa)—and certain conditions regarding volume and other matters are met. Reconciling these various requirements can be a complex task.

The SEC has preliminarily determined that the stabilization rules of the U.K. Securities Investment Board (SIB) are comparable to Rule 10b-7 for these purposes.²²⁰

To deal with the technical problems that arise in a global offering in connection with stabilization levels, the SEC issued a second set of proposed amendments at the same time. If adopted, these would allow:

- stabilization to be initiated at a price determined by reference to the principal foreign market for the securities rather than a U.S. market;
- a stabilizing bid to be placed in any market at the current exchange rate equivalent to a stabilizing bid entered in the principal foreign trading market for the securities; and
- a stabilizing bid in a market other than the principal trading market to be adjusted in response to exchange rate fluctuations in the currencies in which the securities trade in such subsidiary markets against the currency in which the securities trade in the principal market.

These proposed amendments would only apply where the principal trading market was on a “specified foreign securities market” – *i.e.*, the London, Montreal, Paris, Tokyo or Toronto stock exchanges (or such other securities exchanges as the SEC may designate).²²¹

Pending the adoption of the proposed amendments, the SEC staff has indicated that it will not take enforcement action against any participant in a distribution that complies with the proposed rules.²²² Both sets of proposed amendments are codifications of no-action positions taken by the SEC in the context of particular offerings and in response to specific requests for relief. Application will still have to be made to the SEC on a case-by-case basis in circumstances where the proposed amendments do not apply.

²²⁰ Stabilizing to Facilitate a Distribution, 56 Fed. Reg. at 817.

²²¹ *Id.* at 816. The proposed definition of “specified foreign securities market” is discussed in Definitions Principally Relating to International Transactions, Exchange Act Release No. 28,733, 56 Fed. Reg. 820, at 821 (Jan. 9, 1991). Factors that the SEC will consider in deciding whether to designate a particular market are whether it has an established operating history, is subject to oversight by an authority that has a written understanding with the SEC that provides for cooperation and enforcement coordination in regulatory and enforcement matters, requires securities transactions to be reported on a regular basis to a governmental or self-regulatory body, has a system for public dissemination of price quotations, has sufficient trading volume to indicate liquidity and has adequately capitalized financial intermediaries. *Id.* at 821.

²²² Stabilizing to Facilitate a Distribution, 56 Fed. Reg. at 819. For further discussion of the proposed amendments, see Richard J. Bauerfeld, *SEC Eases Up on Applying U.S. Rules to Global Deals*, INVESTMENT DEALERS’ DIG. (Mar. 11, 1991).

d. Rule 10b-8

The SEC has recognized that Rule 10b-8 creates problems similar to those raised by Rule 10b-7. In the context of rights offerings by U.K. issuers, the SEC has granted a series of exemptions from the extra-territorial application of Rule 10b-8 for certain activities that go beyond passive market-making, so long as the exercise price represented a discount of at least 10% from the share price.²²³ In addition, the SEC has permitted British issuers to adjust the Lay-Off Price and the price at which distribution participants could purchase rights to take account of fluctuations in exchange rates.²²⁴ Finally, the SEC has permitted British issuers to adjust the Lay-Off Price in the United States and the price at which the distribution participants can purchase rights in the United States to take into account trading in the principal market abroad.²²⁵

4. *The NASD Rules*

Section 24(c) of the Rules of Fair Practice of the NASD obliges any member of the NASD who grants a selling concession, discount or other allowance to a non-member broker, dealer or other person in a foreign country in connection with a sale of registered shares in a U.S. public offering to obtain from such person an agreement that it will comply with the requirement that the shares be offered at the public offering price, even outside the United States, subject to such selling concessions, discounts or other allowances as would be permitted by NASD members. Similarly, paragraph 8(a) of the interpretation of the Board of Governors of the NASD regarding free riding and withholding obliges a member of the NASD who sells shares to a foreign broker, dealer or bank who is participating in the distribution as an underwriter to obtain an agreement from such underwriter that it will abide by the rules requiring the benefits of "hot issues" to flow to the investing public.

These obligations to obtain agreements from the foreign participants in a distribution will apply in a global equity offering whenever sales of shares are made from the U.S. syndicate to the international

²²³ Saatchi & Saatchi Company, SEC No-Action Letter, 1993 SEC No-Act. LEXIS 879 (May 19, 1993), *supra* note 226, and British Airways PLC, SEC No-Action Letter, 1993 SEC No-Act. LEXIS 718, *supra* note 226.

²²⁴ Tricentrol Limited, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3547 (July 2, 1980) and its progeny.

²²⁵ Daimler-Benz Aktiengesellschaft, SEC No-Action Letter, 1994 SEC No-Act. LEXIS 571 (June 20, 1994).

syndicate pursuant to the orderly marketing agreement. Because it is impossible to know in advance whether any such sales will be made (or in many cases when they are made, whether any particular offer and sale to the public outside the United States is of shares that were part of the international syndicate's initial allocation from the issuer or of shares that were transferred to it pursuant to the orderly marketing arrangements), the relevant NASD rules are generally applied uniformly. While abiding by these rules does not impose significant burdens on the international underwriters, it may require them to comply with obligations to which they are not accustomed and which are not imposed on them by the rules of the national markets in which they operate.

5. Other considerations

The restrictions on the ability of a foreign investment company to offer shares to the public in the United States imposed by the Investment Company Act are discussed in part II.A.4, as are the limitations that apply to the U.S. activities of foreign broker-dealers.

B. Global Equity Offering Involving a U.S. Private Placement

When a global equity offering involves a U.S. private placement instead of a public offering, the impact of the U.S. laws and regulations is far less significant. Moreover, the syndicate structure is often simplified, the private placement in the United States being made by U.S. affiliates of one or more of the underwriters in the international syndicate, or by such underwriters themselves in accordance with the requirements of Rule 15a-6.²²⁶

1. Registration and Related Requirements

Since the registration requirements of the Securities Act do not apply, the structure and conduct of the U.S. placement is likely to conform in a number of important aspects to the needs of the foreign participants in the offering, which will be influenced principally by the commercial and legal requirements of foreign markets. Perhaps most important, the timing of offers and sales is no longer driven by the registration process and will generally be determined by foreign rather than U.S. considerations, with a corresponding increase in flexibility.

²²⁶ It is now common for foreign companies that offer and sell shares in the United States under Rule 144A, 17 C.F.R. § 230.144A, to exchange those restricted shares for unrestricted SEC registered shares when they list or conduct a public offering in the United States. The issues relating to these exchange offers are beyond the scope of this article.

Moreover, because the extensive disclosure requirements of the SEC's regulations and forms do not apply, the private placement memorandum to be used in the United States will often be the foreign offering circular, with a U.S. "wrap-around" containing:

- appropriate securities law legends and a recital of the restrictions on resale;
- a discussion of the U.S. tax consequences of an investment in the shares;
- in some cases, a discussion of the material differences between U.S. GAAP and the accounting principles used in the preparation of the issuer's financial statements; and
- where the placement is being made on the basis of traditional procedures as opposed to Rule 144A, the form of non-distribution letter to be executed by each U.S. purchaser.²²⁷

The level of "due diligence" may also reflect foreign rather than U.S. standards. The underwriters in a private placement will have to decide early in the process whether they wish to engage in U.S.-style due diligence in connection with the drafting of the offering document – which might well be resisted by the issuer – or whether they are willing to accept the risks of proceeding on the basis of the practices that are customary in the issuer's home country, relying on the representations and indemnities given by the issuer with respect to the accuracy of the offering document. In particular, the underwriters will have to consider whether to ask counsel to provide a "10b-5 letter," which could add significantly to the costs of the offering. This decision will vary depending on a number of factors, including the size of the placement in the United States, the review process that is customary in the issuer's jurisdiction, the creditworthiness of the issuer, the legality and enforceability of the issuer's indemnity and the evolution of market practice following the *Gustafson* decision.²²⁸

On the other hand, when the U.S. tranche is expected to represent a significant portion of the global offering as a whole, or is expected to be large in absolute terms, it is more likely that the offering document will be drafted with an eye to U.S. disclosure standards – including for example, risk factors and MD&A – and that due dili-

²²⁷ Offers and sales in a U.S. private placement may also be made on the basis of research reports prepared by the underwriters, or without any marketing materials at all. Research reports may be used increasingly after the *Gustafson* decision, at least when the placement in the United States is relatively small. *Gustafson*, 115 S.Ct. at 1061 (1995). In larger placements, research reports, which often contain projections, may be used as a supplement to the more formal offering document. Any research report used in offering and selling the shares in the United States will be viewed as an offering document and will thus subject the underwriters, and possibly the issuer, to the same potential liabilities they have on the formal offering document.

²²⁸ See *infra* Part II.A.1.b.

gence will be conducted on the basis of U.S. practices. A dilemma arises, however, when information about a company is simply not available. For example, many Russian companies do not currently have consolidated financial statements and accordingly are unable to present and analyze their results of operations and financial condition in ways that would meet customary standards for offering documents in the West. As a result, underwriters offering and selling shares of a Russian company in a U.S. private placement run the risk that they will be held liable for material omissions if an offering document is used in connection with the placement. Although underwriters are not permitted to disclaim liability under the U.S. securities laws, they should be able to reduce substantially the risk of liability for material omissions in connection with the offering in these circumstances if the limits on the availability and reliability of the information are fully disclosed, the underwriters engage in a significant due diligence exercise to ensure that the offering document is as accurate as it can be and that the risks are highlighted, and sales are made only to institutional investors with experience in investing in Russia or other emerging markets who execute letters acknowledging that they are capable of assessing the significance of the omissions and of bearing the risks involved.

Finally, the international underwriters are even less likely than they would be when a U.S. public offering is involved to limit the research reports they distribute outside the United States to those that would be permitted by Rule 138 or 139 under the Securities Act. However, the prohibition on general solicitation, general advertising, and directed selling efforts in the United States will still require that steps be taken to ensure that research reports published abroad that do not comply with Rule 138 or Rule 139 do not flow into the United States.²²⁹

2. Restrictions on Market Activities

The restrictions of Rule 10b-6 apply only when a "distribution" is being made in the United States. The term "distribution" means an offering of securities, whether or not subject to the registration requirements of the Securities Act of 1933, that is distinguished from ordinary trading transactions by the magnitude of the offering and the

²²⁹ The prohibition on general solicitation and general advertising may require that all research reports be excluded from the United States, and the prohibition on directed selling efforts may require that research reports other than those permitted by Rule 139(b) be excluded. *See supra* note 132.

presence of special selling efforts and selling methods.²³⁰ While a registered public offering of shares will constitute a distribution for purposes of Rule 10b-6 in virtually all cases, a private placement will only be a distribution in certain circumstances. Because the meaning of "distribution" is unclear, U.S. legal advisers in a global offering have often been unable to conclude that a particular private placement in the United States was outside its scope. Consequently, they often considered it necessary to approach the SEC in order to obtain assurances that the restrictions of Rule 10b-6 would not apply to the activities of participants in the offering outside the United States or to negotiate the terms of any passive market-making or other exemption. This need to approach the SEC staff obviated one of the principal benefits of the private placement route, which is the freedom to conduct the global offering without consulting U.S. regulators. More important, it jeopardized the timing of the offering, which would have been dictated principally by commercial realities and legal requirements outside the United States. Moreover, the kind of relief that could ultimately be obtained would likely be unacceptable to the issuer and other foreign participants in the offering because it would leave them with significant burdens on ordinary secondary market trading in the principal markets outside the United States, given that the only distribution in the United States was being made on a private basis to institutional investors and that no U.S. listing was being obtained.

The SEC has done much to solve this problem. The significant exemptions granted to highly capitalized German, French and British companies discussed above in the context of U.S. public offerings apply as well when the U.S. distribution is made in a private placement. Global offerings by other companies may benefit from the important amendments to the Trading Rules adopted in May 1993. These amendments provide that the Trading Rules do not apply to a private placement, under Rule 144A or otherwise, of shares in a foreign company, so long as (1) offers and sales in the United States are made only to qualified institutional buyers or persons reasonably believed by the seller to be qualified institutional buyers; and (2) the shares are eligible for resale pursuant to Rule 144A.²³¹

²³⁰ 17 C.F.R. § 240.10b-6(c)(5).

²³¹ 17 C.F.R. § 240.10b-6(i), -7(o), -8(f). Offers and sales in the United States that are "off-shore transactions" under Regulation S do not affect the availability of the exemption. Regulation S Transactions During Distributions of Foreign Securities to Qualified Institutional Buyers, SEC No-Action Letter, 1995 SEC No-Act. LEXIS 1039 (Feb. 22, 1994).

Some problems do remain, however, for offerings by companies that do not fall within the German, French or U.K. exemptions. Many private placements provide for offers and sales both to qualified institutional buyers and to other institutional "accredited investors" (as defined in Regulation D under the Securities Act). The May 1993 amendments clearly do not apply to these so-called "side-by-side" placements. Moreover, the amendments do not apply to rights offerings that are conducted as private placements if the investors include persons other than qualified institutional buyers. In these rights offerings, however, an earlier exemption may come into play. Adopted on April 25, 1991, this exemption provides that the Trading Rules will not apply to non-U.S. trading activities in foreign securities during the period when rights or the underlying securities are being sold in the United States, so long as (1) offers and sales are made only to qualified institutional buyers or other institutional accredited investors; (2) the exercise price represents a discount of at least 8% from the market price of the underlying shares at the time the offering commences; and (3) the issuer has a public float of at least \$150 million in voting securities. Further, the exemption is available only to underwriters and their affiliates, not to issuers and their affiliates.²³²

In circumstances where no exemption is available, the U.S. legal advisers to the offering will either have to conclude that the selling efforts in the United States do not rise to the level of a distribution or seek specific relief from the SEC. The factors to consider when deciding whether a particular placement in the United States constitutes a distribution include:

- the size of the offering in the United States, both in absolute terms and in relation to the value of the issuer's publicly traded shares;
- whether there is an identifiable U.S. underwriting syndicate and, if so, its size;
- whether shares are allocated for sale in the United States;
- the number of investors contacted in the United States; and
- the nature of the selling efforts, including in particular whether a road show involving directors and officers of the issuer is being conducted.

While this area is extremely murky, it would not be unwarranted for the participants in a global offering to proceed on the assumption that a U.S. placement will not be a distribution, regardless of its size, if:

- it is limited to qualified institutional buyers and institutional accredited investors;

²³² Securities Industry Association, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 649 (Apr. 25, 1991).

- there is no identifiable U.S. syndicate;
- no shares are allocated for sale in the United States;
- the number of offerees is limited to one hundred;
- the underwriters contact investors either by telephone or in very small groups; and
- directors and officers of the issuer do not participate in the marketing efforts.

If these conditions are not met, all the relevant facts and circumstances will have to be considered including the size of the placement, and in many cases the U.S. legal advisors may find themselves unable to reach a definitive conclusion. In those instances, the SEC's general relief regarding passive market-making, and the determination of the appropriate cooling-off period, may be relied on if they apply. If they do not apply, specific relief will have to be obtained.

3. Other Considerations

Members of the NASD are not obliged to obtain agreements from the international underwriters of the kind outlined above, since the rules in question do not apply in a private placement. The restrictions regarding a private placement of shares of a foreign investment company are outlined in part II.A.4, as are the limitations on the ability of foreign brokers or dealers to offer and sell securities to U.S. institutional investors.

C. Global Equity Offering Involving Public Offerings in the United States and in other Countries²³³

The potential for conflict between the U.S. and foreign regulatory regimes is greatest when a global equity offering combines a public offering in the United States with a public offering in one or more regulated national markets abroad. Reconciling the various requirements in these circumstances, and obtaining relief from the appropriate regulatory authorities when the rules are irreconcilable, is a subtle and delicate task. While it is beyond the scope of this chapter to analyze the laws and regulations of countries other than the United States, the nature of some of the issues that can arise will be illustrated by discussion of recent global equity offerings in which U.S. public offerings were combined with public offerings in the United Kingdom, France, Germany, Italy and Japan.

²³³ Global equity offerings involving a public offering in both the United States and the countries referred to below are also discussed in [Edward F. Greene et al.]

1. The United Kingdom

The U.K. privatizations of the 1980s and early 1990s combined public offerings in the United Kingdom and elsewhere with traditional U.S. private placements (*i.e.*, the U.K. water companies), U.S. private placements under Rule 144A (*i.e.*, the U.K. electricity industry) and U.S. public offerings (*i.e.*, British Airways plc, British Petroleum plc and British Telecommunications Plc (BT)). The structure and conduct of these global offerings was dictated in large measure by the commercial practices and legal requirements of the United Kingdom.

Until the BT offering in late 1991, the U.K. privatizations followed a broadly similar pattern. Marketing would begin in the United Kingdom on "pathfinder day" with the publishing of the so-called "pathfinder prospectus." Several weeks later, on "impact day," the shares would be priced, the underwriting agreements would be signed, the U.K. prospectus in final form would be made available, and the subscription period would begin. Several weeks after that, on "allotment day," the shares would be purchased and dealings on the London Stock Exchange would commence. In the earliest privatizations, U.K. underwriters and sub-underwriters would be paid commissions for agreeing to take up any shares allocated to the U.K. offering for which subscribers were not found; over time, as HM Treasury gained confidence, the U.K. underwriters and sub-underwriters were gradually eliminated.

It was considered essential in these privatizations that offers be made at the same time in all markets so as to prevent any underwriting syndicate from gaining a marketing advantage. It was also considered necessary to preclude "gray-market" trading of "when-issued" shares during the subscription period, since such trading could disrupt the U.K. marketing efforts. Moreover, the offering documents to be used in all markets were required to conform in substance to the U.K. pathfinder prospectus and final prospectus, and no changes in the substantive disclosure about the issuer or its business were permitted once the pathfinder prospectus was published. Finally, HM Treasury wished to retain complete discretion to decide whether the offering would proceed once the underwriting arrangements were put in place.

These *desiderata* had significant implications for the registration process in the United States. First, while a registration statement could not be publicly filed with the SEC before pathfinder day, it was necessary to clear the preliminary prospectus with the SEC before that time, since no changes would be allowed thereafter, even in response to SEC comments. In order to ensure that the disclosure in

the preliminary prospectus would not change, a confidential filing with the SEC was made sufficiently well in advance of pathfinder day to ensure that comments could be obtained and any required amendments could be reflected in all the offering documents, by pathfinder day.

Secondly, in order to prevent flow-back into the United Kingdom, during the U.K. subscription period, of shares sold elsewhere, the underwriters were prohibited from confirming sales until allotment day. In the United States, this prohibition was strengthened by having the issuer request the registration statement to be declared effective only on allotment day, thus making it unlawful under §5(a) of the Securities Act for the U.S. underwriters to confirm sales in the United States before then.

Finally, in order for HM Treasury to preserve discretion to decide whether the global offering would proceed, all conditions to the underwriters' obligations, including the effectiveness of the registration statement, and all termination rights, including customary *force majeure* provisions, were eliminated. This, combined with the long underwriting period covering the several weeks between impact day and allotment day, resulted in the underwriters assuming significant risks. In the United Kingdom, these risks could be shifted to sub-underwriters or institutional investors, who would give commitments on impact day in return for a share of the commissions. This option was not available to the U.S. underwriters, however, because obtaining commitments from sub-underwriters or institutional investors was considered the equivalent of confirming sales under the Securities Act, which was unlawful until the registration statement was declared effective. Accordingly, when the market crash of October 1987 occurred after impact day but before allotment day in the second British Petroleum offering, the U.S. underwriters took substantial losses.

Two additional peculiarities of the standard U.K. privatization are worth noting. First, an over-allotment option generally was not provided and stabilizing activities were not contemplated. Secondly, intersyndicate transfers of shares were not permitted, except with the permission of HM Treasury.

In the second BT offering, which was made in late 1991, HM Treasury introduced a number of significant innovations, which set the basic pattern for subsequent transactions. For the purposes, the most significant of these was the tender system, which was used by HM Treasury as a basis for pricing and allocating the shares. The system was designed to obtain three principal benefits:

- to increase the “transparency” of the offering – *i.e.*, to allow HM Treasury to look through the underwriters to see the actual interest in the shares of end-investors;
- to allow pricing to occur just before allotment day rather than on impact day, thus permitting market developments that would otherwise be ignored to be taken into account; and
- to shorten the underwriting period with a view to reducing commissions.

Expanded from its somewhat peripheral role in the later stages of the privatization of the electricity industry where it was first tested, the tender system worked as follows:

- On November 13, pathfinder day, the underwriters and HM Treasury executed the orderly marketing agreement, the pathfinder prospectus and other preliminary offering documents were published, and marketing began.
- On November 21, impact day, the underwriters and HM Treasury executed the international tender offer agreement, HM Treasury determined the size of the discount from the tender offer price (to be decided later) that would be made available to U.K. individuals who subscribed for the shares, and the final U.K. prospectus was published. The international tender offer agreement obliged the underwriters to solicit indications of interest from investors in their markets, but did not oblige them to purchase any shares.
- At the end of the day in London on Friday, December 6, the underwriters, through the managing underwriters in each of the ten syndicates, submitted bids on behalf of investors, indicating how many shares each investor wished to purchase and at what price.
- Over the weekend of December 7-8, HM Treasury determined the number of shares to be allocated to each syndicate, with no syndicate being asked to purchase a number of shares in excess of the bids submitted on its behalf by its managing underwriter. If the managing underwriter for a syndicate accepted the number of shares that HM Treasury wished to allocate to it, and the price per share (which was to be the same for all syndicates), it would execute a purchase memorandum committing the syndicate to underwrite those shares. The purchase memoranda were held in escrow until the morning of Monday, December 9, when dealings commenced in London.

In this framework, the U.S. preliminary prospectus was cleared with the SEC on a confidential basis in advance, the registration statement containing the preliminary prospectus was filed on pathfinder day, an interim amendment to the registration statement was filed on impact day, and an amended registration statement was filed and declared effective on Thursday, December 5, allowing the U.S. underwriters to confirm sales promptly after the price was set, and their underwriting obligations crystallized, on December 8. Thus, because the U.S. underwriters were free to sell the shares promptly after as-

suming their underwriting obligations, the risks they accepted in the offering were little different from those encountered in a standard U.S. underwriting. However, because the risks were much reduced from earlier privatizations – even to the point where there was some loose talk of the “elimination of underwriting” – the commissions were lowered to unprecedented levels, well below what is customary in the United States.

There were two other innovative features in the BT offering which were significant for our purposes. First, an over-allotment option was provided and stabilization was contemplated for the first time in a global equity offering involving a public offering in the United Kingdom (the stabilizing activities being conducted under the SIB rules in accordance with the no-action position outlined above). Secondly, the SEC was persuaded to allow market-making by all the underwriters and their affiliates to continue on the London Stock Exchange in the ordinary course, without regard to the restrictions of Rule 10b-6 or the passive market-making requirements.²³⁴

Overall, the British experience represents a significant evolution toward U.S.-style underwriting. In recent transactions, the basic features of the 1991 BT offering have been refined but not fundamentally altered. The latest innovations have involved efforts to use allocation policies to control destructive market behavior by institutions – short selling in particular – before and during the subscription period.

2. France

A global equity offering of shares in a French company also raises difficult questions of coordination, exacerbated by the fact that the French have less experience than the British in reconciling the conflicting commercial and legal requirements. A public offering in France involves, in principle, the issue of preferential subscription rights (*droits préférentiels de souscription*) that entitle existing shareholders to subscribe to newly issued shares in proportion to their existing holdings. The preferential subscription rights are detached from the existing shares on the day the subscription period begins in France and are immediately listed on the Paris Stock Exchange (and/or any

²³⁴ In addition, the U.S. underwriters were able to preserve in their agreement among underwriters the customary method of allocating selling commissions in the United States, which is to give the lead underwriter the authority to make sales for the accounts of the other underwriters and to allocate the selling commissions with respect to those sales as requested by the purchasers. This contrasted with the system that applied to most of the other syndicates, which required in effect that selling commissions be allocated among the underwriters *pro rata* to their underwriting commitments.

local French stock exchange on which the issuer's shares may be listed). The listing remains effective throughout the subscription period,²³⁵ which typically lasts for three weeks (twenty days is the minimum required by law).

Preferential subscription rights may be waived by an extraordinary meeting of shareholders (*assemblée générale extraordinaire*) that authorizes the public offering. Such has been the case in a number of international equity offerings launched by French companies in the last few years. In these circumstances, however, the issue price of the newly issued shares may not be less than the average market price of the existing shares during twenty consecutive business days within the last forty business days preceding the commencement of the offering. Furthermore, the *Commission des Opérations de Bourse* (COB) may insist that the issue price of the new shares be as close as possible to the market price of the existing shares at the time of the pricing of the new shares, particularly if the market price of the existing shares has been increasing in the recent past. An offering predicated on a waiver of preferential subscription rights may therefore prove commercially unfeasible, as the so-called "twenty-forty rule" and the COB's requirements may severely affect the pricing and limit the discount at which the new shares may be offered.

In addition, the COB is not in favor of waivers of preferential subscription rights, which in its view may put smaller shareholders at a disadvantage. In order to mitigate this disadvantage and be responsive to the COB's concerns, it is customary for French issuers, when preferential subscription rights are waived, to grant their existing shareholders priority rights (*droits de priorité*) to subscribe on a *pro rata* basis to the newly issued shares. Unlike preferential subscription rights, priority rights are neither listed nor negotiable and usually cover a shorter period of time (typically around ten business days).

Under French law, the terms of a public offering, including in particular the price of the shares, cannot be made public until they are announced in the *Bulletin des Annonces Légales Obligatoires* (BALO), which must occur at least six days prior to the beginning of the subscription period in France. If this limitation were to apply to the offering being made in the United States, there would be no opportunity for marketing to commence on the basis of a preliminary prospectus, as is customary in a U.S. public offering. Moreover, it is unlikely that the participants in the French offering would allow sales

²³⁵ For practical reasons, it is customary to extend the listing of the preferential subscription rights until two days after the end of the subscription period.

to be confirmed in the United States until the end of the subscription period in France, since gray-market trading of shares bought in the United States on a when-issued basis could prove disruptive. Thus, the risks for the U.S. underwriters would be similar to those in a U.K. privatization before the 1991 BT offering.

These issues were identified, and resolved in a highly satisfactory way, in the global offering of shares in Société Nationale Elf Aquitaine (Elf) in the early summer of 1991. In that offering, the COB permitted the offering to proceed without any priority or preferential subscription rights for existing shareholders, which allowed sales to be confirmed in the United States immediately after pricing since there was no need to wait for the end of a subscription period in France. In addition, the COB permitted marketing in the offerings outside France, including in the public offering in the United States, to begin in advance of the pricing announcement in the BALO on the basis of a preliminary prospectus that, as is customary, would omit pricing information. Finally, simultaneous trading in Paris and New York was facilitated by quoting *promesses d'actions* (rights to acquire shares, akin to "when issued" shares) on the Paris Stock Exchange at the same time as trading began on the New York Stock Exchange. This resolved the inconsistency between U.S. and French practices deriving from the fact that trading in the United States normally begins immediately after pricing while in France it would not commence until closing.

The global equity offering of Euro Disney in the spring of 1994 was conducted quite differently. It involved the issue of preferential subscription rights, which allowed the newly issued shares to be offered at a discount to the market price and also allowed the existing shareholders either to exercise these rights or sell them in the market.

For technical reasons, the offering was also registered with the SEC in the United States. As a result of secondary market trading after Euro Disney's initial public offering in 1989, the issuer was unable to conclude that its shareholder base in the United States was limited to qualified institutional buyers and other accredited investors and thus that a U.S. private placement could be conducted. Moreover, as French law requires that preferential subscription rights, if issued, be issued to all shareholders, U.S. shareholders could not be excluded from the offering. Accordingly, the offering was required to be registered with the SEC. The United States, was not expected to be a significant focus of the offering, however. Accordingly, no particular efforts were made to facilitate the purchase of the newly issued

shares by U.S. shareholders or other U.S. investors. The Euro Disney shares were not listed in the United States before or after the global offering and an ADR program was not put in place. Although an information agent was appointed in the United States, no mechanism was provided to help U.S. investors or their brokers to convert U.S. dollars into French francs in order to pay the purchase price of the shares or to protect them against foreign exchange risks incurred as a result of such conversion. Moreover, no mechanism similar to the one implemented by Elf in order to permit trading of the new shares on a when-issued basis immediately after pricing was implemented: the shares were delivered on August 12, 1994 and listed in Paris on August 17, 1994, more than one month after the closing of the subscription period and over two months after pricing.

3. *Germany*

Substantial issues of coordination arise in a global offering involving shares of a Germany company. As in France, there is little experience in reconciling inconsistent practices, as only one German company, Daimler-Benz AG (Daimler), has to date made public offering of its shares in the United States as part of a global offering.

German public offerings are generally conducted as offerings of subscription rights to existing shareholders.²³⁶ German rights offerings are structured as so-called "clawback" rights offerings, in which the underwriting syndicate purchases all of the new shares to be issued in the rights offering from the issuer prior to the commencement of the subscription period. Exchange trading in the rights may take place throughout the subscription period, which, in the case of Daimler, lasted two weeks. The price of the shares to be offered is fixed well prior to the commencement date for the rights offering (permitting the issuance of the new shares to be entered into the commercial register on the basis of the subscription, therefore, by the syndicate members) and typically includes a steep discount (up to twenty percent). The syndicate members may purchase and sell rights in the market during the subscription period and then, upon the expiration of the subscription period, may commence offering any unsubscribed

²³⁶ German corporate law makes it difficult for a German company to increase its capital other than by offering rights to existing shareholders. One new exception to the general rule permits companies to increase their capital by up to ten percent without being required first to offer the new shares to existing shareholders. This exception is likely to make it easier for German companies to offer relatively small amounts of shares in the United States and elsewhere outside Germany in a manner that conforms more closely to the practices in the jurisdictions in which such offerings are made.

shares remaining in their possession to new investors in Germany and abroad. This structure presents significant risks for syndicate members, who, in the case of Daimler, were exposed to price fluctuations and other market risks for nearly one month (albeit with the significant cushion provided by the offer discount).

Marketing took place in the United States in the Daimler offering on the basis of a preliminary prospectus, dated the day after the price was established, that included the pricing information. Effectiveness was delayed until immediately before the commencement of the subscription period for the new shares; in order to prevent market disruption in Germany, it was important to the syndicate members to preclude trading of rights or new Daimler shares on a when-issued basis prior to the commencement of the subscription period.

Other reconciliation issues that arose in the Daimler offering involved the disclosure of certain details relating to the underwriting arrangements. The actual underwriting agreement in a German offering is not a matter of public record; even underwriters other than the lead underwriter do not normally have access to the underwriting agreement other than in summary form with respect to the information affecting them individually. Even allocations among the underwriters are generally treated as confidential by the issuer and the lead underwriter. This practice is inconsistent with the U.S. requirement that the underwriting agreement be filed as an exhibit to the registration statement and that detailed disclosure relating to the underwriting arrangements (including allocations to underwriters and the underwriters' compensation arrangements) be made. In the case of Daimler, the underwriting agreement was in fact filed as an exhibit to the registration statement, but certain of the details relating to the commission structure and viewed as more highly sensitive were redacted out of the document filed. The allocations among the underwriters were disclosed, however

4. Italy

Until the global offering by the Italian Treasury (and other smaller shareholders) in early 1994 of shares in Istituto Mobiliare Italiano S.P.A. (IMI), the Italian regulatory framework and market practice would effectively have made it impossible to conduct an initial public offering with simultaneous listing and trading on Italian and non-Italian stock exchanges. The IMI global offering had three tranches: a domestic public offering, a U.S. public offering and an institutional offering, both domestic and international.

Public offers of securities may be made in Italy only on the basis of a prospectus filed with the *Commissione Nazionale per le Società e la Borsa* (CONSOB). CONSOB regulations require that the prospectus be filed at least five days before the beginning of the subscription period, stating the quantity and, in the case of initial public offerings, also the price of the securities being offered for sale (only in the case of offerings of securities of a listed company is it possible to announce the price no later than the day before the start of the subscription period). No solicitation may take place until the prospectus is published. The practice and the regulations do not contemplate the filing and publication of a preliminary prospectus on the basis of which marketing activities may begin. Moreover, the usual timing of the admission to listing and beginning of trading, as determined by CONSOB regulations, would create a further conflict with the timing of an offering in international markets. As a prerequisite for admission to listing in Italy, shares must have a "sufficient distribution" (*i.e.*, in principle no less than 25 percent of a given class of shares and 500 shareholders). As a rule, in the case of an initial public offering, the CONSOB does not set the date for the beginning of trading until it has ascertained that a sufficient distribution has been made, upon receipt from the issuer of detailed information on the number of investors and of shares sold and a declaration that the shares have been delivered to the investors. This procedure normally takes ten to twenty days. Furthermore, trading may not begin until five days have elapsed from the publication of a notice announcing the date set by the CONSOB for the beginning of trading.

In response to IMI's requests aimed at coordinating the timing of the domestic and international offerings, the CONSOB granted IMI extensive relief from, or formally amended, a number of its rules, thus permitting all key stages of the offering to be conducted simultaneously in Italy and abroad. The U.S. and international preliminary prospectuses and the Italian prospectus were published on the same day, approximately three weeks before pricing, including only a range for the number of shares and the price of the shares in the Italian public offering. Thus, marketing and book-building activities could take place simultaneously in Italy and abroad.

The pricing of the Italian offering, sizing of the global offering and execution of the underwriting agreements were permitted to take place just two days before the Italian subscription period was due to open, on Saturday, January 29, and a notice completing the terms of the Italian offering was published the following day in the Italian press

(the notice did not fix, however, the exact size of the Italian offering, since the CONSOB allowed the Treasury to maintain discretion to re-allocate shares among the three tranches of the global offering). The subscription period commenced on Monday, January 31, and was due to last five days. It was closed on February 1, after only two days, as the offering was heavily over-subscribed.

Moreover, CONSOB introduced a new section (18*bis*) to its Regulation No. 4088/1989 on admission to listing and trading, applicable only in the case of a simultaneous equity offering in Italy and abroad, permitting trading to begin in Italy essentially on a "when issued basis" (*i.e.*, waiving the requirement that shares be issued to the investors *before* trading could begin and requiring only that the domestic underwriters commit to completing the allocation procedures and be in a position to confirm sales on the first day of trading). Unlike the COB in France, however, the CONSOB required that the U.S. and international underwriters undertake not to allow a gray market to develop abroad; the underwriters were not permitted to confirm sales outside Italy before trading started in Italy. As a result of these rules, the market risk borne by U.S. and international underwriters was reduced to the period of seven business days from pricing to confirmation. On February 7, the CONSOB confirmed, on the sole basis of the total number of shares allotted to the Italian public offering, that the offering had achieved a sufficiently wide distribution in Italy and that, as a consequence, trading could begin the day after a notice of its decision was published (publication occurred the following day). On February 8, the U.S. registration statement was declared effective. On February 9, the eighth business day after pricing, trading commenced simultaneously on the Sistema Telematico delle Borse Valori Italiane (the Italian screen-based stock exchange) and New York Stock Exchange.

The CONSOB initially took the position that an over-allotment option would conflict with the Italian legal and regulatory provisions that require the maximum size of public offering in Italy to be determined in advance. This objection was overcome, however. The selling shareholder was permitted by the CONSOB to reallocate to the Italian public offering a number of shares initially offered in the two other tranches of the global offering. The shortfall in the other tranches could then be filled through the exercise of an over-allotment option (exercisable within thirty days of the effective date of the U.S. and international prospectuses and limited to 15 percent of the institutional and U.S. public offering tranches).

5. *Japan*

In Japan, a foreign company wishing to offer equity to the Japanese public was, until 1989, required, as a practical matter, to obtain a listing on the Tokyo Stock Exchange. Since that exchange's listing criteria are stringent, and the listing process is time-consuming and expensive, many foreign issuers had been deterred from raising capital in Japan's public markets and had relied instead on a private placement exemption²³⁷ or secondary sales when offering securities to Japanese investors.²³⁸

In 1989, procedures doing away with the Tokyo listing requirement were put into effect. These procedures make it easier for foreign companies to offer shares in a public offering in Japan, particularly in connection with a global offering involving a public offering in the United States or in another national market. For a company to be able to use these procedures to conduct a "public offering without listing," its stock must be listed on its home stock exchange (which must be an exchange approved by the Japanese Securities Dealers Association).²³⁹

Under the procedures for public offerings, the precise number of shares to be offered in Japan generally must be registered before sales can be confirmed, and a securities registration statement in Japanese must be declared effective by the Ministry of Finance pursuant to the Securities and Exchange Law of Japan. In terms of substance, a U.S. registration statement or U.K. listing particulars can easily be converted into a Japanese registration statement. As a general matter, the registration statement cannot be declared effective and sales may not be confirmed until the second Tokyo business day after an amendment to the registration statement setting forth the price of the shares has been filed. In the past, the Ministry of Finance has relaxed this requirement on an ad hoc basis for global offerings.²⁴⁰ Regulatory

²³⁷ In Changes in the Japanese Securities and Exchange Law effected in 1993 clarified the use of private placements in Japan, and specifically permit private placements of newly issued equity securities to less than 50 persons without requiring the filing of a registration statement with the Ministry of Finance.

²³⁸ Secondary sales include sales of shares that are purchased by underwriters in primary offerings outside Japan and then resold in Japan through Japanese brokers on the day after the closing.

²³⁹ In 1994 these exchanges, which had been limited to the exchanges of OECD countries, were expanded to include non-OECD country exchanges that have disclosure requirements sufficient for the protection of investors, as determined by the Japanese Securities Dealers Association.

²⁴⁰ For example, in the offering by *Compañía de Teléfonos de México (Telmex)*, the Ministry of Finance allowed sales to be confirmed on the first business day after that filing.

changes that became effective in 1994, however, allowed pricing amendments to a registration statement to be declared effective on the first Tokyo business day after they are filed in circumstances where the underwriters obtain indications of interest in the offering during a marketing period in which a preliminary prospectus is used (*i.e.*, through a book-building process). Beginning in July 1995, the Ministry of Finance will declare a pricing amendment effective on the same day it is filed when a book-building process is involved.²⁴¹ These changes greatly reduce the risk to the Japanese syndicate in a global offering associated with the time lag between trading in Japan and trading in markets located outside Japan.

In a global offering that includes a public offering in Japan, transfers of shares to or from the Japanese syndicate are generally not possible, nor is it possible for the Japanese syndicate to participate in an over-allotment option, due to the requirement that the precise number of shares to be offered in Japan be registered with the Ministry of Finance at the time the registration statement is declared effective. In the 1991 Telmex offering, however, the Ministry of Finance permitted the use in Japan of an over-allotment option so long as the Japanese syndicate controlled whether the option would be exercised by the Japanese syndicate, the registration statement covered the maximum number of shares to be offered and sold in Japan (including the shares that would have been sold upon the exercise of the option) and the settlement date for the shares subject to the option was the same as the settlement date for the other shares.²⁴²

IV. CONCLUSION

As the world's capital markets become more integrated, global offerings of shares are likely to remain the preferred way for governments to privatize their state-owned companies and industries, and for

²⁴¹ In the case of Japanese issuers, the offering price is often calculated in accordance with a specific formula. If the formula is disclosed in the original registration statement, sales can be confirmed immediately after the registration statement is declared effective (which generally takes place 14 days following the original filing). While an amendment disclosing the actual price is required to be filed even where the pricing formula is disclosed in the original filing, the filing of such an amendment is not a precondition to confirmation of sales.

²⁴² Under a normal over-allotment option, the global coordinator decides whether to exercise the option and allocates the shares on a *pro rata* basis to each syndicate, subject to inter-syndicate transfers pursuant to the orderly marketing arrangements. The settlement date for the shares subject to the option may also be later than the settlement date for the shares in the initial offering. The Ministry of Finance has thus far not permitted use of this standard type of over-allotment option in Japan.

world-class private issuers to raise equity capital. Two kinds of developments can be anticipated:

- commercial innovations, which among other things may involve efforts to increase “transparency,” improve pricing mechanisms and reduce commissions, perhaps following the path broken by HM Treasury in the recent U.K. privatizations; and
- coordination among regulatory authorities, which will harmonize many of the conflicting requirements of the legal regimes of the principal countries where offerings are generally made.

While commercial innovations are difficult to anticipate, the main lines of regulatory coordination, at least in so far as the U.S. authorities are concerned, can now be seen.

First, the SEC will probably continue to refine its thinking about the application of the Trading Rules to foreign trading activities. Not only will the SEC create further exemptions for offerings by highly-capitalized foreign companies, but it is likely to change the Trading Rules in their entirety along the lines of proposed Regulation M.

Second, the SEC has proposed the adoption of rules permitting certain kinds of offerings – *i.e.*, exchange offers and rights offerings when only a small proportion of the shares in the company in question is held in the United States – to be made in the United States on the basis of the offering documents that are used in the issuer’s home market, without requiring additional disclosures (including in particular with regard to the issuer’s financial statements). Although proposals on these matters have been made, they have not yet been adopted.²⁴³ The principal purpose of relaxing the U.S. requirements in these kinds of offerings is to allow U.S. shareholders to take advantage of opportunities they would otherwise be denied. Under the current system, U.S. shareholders are often excluded because of the issuer’s unwillingness to comply with SEC requirements, because doing so could require additional disclosure, involve additional costs and potential liabilities, and subordinate the timing of the offering to the SEC registration process.

Finally, the SEC is exploring ways in which other kinds of public offerings can be made in the United States on the basis of “home country disclosure.” The most fruitful approach thus far has been to establish reciprocal arrangements with foreign regulatory authorities whereby certain classes of companies in each country are permitted to offer securities in the other country on the basis of the disclosure re-

²⁴³ Securities Act Release No. 6898, Exchange Act Release No. 29277, 17 Fed. Reg. 229, at 240, 249 (June 6, 1991) deals with exchange offers, while Securities Act Release No. 6896, 56 Fed. Reg. 27,564 (June 14, 1991) covers rights offerings.

quirements of the home market. These arrangements have been established with Canada and comparable arrangements may now be considered for other countries. More likely, however, is the continued dialog between the regulators of different countries over incremental changes to accounting principles and financial statement requirements, which in the end form the basis of all disclosure.