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American Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies

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Abstract

One of the more popular means utilized by foreign private issuers in recent years to create a market for their securities and to raise capital in the United States has been the issuance of American Depository Receipts ("ADRs"). The estimated total dollar volume of ADR trading on U.S. exchanges in 1992 was approximately U.S.\$125 billion. ADRs are negotiable certificates issued by a United States bank or trust company. These certificates represent an ownership interest in a foreign private issuer's securities deposited, usually outside the United States, with a financial institution as depository. The underlying securities represented by ADRs may be either debt or, more commonly, equity instruments. This Article will address the benefits and uses of ADR financing and the legal and practical issues related to the establishment and operation of ADR facilities. Additionally, this Article will provide an analysis of pending Securities and Exchange Commission ("SEC") initiatives with respect to international securities regulations, which are likely to impact the ADR market.

AMERICAN DEPOSITARY RECEIPTS: AN INTRODUCTION TO U.S. CAPITAL MARKETS FOR FOREIGN COMPANIES

*Mark A. Saunders**

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INTRODUCTION

One of the more popular means utilized by foreign private issuers in recent years to create a market for their securities and

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to raise capital in the United States has been the issuance of American Depositary Receipts ("ADRs").¹ The estimated total dollar volume of ADR trading on U.S. exchanges in 1992 was approximately U.S.\$125 billion.² ADRs are negotiable certificates issued by a United States bank or trust company. These certificates represent an ownership interest in a foreign private issuer's securities deposited, usually outside the United States, with a financial institution as depository.³ The underlying securities represented by ADRs may be either debt or, more commonly, equity instruments.⁴ This Article will address the benefits and uses of ADR financing and the legal and practical issues related to the establishment and operation of ADR facilities. Additionally, this Article will provide an analysis of pending Securities and Exchange Commission ("SEC") initiatives with respect to international securities regulations, which are likely to impact the ADR market.

1. In this Article, the term "foreign private issuer" is defined as in Rule 405 under the Securities Act of 1933, 17 C.F.R. § 230.405 (1992).

2. THE BANK OF NEW YORK, DEPOSITARY RECEIPTS, ADRS/GDRS, 1992 THE YEAR IN REVIEW 1 (1993). From 1980 through 1986, foreign corporations raised approximately U.S.\$8.6 billion through the public offering of equity securities in United States capital markets. See REPORT OF THE STAFF OF THE U.S. SEC. AND EXCH. COMM'N TO THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS AND THE HOUSE COMM. ON ENERGY AND COMMERCE, INTERNATIONALIZATION OF THE SEC. MKTS., 100th Cong., 1st Sess., II-106 (July 27, 1987) [hereinafter SEC REPORT]. In 1986 alone, the registered public offerings by foreign private issuers of their equity securities in the United States totaled approximately U.S.\$2.5 billion. *Id.*

3. See Regis E. Moxley, *The ADR: An Instrument of International Finance and a Tool of Arbitrage*, 8 VILL. L. REV. 19, 22-23 (1962). Other names ascribed to ADR type instruments include "American Share Certificates," "American Shares," and "New York Shares." See generally LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 229 (2d ed. 1988) (defining ADRs). For the purpose of this article, all ADR type instruments shall be referred to as either "American Depositary Receipts" or "ADRs."

4. See generally Jonathan W. Royston, *The Regulation of American Depositary Receipts: Americanization of the International Capital Markets*, 10 N.C. J. INT'L L. & COM. REG. 87 (1985) (examining ADR regulation). The United States Securities and Exchange Commission (the "SEC") defines a "Depositary Share" as "a security, evidenced by an American Depositary Receipt, that represents a foreign security or a multiple of or fraction thereof deposited with a depository." Securities Act of 1933, 17 C.F.R. § 230.405 (1992). A typical ADR represents a single depositary share. *Id.* The ADR, however, may be issued in units that represent either a fraction or multiples of the deposited security. *Id.*

I. A PRIMER ON THE ISSUANCE AND TRADING OF AMERICAN DEPOSITARY RECEIPTS

A. U.S. Capital Markets and the ADR Mechanism

U.S. capital markets afford significant opportunities to foreign private issuers interested in financing their domestic and international operations. Factors making the United States an attractive capital market for foreign private issuers include the following: (i) American capital markets provide access to domestic U.S. investors who cannot easily purchase foreign securities that are traded only in the equity markets of the foreign private issuer's own country, (ii) valuation standards for determining price/earnings ratios may be higher in the United States than in the foreign private issuer's home market, (iii) U.S. markets have shown consistent liquidity and depth, thus making it easier for foreign private issuers to raise large amounts of funds by issuing securities, (iv) capital raised in U.S. markets is denominated in U.S. dollars, which facilitates financing activities in the United States, international transactions and the repayment of U.S. dollar denominated debt, (v) a public offering of securities in the United States provides recognition, which may assist a company in marketing its products and services in the United States and in other countries, and (vi) "a foreign issuer with a class of securities listed on a U.S. securities exchange can more easily issue additional securities of the same class to finance acquisitions without depleting its cash reserves."⁵

Introduced in the United States in 1927, ADR use has grown substantially to the point where the issuance of ADRs is the most common method employed by foreign private issuers to raise capital in the U.S. capital market.⁶ Foreign companies

5. Donald L. Calvin, *Raising Capital in United States Markets*, unpublished paper delivered at a seminar on Developments in Primary Markets 4-5 (Sept. 20, 1986) (on file with the *Fordham International Law Journal*).

6. *Id.* at 17. Foreign private issuers appear to have historically recognized the benefits of offering their shares in the United States. See SEC REPORT, *supra* note 2, at I-1 (discussing internationalization of securities markets). In 1977 registered public offerings of foreign corporate government debt and business equity in the United States represented 13%, or U.S.\$4.7 billion, of the dollar volume of the U.S. public new issues market totalling U.S.\$36.5 billion. *Id.* at II-82. By 1986 foreign issues had dropped to 3%, or U.S.\$6.4 billion, of the U.S. public new issues market, which totalled U.S.\$228.4 billion in 1986. *Id.* at II-83. However, despite the drop in percentage, the number of new foreign issues offered in the United States has remained relatively stable. In 1977 there were 51 new issues, while in 1986 there were 52 new issues. *Id.* at II-105. The

have utilized ADRs in connection with mergers and acquisitions, restructurings, foreign government debt offerings, and employee benefit plans.⁷ This trend is expected to continue as a result of the increasing globalization of world securities markets and the growing number of foreign corporations seeking access to U.S. capital markets.⁸

The expansion of the ADR market can be attributed to the significant benefits that accrue to both the ADR issuer and the security holder. For the foreign private issuer, ADRs provide a new market for securities that is cost-effective, with minimum disclosure and attendant potential liability.⁹ For the security holder, ADRs offer the opportunity to own foreign securities through a mechanism that affords the advantages normally associated with ownership of securities of domestic U.S. issuers.¹⁰

A primary security holder benefit associated with ADRs is issuance in registered form, as contrasted with the bearer format of many foreign security certificates.¹¹ The registration of ADR

highest number of new issues between 1977 and 1986 was 92 in 1983 and the lowest 32 in 1979. *Id.*

7. See American Depositary Receipts, Securities Act Release No. 6894, Exchange Act Release No. 29,226, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740 (May 23, 1991) [hereinafter 1991 SEC REPORT]. In addition, ADR offerings under Rule 144A of the Securities Act of 1933 are gaining in popularity. *Id.*; 17 C.F.R. § 230.144A (1992).

8. See SEC REPORT, *supra* note 2, at II-84-86. "The leading sources of ADRs over the last 10 years have been Australia (308 registrations), the United Kingdom (174), Japan (149), and South Africa (142)." *Id.* In 1986, there were 204 ADR registrations by foreign private issuers as compared with 11 registrations of foreign government debt, 50 of corporate equity and 9 of corporate debt. *Id.* at II-86. However, the SEC has not indicated what portion of the ADR registrations accounted for new foreign issues and which were simply registrations of additional shares of issues already traded in the United States. *Id.* at II-84.

ADR registrations in the United States generally increased steadily from 1977 to 1986. The exact numbers of registrations were as follows: 1977 (35 registrations), 1978 (31), 1979 (58), 1980 (66), 1981 (106), 1982 (45), 1983 (60), 1984 (139), 1985 (288) and 1986 (204). *Id.* at II-86.

9. See LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 774-75 & n.72 (3d ed. 1989).

10. See generally Anna Merjos, *Investors' Ticket Abroad: American Depositary Receipts Are Growing in Popularity*, BARRON'S, Apr. 30, 1984, at 24 (explaining that development of ADRs was designed to allow American investors to trade in foreign securities without "risks, delays, inconvenience and expenses not usually encountered in domestic markets"). *Id.*

11. *Id.* (discussing risks, delays, inconvenience and expenses associated with bearer format securities); see Ronald R. Adee, *Offerings by Foreign Private Issuers*, in SECURITIES UNDERWRITING - PRACTITIONER'S GUIDE 413, 416 (Kenneth J. Bialkin & William J. Grant,

certificates in the record holder's name on the books of the depository facilitates (i) the payment of dividends to security holders, (ii) the transfer of ownership of deposited securities, and (iii) communications between the foreign private issuer and security holders.¹²

First, ADRs simplify the collection of dividends. Generally, dividends on bearer securities are declared through publication in newspapers in the foreign private issuer's country of domicile.¹³ The owner of the bearer securities would collect the dividend by presenting the security certificates to a paying agent.¹⁴ Consequently, prior to the advent of the ADR, U.S. investors in foreign securities had to monitor foreign newspapers and then attempt to collect their dividends through the international mails.¹⁵ ADRs obviate this problem by interposing the depository between the foreign private issuer and the U.S. security owner. The depository now issues ADRs after deposit of the foreign securities and maintains a registry of ADR holders.¹⁶ The depository's foreign branch or correspondent monitors the newspapers in the foreign private issuer's home country for dividend declarations and collects the dividends by presenting the bearer shares, which it holds on deposit, to the paying agent.¹⁷ The foreign branch or correspondent then transmits the foreign dividend funds to the depository, which converts the dividend into dollars and pays the dividend to the registered holder of the ADR.¹⁸

Jr. eds., PLI 1985). The basic distinction between bearer shares and shares in registered form is that with the former, anyone who has possession of them is considered the owner, while, with the latter, the foreign private issuer considers those persons named in the corporate stock ledger as the owners of its shares. JOHN DOWNES & JORDAN ELLIOT GOODMAN, *DICTIONARY OF FINANCE AND INVESTMENT*, TERMS 32, 331 (2d ed. 1987).

12. Adee, *supra* note 11, at 415-16.

13. *Id.* at 416.

14. *Id.*

15. Merjos, *supra* note 10, at 24.

16. Adee, *supra* note 11, at 416.

17. *Id.*

18. *Id.*; see Moxley, *supra* note 3, at 23 (outlining ADR transactions). The depository is also typically authorized to sell any rights distributed in respect of the deposited securities and to pay the proceeds of such sale directly to ADR holders. *Id.* Rights offerings related to depository shares are not generally made directly to ADR holders to avoid the registration of the offerings under the Securities Act. See Securities Act Release No. 3266, LEXIS 46 (Nov. 25, 1947) [hereinafter Securities Act Rel. No. 3266]; see also LOSS & SELIGMAN, *supra* note 9, 759 and 762 n.43 (discussing disclosure requirements and potential liability).

Second, as the record or legal owner of the deposited securities, the depositary (or its nominee) is also able to facilitate the transfer of shares by ADR holders.¹⁹ The mechanics of ADR transfers are similar to those utilized in transfers of other U.S. security instruments. The holder of an ADR certificate can transfer the certificate in the United States through endorsement and delivery to the depositary,²⁰ which, in turn, transfers the ownership of the underlying deposited securities by making an entry on the depositary's books.²¹ Without this transfer mechanism, a U.S. owner of foreign securities would be required to transfer securities pursuant to the transfer procedures of the foreign jurisdiction where the foreign private issuer is organized.²² In addition, upon surrender of ADR certificates to the depositary, the ADR holder may elect either to (i) in the case of SEC-registered and most privately placed ADR issues, sell the deposited shares in the foreign market, in which case the foreign shares would be released to the designee of the ADR holder for delivery against payment to close the foreign sale,²³ or (ii) surrender the ADR certificates to the depositary, in which case the holder would receive the deposited shares represented by the ADR certificate.²⁴

19. Adeo, *supra* note 11, at 416.

20. Adeo, *supra* note 11, at 416. As an alternative to the transfer of a holder's ADR certificates through a depositary in the United States, the ADR holder can elect to exchange ADR certificates for the underlying deposited securities and thereafter sell those securities directly on a foreign securities exchange. *Id.*; see also Moxley, *supra* note 3, at 23 (discussing transfer mechanisms for ADRs); Securities Act Form F-6, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 7002, at 6111 (Sept. 2, 1992) [hereinafter Securities Act Form F-6, General Instructions] (outlining ADR registration process). Form F-6 was adopted by the SEC in American Depositary Receipts, Securities Act Release No. 6459, 48 Fed. Reg. 12,346 (March 18, 1983), amended by Technical Amendment to Form F-6, Securities Act Release No. 33-6951, 57 Fed. Reg. 37,084 (Aug. 18, 1992). Regulations governing the usage of Form F-6 are codified at 17 C.F.R. § 239.36 (1992).

21. Adeo, *supra* note 11, at 416.

22. See generally *Jellenik v. Huron Copper Mining Co.*, 177 U.S. 1, 13 (1899) (stating that "property represented by certificates of stock may be deemed to be held by the company within state whose creature it is," and that certificate of stock is not stock itself, but merely evidence of stockholder's interest in the company); see also *Miller v. Kaliwerke Aschersleben AG*, 283 F. 746, 755 (2d Cir. 1922) (holding that shares are located in state of incorporation); *Oliner v. Canadian Pac. Ry. Co.*, 34 A.D.2d 310, 313, 311 N.Y.S.2d 429, 432 (N.Y. App. Div. 1970) ("Where the question is one of ownership of the certificates the situs is the domicile of the issuer.").

23. Moxley, *supra* note 3, at 23; Merjos, *supra* note 10, at 26.

24. The general instructions to Form F-6 provide:

Third, the ADR mechanism increases the likelihood that the security holder will be better informed about the foreign private issuer of the deposited securities.²⁵ Concerns related to cost and possible liability under U.S. federal securities laws have made foreign private issuers reluctant to transmit communications directly to their U.S. stockholders.²⁶ However, as the record holder of the deposited securities, the depositary receives these communications directly. Thus, the depositary, which is also typically located in the foreign private issuer's jurisdiction of organization, is in a better position to obtain information about the foreign private issuer and its securities.²⁷ Further, in accordance with most deposit agreements, the depositary can usually vote proxies on the deposited securities pursuant to the instructions of the ADR holders.²⁸ Finally, other security holder benefits associated generally with the ADR mechanism include: (i) price quotes for ADRs readily available in U.S. dollars,²⁹ and (ii) upon the death of an ADR holder, the holder's beneficiaries are generally required to comply with only U.S. inheritance and transfer laws, and not with the laws of the foreign private issuer's home country.³⁰

B. *The Two Types of ADR Facilities—Sponsored and Un-sponsored Arrangements*

There are two basic types of ADR facilities, sponsored and unsponsored. An unsponsored ADR facility is one that is created without active participation from the foreign private issuer

[t]he holder of the ADRs is entitled to withdraw the deposited securities at any time subject only to (i) temporary delays caused by closing transfer books of the depositary or the issuer of the deposited securities or the deposit of shares in connection with voting at a shareholders' meeting, or the payment of dividends, (ii) the payment of fees, taxes and similar charges, and (iii) compliance with any laws or governmental regulations relating to ADRs or to the withdrawal of deposited securities.

Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7002, at 6111.

25. Adee, *supra* note 11, at 416-17.

26. *Id.* Among the documents that foreign private issuers have been hesitant to transmit are disclosure documents on rights and tender offerings as well as annual reports and proxy statements. *Id.*

27. *Id.* at 417.

28. *Id.* at 417 n.6.

29. See THE BANK OF NEW YORK, GLOBAL OFFERINGS OF DEPOSITARY RECEIPTS 1 (1992) [hereinafter THE BANK OF NEW YORK].

30. *Id.*

of the deposited securities.³¹ If the foreign private issuer of such securities is not a reporting issuer pursuant to the Securities Exchange Act of 1934 (the "Exchange Act"),³² but wants to facilitate the unsponsored ADR offering, it must either seek an exemption from the Exchange Act reporting requirements pursuant to Exchange Act Rule 12g3-2(b)³³ or, less typically, register its securities with the SEC under the Exchange Act.³⁴

In the case of an unsponsored ADR facility, the depository must file a registration statement under the Securities Act of 1933 (the "Securities Act")³⁵ on Securities Act Form F-6 ("Form F-6").³⁶ Once this statement becomes effective, the depository can accept deposits of securities of a foreign private issuer and issue ADRs with respect to such deposits.³⁷ The ADR certificate acts as a contract between the ADR holder and the depository.³⁸ As a general rule, holders of unsponsored ADRs bear the costs of such facilities, which are passed on to the holders by way of fees for the deposit and withdrawal of deposited securities, and for other services.³⁹ However, in recent years the trend in the creation of ADR facilities is toward sponsored, rather than unsponsored, arrangements.⁴⁰

A sponsored ADR facility is created jointly by a foreign private issuer and a depository. The foreign private issuer signs the Form F-6 registration statement and enters into a depository

31. See 1991 SEC REPORT, *supra* note 7, at 81,588 (distinguishing between sponsored and unsponsored ADRs). A depository may establish an unsponsored facility without the approval of the foreign private issuer. *Id.* However, it is typical for the depository, prior to establishing such facility, to ascertain that such issuer does not object to the creation of a U.S. ADR market for its securities. *Id.*

32. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988).

33. 17 C.F.R. § 240.12g3-2(b)(1) (1992). Generally, a foreign private issuer may obtain an exemption from Section 12(g) of the Exchange Act by timely furnishing to the SEC certain documentation that the foreign private issuer, since the beginning of its last fiscal year, (A) "has made or is required to make public pursuant to the law of the country of its domicile or in which it is incorporated or organized," (B) "has filed or is required to file with a stock exchange on which its securities are traded and which was made public by such exchange," or (C) "has distributed or is required to distribute to its security holders." *Id.*

34. 15 U.S.C. §§ 78a-78ll (1988).

35. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988).

36. 17 C.F.R. § 239.36 (1992).

37. See 1991 SEC REPORT, *supra* note 7, at 81,588 (discussing establishment of unsponsored ADR facilities without foreign private issuer's participation).

38. Merjos, *supra* note 10, at 24.

39. 1991 SEC REPORT, *supra* note 7, at 81,588.

40. *Id.* at 81,591.

agreement with the depositary. This agreement governs the rights and responsibilities of the parties, and sets forth the allocation of fees. In a typical sponsored ADR arrangement, a depositary agrees to provide notice of shareholder meetings and other information about the foreign private issuer so that ADR holders may exercise their voting rights through the depositary.⁴¹ The foreign private issuer pays administration fees, which are often waived, to the depositary for servicing and maintaining the program.⁴² A contractual relationship is established between the shareholder, the depositary, and the foreign private issuer by virtue of the depositary agreement.⁴³ Additionally, the foreign private issuer in a sponsored ADR facility must establish an exemption from registration under Rule 12g3-2(b) of the Exchange Act, or else effect registration of its securities under this statute.⁴⁴

A foreign private issuer enjoys several benefits by selecting a sponsored, rather than an unsponsored, ADR facility. Among them are the following:

(1) The foreign private issuer is able to maintain a greater degree of control over the ADR facility because:

(a) only one U.S. depositary generally sponsors an ADR program, while unsponsored ADR programs may be duplicated without the foreign private issuer's consent;⁴⁵ and

(b) the depositary is under a contractual obligation to the foreign private issuer pursuant to which the foreign private issuer may request the depositary to undertake certain tasks such as mailing reports.⁴⁶

(2) With a sponsored ADR, the depositary generally does not deduct a fee from dividends before paying them out to ADR holders. With an unsponsored ADR, this fee usually is deducted. Consequently, since holders of ADRs receive a higher yield on

41. *Id.* at 81,589.

42. THE BANK OF NEW YORK, *supra* note 29, at 2, 11-26. The sponsored ADR facility is established most often when a foreign private issuer seeks to conduct a public offering, list on a national exchange or increase the marketability of its ADRs through the payment of facility fees, which ADR holders would otherwise have to pay. *Id.*

43. *Id.*

44. See 17 C.F.R. § 240.12g3-2(b)(1)(1992), *supra* note 33 (listing exemptions from registration requirements for foreign private issuers).

45. THE BANK OF NEW YORK, *supra* note 29, at 2.

46. *Id.*

their dividends, the sponsored facility is much more attractive and marketable.⁴⁷

(3) Certain stock exchanges, including the American and New York Stock Exchanges, require sponsored ADRs as a prerequisite to listing.⁴⁸

These benefits have resulted in an increasing number of sponsored facilities and a corresponding decrease in the use of unsponsored ADR arrangements.

C. Trading of ADRs

ADRs are traded in the United States using the same facilities as equity securities, including the New York Stock Exchange, the American Stock Exchange, the National Association of Securities Dealers Automatic Quotation System ("NASDAQ"), and the National Association of Security Dealers ("NASD") over-the-counter pink sheets. Purchasers and sellers of ADRs range from retail customers and institutional investors to arbitragers and brokers. The prices at which ADRs are traded are influenced by several factors, including the price of the deposited security in its home market and foreign currency rates.⁴⁹

The actual certificates for ADRs are typically held by securities depositaries, which hold the ADRs in their vaults and keep computerized bookkeeping entries of the transfer of ADRs, payment of dividends and related matters.⁵⁰ Thus, ADRs may be purchased through brokerage firms like any other security.

D. Federal Regulation of ADRs

Two principal bodies of law provide the primary federal regulation of ADR issuance and trading. The first of these statutes, the Securities Act, governs public distributions by a foreign private issuer of ADRs and its affiliates in the United States.⁵¹ The

47. *Id.* at 1-2.

48. AMERICAN STOCK EXCHANGE, SECURITIES DIVISION, LISTING FOREIGN SECURITIES 3 (1987); NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL ¶ 103.04 (1990). The automated quotation system of the National Association of Securities Dealers [hereinafter NASDAQ] "allows registered, unsponsored receipts but prefers sponsored programs." Gordon Matthews, *Banks' Depositary Receipt Business Sees Boom; Instruments Link Investors in U.S. to Foreign Firms*, AMERICAN BANKER, Dec. 31, 1986, at 2.

49. 1991 SEC REPORT, *supra* note 7, at 81,591.

50. *Id.* at 81,592.

51. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1988).

second, the Exchange Act, governs secondary trading in ADRs in U.S. capital markets.⁵² Usually, a foreign company will first establish a secondary trading market for ADRs in the United States in order to determine whether an active market for its securities will develop. If an active market exists, the foreign company may then decide to make primary public distributions of its securities. This Article will first address legal considerations related to the establishment of a primary ADR market under the Securities Act, and will then focus on legal considerations concerning the establishment of a secondary ADR market in the United States under the Exchange Act.

II. REGULATION OF ADRs UNDER THE SECURITIES ACT

Under the Securities Act, the depositary shares represented by the ADRs are securities, separate and apart from the deposited foreign securities they represent.⁵³ Unless an exemption is available, the ADRs must be registered under the Securities Act before they may be publicly distributed within the United States.⁵⁴

52. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988).

53. 15 U.S.C. § 77b(1)(1988). Section 2(1) of the Securities Act defines a security as "any . . . stock[,] . . . certificate of deposit for a security, . . . [or any] receipt for . . . any of the foregoing." *Id.*

54. *See* Securities Act § 5(a), 15 U.S.C. § 77e(a)(1988). Section 5(a) of the Securities Act provides:

(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

Id. Section 4(4) of the Securities Act exempts "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." 15 U.S.C. § 77d(4)(1988). Section 4(1) of the Securities Act exempts "transactions by any person other than an issuer, underwriter, or dealer." 15 U.S.C. § 77d(1)(1988). Section 4(2) of the Securities Act exempts "transactions by an issuer not involving any public offering." 15 U.S.C. § 77d(2)(1988). Section 4(3) of the Securities Act exempts within specific time constraints, transactions by dealers, including underwriters no longer acting as underwriters with respect to the securities involved in the transaction. 15 U.S.C. § 77d(3) (1988).

A. *The Voluntarism Principle*

Historically, the SEC treated "foreign issuers"⁵⁵ differently than domestic issuers.⁵⁶ This is so even though the SEC recognizes that:

The legislative history of the 1933 Act indicates an intent to treat foreign private issuers (as distinct from foreign governments) the same as domestic issuers. The SEC, therefore, has generally perceived its function as neither discriminating against nor encouraging foreign investment in the United States or investment in foreign securities.⁵⁷

The SEC has addressed the regulation of foreign private issuers in the "context of . . . neutrality" by weighing and balancing two competing policies.⁵⁸ First, the investing public in the United States requires the same information with respect to its investment prospects, regardless of whether the prospects are domestic or foreign.⁵⁹ Second, the interests of the investing public are best served by having the opportunity to invest in foreign securi-

55. 17 C.F.R. § 230.405 (1992). A "foreign issuer" is defined as "any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country." *Id.* Rule 405 further defines, for purposes of Regulation C under the Securities Act, the terms "foreign government" and "foreign private issuer." *Id.* A "foreign government" includes "the government of any foreign country or of any political subdivision of a foreign country." *Id.* A "foreign private issuer" is defined as any foreign issuer, except a foreign government or an issuer meeting certain conditions. *Id.* Thus:

[A]n issuer [is not a foreign private issuer if it meets] the following conditions: (1) More than 50 percent of the outstanding voting securities of such issuer are held of record either directly or through voting trust certificates or depositary receipts by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States. For the purpose of this paragraph the term *resident*, as applied to security holders, shall mean any person whose address appears on the records of the issuer, the voting trustee, or the depositary as being located in the United States.

Id.

56. Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 6360 [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,054, at 84,643 (Nov. 20, 1981) [hereinafter Securities Act Rel. No. 6360].

57. Adee, *supra* note 11, at 428 (citing *Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 89-90 (1933); *Hearings on H.R. 4314 Before the Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 12-13 (1933)).

58. Securities Act Rel. No. 6360, *supra* note 56, at 84,645.

59. *Id.*

ties.⁶⁰ The SEC perceives that these two policies compete with each other because, if all foreign private issuers were required to comply with the same requirements as domestic issuers, foreign private issuers might not enter the U.S. capital markets.⁶¹ As a result, U.S. investors would be deprived of the opportunity to broaden their investment targets.⁶²

In lieu of adopting either principle, the SEC has "regularly" balanced the competing policy interests using a principle of "voluntarism."⁶³ According to the principle of voluntarism, "the more voluntary steps a foreign company has taken to enter the U.S. capital markets, the degree of regulation and amount of disclosure more closely approaches the degree of regulation of domestic registrants."⁶⁴ However, the concept of "voluntarism" is by its nature nebulous and has few defined parameters. Many instances in which ADRs are utilized would probably qualify as involuntary entries into U.S. markets. For example, a foreign dealer or private shareholder may deposit securities of a foreign private issuer with a depository in order to establish an unsponsored ADR facility.⁶⁵ This usually occurs when a U.S. trading market previously had been created for the foreign private issuer's outstanding securities.⁶⁶ However, regardless of whether the depository or the shareholders have initiated the depository mechanism, if the foreign private issuer has not actively participated in the establishment of the ADR facility, the foreign private issuer should not be deemed to have voluntarily entered the

60. *Id.*

61. Adee, *supra* note 11, at 428.

62. Securities Act Rel. No. 6360, *supra* note 56, at 84,645.

63. *Id.*

64. *Id.* In designing the current system of disclosure for foreign private issuers, the SEC believes that both foreign and domestic companies should be subject to the same requirements under the securities laws. *Id.* However, the SEC recognizes that the process is an evolutionary one with the current regulatory scheme being the first step. *Id.* Apparently, one of the SEC's main concerns in establishing the current system is that if U.S. investors desired, they could invest freely in foreign markets where disclosure is not equivalent to U.S. standards. *Id.* Consequently, the SEC recognizes that a system that discourages disclosure in U.S. markets is against public interest. *Id.* at 84,651.

65. See Royston, *supra* note 4, at 89 (discussing voluntarism and regulation of ADRs).

66. See Note, *SEC Regulation of American Depositary Receipts: Disclosure, Ltd.*, 65 *YALE L.J.* 861, 863 (1956). In many instances, the depository bank assumes the initiative in establishing the ADR mechanism. *Id.* The depository does so by announcing that it is prepared to issue ADRs against the deposit of certain foreign securities. *Id.*

U.S. capital markets.⁶⁷

Despite the rather amorphous nature of this concept, the SEC has given some guidance as to the parameters of the "voluntarism principle." The SEC deems "all foreign companies having either securities listed on a United States exchange or having made a public offering of securities registered under the Securities Act as having voluntarily entered the United States market."⁶⁸ In addition, pursuant to its regulatory authority under the Exchange Act, the SEC has indicated that the quotation of shares, including ADRs, on NASDAQ⁶⁹ would qualify as a voluntary entry into U.S. markets.⁷⁰ The SEC based its decision on the requirement that for a foreign private issuer to have shares, or ADRs representing shares, quoted on NASDAQ, a foreign private issuer must apply to NASDAQ for the quotation privilege and pay a prescribed fee.⁷¹ The SEC deems these voluntary actions sufficient to justify the application of U.S. securities regulation to foreign ADR issuers.

Under the principle of voluntarism, establishing an ADR facility for foreign securities for which a trading market already exists results in the offer or distribution of the American share equivalents.⁷² Thus, these American share equivalents must be registered absent the availability of, and compliance with, a statutory exemption.⁷³ The underlying shares, such as deposited securities, must also be registered unless they are offered and sold in transactions that qualify for an exemption from registration under the Securities Act.⁷⁴ The registration forms and other material aspects related to the distribution of ADRs and their underlying securities are discussed below.

67. See Royston, *supra* note 4, at 89 (discussing voluntarism and offerings by foreign private issuers).

68. Securities Act Rel. No. 6360, *supra* note 56, at 84,643.

69. See NATIONAL ASSOCIATION OF SECURITIES DEALERS, NASD MANUAL (CCH) ¶ 1803, at 1564 (1991) (reprinting Schedule D to the NASD By-laws, which sets forth qualification requirements for NASDAQ securities).

70. See Exchange Act Rule 12g3-2(d)(3), 17 C.F.R. § 240.12g3-2(d)(3)(1992).

71. Foreign Securities, Securities Act Release No. 6433, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,272 (Oct. 28, 1982); see Foreign Securities, Securities Act Release No. 6493, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,435 (Oct. 6, 1983) [hereinafter Securities Act Rel. No. 6493].

72. Adee, *supra* note 11, at 419.

73. *Id.*

74. *Id.*

B. *The Use of Form F-6 and the Registration of ADRs*

When a foreign private issuer wants to raise capital in the U.S. market through a public offering, such issuer generally proceeds in a manner similar to that of a U.S. issuer conducting a domestic offering.⁷⁵ When ADRs are to be offered, the foreign private issuer will establish an ADR mechanism, usually a sponsored facility, through which U.S. investors can purchase the issuer's ADRs.⁷⁶ In most ADR offerings, the foreign private issuer files two registration statements: (1) Form F-6, to register the depositary shares⁷⁷ and (2) Forms F-1, F-2, F-3 or F-4, to register the deposited shares.⁷⁸ The requirement that a filing be made with respect to both the depositary shares and the deposited shares is not specifically mandated by any rule promulgated by the SEC. Rather, the requirement stems from an interpretation of the conditions precedent to the use of Form F-6, which provide that the form may be used only if "[t]he deposited securities are offered or sold in transactions registered under the Securities Act or in transactions that would be exempt therefrom if made in the United States"⁷⁹ When U.S. investors purchase the securities of a foreign private issuer in a secondary market transaction, this transaction usually is exempt from registration under

75. *Id.*

76. *Id.* at 419-20; see *THE BANK OF NEW YORK*, *supra* note 29, at 2 (outlining various forms of ADRs).

77. Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7002, at 6111. Depositary shares are also permitted to be registered on any other form used to register the deposited securities provided that such alternative form conforms to the requirements of Parts I and II of Form F-6 and either the depositary or the legal entity created by the issuance of the ADRs signs the registration statement. *Id.* ¶ 7003, at 6112. As defined in Regulation C of the Securities Act, a "depositary share" is "a security, evidenced by an American Depositary Receipt, that represents a foreign security or a multiple of or fraction thereof deposited with a depositary". 17 C.F.R. § 230.405 (1992).

78. Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7002, at 6111. An example of one such double registration was the filing by Tokio Marine and Fire Insurance Company, Limited, a Japanese company, of a Form F-3 on August 4, 1987 relating to shares of common stock and a Form F-6, declared effective on September 4, 1987, relating to American Depositary Shares. The First Boston Corporation, SEC No-Action Letter, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,519, at 77,672 (Oct. 1, 1987). While unsponsored ADR mechanisms, involving only the filing of Form F-6, generally take four to seven weeks to establish, sponsored ADR mechanisms, involving an equity offering, may take twelve weeks or longer to establish. See *THE BANK OF NEW YORK*, *supra* note 29, at 11-12 (explaining that extra time is required for negotiation of Depositary Agreement and SEC's review of registration statement for deposited securities). *Id.* at 11-26.

79. Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7002, at 6111.

one of the provisions of Section 4 of the Securities Act.⁸⁰ Therefore, since deposited shares underlying the ADRs could be purchased in secondary market transactions without registration, only Form F-6 must be filed to comply with the above quoted Form F-6 instruction. However, when a foreign private issuer makes a public offering of ADRs under the Securities Act, both the depositary shares and the deposited securities must be registered.⁸¹

Three conditions precedent must be satisfied in order to use Form F-6 to register depositary shares represented by ADRs. First, subject to certain limited exceptions, the holder of the ADRs must be entitled to withdraw the deposited securities at any time.⁸² Second, the deposited securities must be offered or sold in transactions registered under the Securities Act or in transactions that, if made in the United States, would be exempt from the Securities Act.⁸³ Third, as of the date of filing of Form F-6, the foreign private issuer of the deposited securities must be a reporting company under the Exchange Act or the deposited securities must be exempt from such reporting requirements.⁸⁴ If, however, the foreign private issuer concurrently files a registration statement for the deposited securities on another form,⁸⁵ the foreign private issuer need not comply with this condition.

The first condition precedent to the use of Form F-6, which relates to withdrawal rights for the deposited securities, generally is met by the terms of the depositary agreement or by the terms of the certificate issued to investors to evidence the ADR.⁸⁶ Moreover, when a public offering of ADRs is made, the second and third conditions precedent to the use of Form F-6 are satisfied by registering the deposited securities *via* a second registration, typically Form F-1.

The Form F-6 registration statement is divided into two parts. Part I, which lists the information required in the prospectus, requires disclosure of certain information with respect

80. See *supra* note 54 (listing pertinent exemptions).

81. Adee, *supra* note 11, at 419-20.

82. Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7002, at 6111.

83. *Id.*

84. *Id.* ¶ 7002, at 6112.

85. *Id.* ¶ 7002, at 6112.

86. See, e.g., Hard Rock Cafe plc, Deposit Agreement, Exhibit to Amendment No. 3 to Form F-1 Registration Statement No. 33-12402 (filed with the SEC on Apr. 23, 1987) (on file with the *Fordham International Law Journal*).

to the depositary and its obligations, the depositary mechanism and the rights of the ADR holders.⁸⁷ To the extent not otherwise disclosed, more extensive information about the effect of foreign laws upon the ADR holders may have to be provided.⁸⁸ Part I also requires a foreign private issuer to disclose its basis for filing reports with the SEC pursuant to the Exchange Act.⁸⁹

Part II of Form F-6, which provides for information not required in the prospectus, describes the exhibits filed and undertakings made by the depositary. The exhibits include the depositary agreement and other agreements related to the issuance of the ADRs, material contracts between the foreign private issuer and the depositary entered into within the last three years, and an opinion of counsel as to the legality of the ADRs being issued.⁹⁰ The Form requires disclosure in an Exhibit of certain information with respect to each securities dealer, known by the registrant or the depositary, who (1) has deposited shares against the issuance of ADRs in the prior six months, (2) proposes to deposit shares against the issuance of ADRs, or (3) has assisted in creating a plan for the issuance of the ADRs, the selection of the ADRs, or the selection of the deposited securities.⁹¹

Compliance with Form F-6 also imposes certain other obligations on the depositary. The depositary must undertake to supply to the SEC, on a semi-annual basis, information concern-

87. Securities Act Form F-6, Item 1, *supra* note 20, ¶ 7003, at 6112 (incorporating Regulation S-K Item 202(f), 17 C.F.R. § 229.202(f) (1992) [hereinafter Reg. S-K]). With respect to the terms of deposit of the deposited securities, the following, if applicable, must be described:

- (i) [t]he amount of deposited securities represented by one unit of [ADRs];
- (ii) [t]he procedure for voting, if any, the deposited securities; (iii) [t]he collection and distribution of dividends; (iv) [t]he transmission of notices, reports and proxy soliciting material; (v) [t]he sale or exercise of rights; (vi) [t]he deposit or sale of securities resulting from dividends, splits or plans of reorganization; (vii) [a]mendment, extension or termination of the deposit; (viii) [r]ights of holders of receipts to inspect the transfer books of the depositary and the list of holders of receipts; (ix) [r]estrictions upon the right to deposit or withdraw the underlying securities; [and] (x) [l]imitation upon the liability of the depositary.

17 C.F.R. § 229.202(f)(2) (1992).

88. *Id.* Item 202, Instruction 2.

89. Securities Act Form F-6, Item 2, *supra* note 20, ¶ 7003, at 6112. Part I of Form F-6 sets forth information for inclusion in the prospectus. *Id.* If, however, the ADR is registered on Form F-6 and the seller of the ADR is a dealer, no prospectus need be delivered in the sale transaction. 17 C.F.R. § 230.174(a) (1992).

90. Securities Act Form F-6, Item 3, *supra* note 20, ¶ 7004, at 6113.

91. *Id.*

ing the number of depositary shares, the holders thereof, and the name of each dealer known to the depositary to have deposited shares against the issuance of ADRs during the period covered by the report.⁹² The depositary must undertake to supply fee information, and make available at its U.S. office any reports that are generally made available to the holders of the underlying securities by the foreign private issuer and that are received from the foreign private issuer of the deposited securities by the depositary in its capacity as the holder of the deposited securities.⁹³

One of the recurrent legal issues related to the use of Form F-6 involves the question of which entity actually signs the form.⁹⁴ Until the adoption of Form S-12⁹⁵ (the predecessor to Form F-6), depositaries argued that if they were considered the issuer of the ADRs, the issuance was exempt from registration requirements by virtue of the exemption granted under Section 3(a)(2) of the Securities Act for "any security issued or guaranteed by any bank."⁹⁶ This argument placed the SEC in a regulatory conundrum. If the SEC accepted the depositaries' argument, the ADRs would be issuable without SEC regulation.⁹⁷ Since no other party arguably performed the functions of an issuer, the SEC could not assert that the depositary was not the issuer.⁹⁸ Therefore, it followed that because ADRs were issued

92. Securities Act Form F-6, Item 4, *supra* note 20, ¶ 7004, at 6113.

93. *Id.*

94. *See, e.g.,* Royston, *supra* note 4, at 95 (discussing legal definition of entity for purposes of Form F-6); Adee, *supra* note 11, at 420-21 (outlining legal definition of entity).

95. Form S-12 was proposed in Notice of Proposed Adoption of Form S-12, Securities Act Release No. 3570, [1952-1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,358 (Aug. 31, 1955) (*adopted in* Adoption of Form S-12, Securities Act Release No. 3593, [1952-1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,372 (Nov. 17, 1955); *rescinded in* American Depositary Receipts, Exchange Act Release No. 19,612 [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,329 (Mar. 18, 1983), effective March 24, 1983, 48 Fed. Reg. 12,346 (1983)).

96. *See generally* Note, *supra* note 66, at 868 (citing OFFICIAL REPORT OF PROCEEDINGS BEFORE THE SECURITIES AND EXCHANGE COMMISSION, CONFERENCE ON AMERICAN DEPOSITARY RECEIPTS at 24, 41 (June 20, 1955)). The wording of Section 3(a)(2) of the Securities Act in existence in the 1950s differed from the language of Section 3(a)(2) quoted in the text. *Id.* In the 1950s, Section 3(a)(2) provided an exemption for securities "issued or guaranteed by any national bank, or any banking institution the business of which is . . . supervised by the State or Territorial banking commission or similar official." *Id.* at 868 (citing 15 U.S.C. § 77c(a)(2)(1952)).

97. *Id.* at 868.

98. *Id.* at 868-69.

by a bank, the issuance was entitled to the bank exemption contained in Section 3(a)(2).⁹⁹

The SEC solved this problem by deeming the issuer a fictitious legal entity that proposed to issue the ADRs.¹⁰⁰ The rationale for this determination was based on an interpretative reading of the definition of "issuer" contained in Section 2(4) of the Securities Act.¹⁰¹ Section 2(4) provides that an "issuer" is "every person who issues or proposes to issue any security . . . except that in the case of . . . a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the . . . trust, committee, or other legal entity" ¹⁰² Accordingly, the SEC apparently relied on this language to remove the depositary from the scope of the definition of "issuer" and to replace the depositary with a fictitious "entity" that was not within the bank exemption.¹⁰³ The "entity" that the SEC envisioned was probably a type of joint venture between the depositaries and brokers that dealt in the foreign securities.¹⁰⁴ The SEC allowed the depositary to register on behalf of the fictitious entity on Form S-12.¹⁰⁵

The use of the fictitious legal entity in place of the depositary as the foreign private issuer accomplishes two purposes. First, the issuance of the ADRs, absent another exemption, must be registered. The fictitious legal entity facilitates this practical legal mechanic.¹⁰⁶ Second, since the banks were left in a posi-

99. *Id.*

100. *Id.*

101. 15 U.S.C. § 77b(4)(1988).

102. *Id.*

103. Note, *supra* note 66, at 869.

104. *Id.* at 869 n.46.

105. *Id.* at 869-70. Form F-6 provides in relevant part:

The depositary may sign on behalf of [the legal entity created by the agreement for the issuance of the ADRs], but the depositary for the issuance of ADRs itself shall not be deemed to be an issuer, a person signing the registration statement, or a person controlling such issuer.

Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7005, at 6114.

106. Loss, *supra* note 3, at 230. With respect to this fictitious entity accommodation, Professor Loss has observed that:

The form provides specifically that the depositary is not to be deemed an issuer or a person controlling the issuer notwithstanding its signing the registration statement in the name of the altogether fictitious "entity." This awe inspiring (and altogether laudable) demonstration of administrative flexibility means that nobody has the liability of an "issuer" under § 11. . . .

Id.

tion of no liability, the creation by the SEC of the fictitious legal entity served the banks' interests.¹⁰⁷

Nonetheless, with a sponsored ADR facility, Form F-6 requires the foreign private issuer of the deposited securities and the depositary to sign the registration statement.¹⁰⁸ Therefore, the foreign private issuer of the foreign deposited securities may, pursuant to Section 11 of the Securities Act, become liable for misrepresentations in, or omissions of material fact from, the registration statement.¹⁰⁹

Pursuant to Section 2(4) of the Securities Act, in the case of certificates of deposit and like instruments, the term "issuer" means "the . . . persons performing the acts and assuming the duties of depositor or manager . . ." ¹¹⁰ As discussed above, this language, when read in light of an instruction to Form S-12 can be interpreted as sanctioning the imposition of Section 11 liability on a sponsoring foreign private issuer.¹¹¹ Accordingly, foreign private issuers and their counsel should explore carefully the question of Section 11 liabilities when publicly offering ADRs to U.S. investors.

107. Note, *supra* note 66, at 870.

108. Securities Act Form F-6, General Instructions, *supra* note 20, ¶ 7005, at 6114.

109. 15 U.S.C. § 77k(a)(1)(1988). Section 11 of the Securities Act authorizes a cause of action in favor of persons who acquire securities issued under a false or misleading registration statement. *Id.* The cause of action may be brought against, among others, "every person who signed the registration statement." *Id.*

110. 15 U.S.C. § 77b(4)(1988).

111. The instruction to Form S-12 provided the following:

Where no . . . persons perform the acts and assume the duties of sponsor or manager pursuant to the provisions of the trust or other agreement or instruments under which receipts are to be issued, the entity created by the agreement for the issuance of ADRs . . . shall be deemed to be the issuer of the ADRs for all purposes of this Form and the [Securities] Act.

Royston, *supra* note 4, at 95 n.46 (citing Rule as to Use of Form S-12, 17 C.F.R. § 239.19 (1982) (*rescinded* Mar. 24, 1983)). The interpretation arising out of the above-quoted instruction is that where there is a "sponsor" of the arrangement, the sponsor may take on the guise of a foreign private issuer for Securities Act liability purposes. *Id.* In this regard, one commentator has stated that "[t]he distinction between a sponsor or manager of the ADR arrangement and an issuer with respect to a distribution of the deposited securities principally depends on the purpose of the ADRs, issuance and the degree of control over the ADR certificates vested in the foreign issuer." Loss, *supra* note 3, at 228-29.

*C. The Use of Forms F-1, F-2, F-3 and F-4 for the Registration of
Deposited Securities*

In a public offering of ADRs, the deposited securities must be registered under the Securities Act on the appropriate registration form. For all foreign private issuers, other than foreign governments, the appropriate Securities Act registration form will be Forms F-1, F-2, F-3 or F-4.¹¹² To be eligible to use Forms F-2 or F-3, a foreign private issuer must be qualified to use Form 20-F to report under the Exchange Act.¹¹³

Form F-1 is generally used for initial public offerings of ADRs.¹¹⁴ Forms F-2 and F-3 are used by foreign private issuers that previously have registered securities under the Securities Act or the Exchange Act.¹¹⁵ Forms F-2 and F-3 permit incorporation by reference of reports filed under the Exchange Act. Form F-2, however, requires delivery of these reports with the prospectus.¹¹⁶

Form F-3 may be used only by foreign private issuers who

112. Securities Act, Forms F-1, F-2, F-3 and F-4 (codified as 17 C.F.R. §§ 239.31-34 (1988) and *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶¶ 6952-85 at 6061-6103 (1992)); *see* Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 6360 [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,054, at 84,643 (Nov. 20, 1981) [hereinafter Securities Act Rel. No. 6360] (proposing Forms F-1, F-2, F-3 and F-4); *see also* Adoption of Foreign Issuer Integrated Disclosure System, Securities Act Release No. 6437, 1982 WL 35947 (Nov. 19, 1982) [hereinafter Securities Act Rel. No. 6437] (adopting Forms F-1, F-2 and F-3); Securities Act Release No. 6579, [1937-1982 Accounting Series Reports] Fed. Sec. L. Rep. (CCH) ¶ 72,407 (Nov. 19, 1982) (adopting Form F-4).

Certain Canadian issuers are also eligible to register deposited shares on Forms F-7, F-8, F-9, F-10 or F-80. 17 C.F.R. § 239.37-41 (1992) *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶¶ 7011-7052 & 7082 (1992); *see* Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 29,354 [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,812 (June 21, 1991) [hereinafter Exchange Act Rel. No. 29,354] (adopting Forms F-7, F-8, F-9, F-10 and F-80).

113. Securities Act Form F-2, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6962, at 6071 (1992); Securities Form F-3, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6972, at 6081-82 (1992).

114. Securities Act Form F-1, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6952, at 6061 (1993). Form F-1 provides that it is used where no other form is authorized or prescribed. Form F-1, *supra* note 112, 17 C.F.R. §§ 239.31 *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶¶ 6952 at 6061 (1992).

115. Securities Act Form F-2, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6962, at 6071 (1993). Securities Act Form F-3, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6972, at 6081-82 (1993).

116. Securities Act Form F-2, Item 12 *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6963, at 6074 (1993).

are reporting under the Exchange Act for at least thirty-six months.¹¹⁷ In addition, those using Form F-3 must be so-called "world class issuers."¹¹⁸ The form may be used for the following: (1) certain primary offerings; (2) offerings of investment grade debt securities; (3) securities issued on the exchange of certain rights and warrants; (4) securities issued pursuant to a dividend reinvestment plan or on conversion of outstanding securities; or (5) securities issued in a secondary offering.¹¹⁹ Form F-4 is available for securities issued in business combinations including certain reclassifications, mergers, consolidations, transfers of assets and exchange offers.¹²⁰

The disclosure requirements for foreign private issuers using Forms F-1, F-2, F-3 and F-4 are similar to those for domestic United States issuers. There are four principal differences:

(1) Foreign issuer financial statements must have an informational content substantially similar to that required of domestic companies. They need not be prepared in accordance with United States generally accepted accounting principles ["GAAP"]; however, they must be presented in accordance with accounting principles generally accepted in the domicile country, and a reconciliation of significant variations from United States GAAP and Regulation S-X must be furnished. Reconciliation only of the differences in the measurement items (income statement and balance sheet amounts) is required in annual reports of foreign private issuers and for offerings of certain non-convertible investment grade debt, securities issued upon exercise of certain rights, or warrants, pursuant to a dividend reinvestment plan, or upon conversion of outstanding securities. Full reconciliation of financial

117. Securities Act Form F-3, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6972, at 6082 (1993).

118. *Id.* at 6082-83. A "world class issuer" is defined as an issuer, whose voting stock held worldwide by non-affiliates, has an aggregate market value equivalent to U.S.\$300 million or more. *Id.* The aggregate market value of the stock is computed by use of the last sales price of the stock or the average of the bid and asked prices of the stock in the principal market for such stock within 60 days prior to the date of filing of Form F-3. *Id.*

119. *Id.* ¶ 6972, at 6083-84. The requirement that the registrant be a "world class issuer" does not apply where the offering is of investment grade debt securities or of securities offered pursuant to rights plans, dividends or investment plans, or upon the conversion of warrants or other outstanding convertible securities. *Id.*

120. Securities Act Form F-4, General Instructions *reprinted in* 2 Fed. Sec. L. Rep. (CCH) ¶ 6982, at 6091 (incorporating Securities Act Rule 145(a), 17 C.F.R. § 230.145(a) (1992)).

statements to United States GAAP and Regulation S-X (which sets forth the SEC's financial statement regulations) is required for other offerings.

(2) Unless a full reconciliation to United States GAAP is specified or required because of the nature of the offering or the securities, only revenue information need be broken into categories of activity and geographic markets ("segments") unless the total operating profit from each segment materially differs from their respective contributions to total sales and revenue, in which case narrative disclosure is required.

(3) Compensation of directors and officers need be disclosed only in the aggregate unless the issuer discloses such information to its shareholders or otherwise makes this information public.

(4) Information regarding transactions with management is required, but need be presented only to the extent the registrant discloses such information to its shareholders or otherwise makes public the information.¹²¹

The SEC has also adopted a multijurisdictional disclosure system for Canadian issuers allowing the offering of securities in the United States on the basis of documentation that complies primarily with Canadian, rather than U.S., disclosure requirements.¹²² The SEC has also adopted Rule 144A under the Securities Act,¹²³ which provides a liquid, private market with less stringent disclosure standards than the public market. These provisions illustrate the SEC's response to the increasing globalization of world capital markets. It is anticipated that federal regulation of domestic U.S. corporations and foreign private issuers of securities will continue to become more uniform, and accordingly, that differences in disclosure requirements for U.S. and non-U.S. issuers will become increasingly harmonized.

D. Private Placements of ADRs under Rule 144A

To encourage access to U.S. capital markets, the SEC adopted Rule 144A under the Securities Act on April 19, 1990. The Rule's purpose is to provide a non-exclusive exemption from the registration requirements of the Security Act for the

121. SEC REPORT, *supra* note 2, at III-68.

122. See Exchange Act Rel. No. 29,354, *supra* note 112 (detailing changes in registration and reporting requirements for Canadian issuers).

123. 17 C.F.R. § 230.144A (1992).

resale of certain securities, including ADRs, to qualified institutional buyers.¹²⁴ The exemption from registration for offers and sales under the Rule is for entities other than issuers of securities.¹²⁵ Thus, a foreign private issuer of ADRs must itself use other available exemptions under the Securities Act¹²⁶ to effect the original placement of ADRs with an intermediary, such as a financial institution or securities brokerage, for resale to eligible purchasers.¹²⁷

124. See Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Securities Act Release No. 6862, Exchange Act Release No. 27,928 [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (Apr. 23, 1990) (adopting Rule 144A).

125. 17 C.F.R. § 230.144A(b) (1992).

126. See, e.g., Securities Act § 4(2), 15 U.S.C. § 77d(2) (1988); Regulation D, Rules Governing the Limited Offer and Sale of Securities Under the Securities Act of 1933, 17 C.F.R. § 230.501-08 (1992) (detailing exemptions to Securities Act).

127. Eligible purchasers, or qualified institutional buyers, are defined in Rule 144A to include:

(i) Any of the following entities, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the entity:

(A) Any *insurance company* as defined in Section 2(13) of the Act;

(B) Any *investment company* registered under the Investment Company Act of 1940 . . . or any *business development company* as defined in Section 2(a)(48) of that Act;

(C) Any *Small Business Investment Company* licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958;

(D) Any *plan* established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;

(E) Any *employee benefit plan* within the meaning of title I of the Employee Retirement Income Security Act of 1974;

(F) Any *business development company* as defined in Section 202(a)(22) of the Investment Advisers Act of 1940;

(G) Any organization described in Section 501(c)(3) of the Internal Revenue Code, corporation (other than a bank as defined in Section 3(a)(2) of the Act or a savings and loan association or other institution referenced in Section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution), partnership, or Massachusetts or similar business trust; and

(H) Any *investment adviser* registered under the Investment Advisers Act.

(ii) Any *dealer* registered pursuant to Section 15 of the Exchange Act, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least \$10 million of securities of issuers that are not affiliated with the dealer, *Provided*, That securities constituting the whole or a part of an unsold allotment to or

For an issue of ADRs to qualify for the exemption under Rule 144A, the four following conditions must be satisfied:

(1) The securities must be offered or sold only to qualified institutional buyers. The Rule sets forth several methods by which the qualified status of an institutional buyer may be established by the seller or seller's representatives.¹²⁸

(2) The seller and its representative must take reasonable steps to ensure the purchaser is aware of the seller's reliance on

subscription by a dealer as a participant in a public offering shall not be deemed to be owned by such dealer;

(iii) Any *dealer* registered pursuant to Section 15 of the Exchange Act acting in a riskless principal transaction on behalf of a qualified institutional buyer; . . .

(iv) Any investment company registered under the Investment Company Act, acting for its own account or for the accounts of other qualified institutional buyers, that is part of a family of investment companies which own in the aggregate at least \$100 million in securities of issuers, other than issuers that are affiliated with the investment company or are part of such family of investment companies. *Family of investment companies* means any two or more investment companies registered under the Investment Company Act, except for a unit investment trust whose assets consist solely of shares of one or more registered investment companies, that have the same investment adviser (or, in the case of unit investment trusts, the same depositor), Provided That, for purposes of this section:

(A) Each series of a series company (as defined in Rule 18f-2 under the Investment Company Act . . .) shall be deemed to be a separate investment company; and

(B) Investment companies shall be deemed to have the same adviser (or depositor) if their advisers (or depositors) are majority-owned subsidiaries of the same parent, or if one investment company's adviser (or depositor) is a majority-owned subsidiary of the other investment company's adviser (or depositor);

(v) Any entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers; and

(vi) Any bank as defined in Section 3(a)(2) of the Act, any savings and loan association or other institution as referenced in Section 3(a)(5)(A) of the Act, or any foreign bank or savings and loan association or equivalent institution, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with it and that has an audited net worth of at least \$25 million as demonstrated in its latest annual financial statements, as of a date not more than 16 months preceding the date of sale under the Rule in the case of a U.S. bank or savings and loan association, and not more than 18 months preceding such date of sale for a foreign bank or savings and loan association or equivalent institution.

17 C.F.R. § 230.144A(a)(1) (1992)(emphasis in original).

128. 17 C.F.R. § 230.144A(d)(1) (1992).

the Rule 144A safe-harbor exemption from the registration requirements of Section 5 of the Securities Act.¹²⁹

(3) The securities are not: (a) when issued, of the same class as securities listed on a U.S. national securities exchange registered under Section 6 of the Exchange Act or quoted in a U.S. automated inter-dealer quotation system; and (b) securities of an open-end investment company, unit investment trust or face-amount certificate company that is or is required to be registered under Section 8 of the Investment Company Act of 1940.¹³⁰

(4) The security holder and the holder's prospective purchaser must have the right to obtain from the foreign private issuer, on holder's request, the following information, which must be reasonably current in relation to the date of resale: (a) a brief statement of the nature of the foreign private issuer's business and the products and services it offers; and (b) the foreign private issuer's most recent balance sheet, profit and loss statements, retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the foreign private issuer is in operation, preferably on an audited basis. This information need not be prepared in accordance with U.S. GAAP. This condition is applicable only when the securities offered are those of a foreign private issuer that is neither subject to Section 13 or 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, nor a foreign government as defined in Rule 405 eligible to register securities under Schedule B of the Securities Act.¹³¹ Securities acquired by a qualified institutional buyer pursuant to Rule 144A are deemed restricted securities. Absent registration, these securities may only be resold in accordance with the provisions of the Rule or another applicable exemption under the Securities Act.¹³²

Rule 144A offers a foreign private issuer several distinct advantages over a registered offering under the Securities Act. These advantages include: (i) more efficient placement, (ii) a corresponding reduction in transaction costs, and (iii) signifi-

129. *Id.* § 230.144A(d)(2).

130. *Id.* § 230.144A(d)(3).

131. *Id.* § 230.144A(d)(4).

132. *See* Preliminary Note 6 to Rule 144A, 17 C.F.R. § 230.144A (1992).

cant reduction in required informational disclosure. For these reasons, a foreign private issuer may wish to consider the private U.S. capital markets as an appropriate initial entry forum for the introduction of its ADRs into the United States.¹³³

133. *Benefits of Utilizing DRs in Private Placements*, in THE BANK OF NEW YORK, *supra* note 29, at 27-28. Additional benefits associated with private placements are as follows:

[ADRs will] attract a wider range of qualified institutional buyers (QIBs) [than ordinary shares]. This is especially important considering only a relatively few QIBs have experience in international investing, [private placements,] or in purchasing ordinary shares of a non-U.S. company. In addition, numerous QIB's may have investment restrictions on purchasing non-dollar securities. [ADRs] are U.S. dollar securities. Privately placed [ADRs] can receive registration rights (piggy back rights) in the event the issuer decides to do a public offering or list on an exchange in the U.S. This feature will appeal to most QIBs.

[ADRs] will offer a cost advantage to QIBs as compared to ordinary shares because a global custodian, [such as Cedel], is not necessary.

[ADRs will] enhance liquidity, especially when a Level-I program is established in conjunction with a private placement. If there are no buyers under 144A, the [ADRs] can be canceled and the ordinary shares sold into the home market.

The [ADR] mechanism allows for a ratio of ordinary shares to [ADRs] which enables the [ADRs] to be priced according to U.S. [standards].

U.S. investor relations efforts are aided by the presence of a [n ADR] program. The Depository Bank is better able to track and report information on U.S. shareholders. In addition, if flowback occurs, it can readily be determined and appropriate action taken. If ordinary shares are used, it would be more difficult to track flowback and shareholders.

At the end of the two to three year restricted period, 144A [ADRs] can be publicly traded in the U.S. without S.E.C. registration and can be combined with a Sponsored Level-I [ADR] program (*Over-the-Counter [ADR] program*).

A Sponsored Level-I [ADR] program can be established and can co-exist with a 144A [ADR] facility. As a result, along with the private placement of [ADRs], additional U.S. investor demand (retail and institutional) can be satisfied through the Level-I [ADR] program. Furthermore, Regulation S in most cases will reduce or eliminate entirely the seasoning period for these securities, thus facilitating more efficient arbitrage between the home market and the U.S. public market (Sponsored Level-I).

Some QIBs are precluded from opening foreign custodian accounts with banks or depositories. As a result, they will only be able to purchase [ADRs] through a 144A [ADR] program.

QIBs will benefit from the convenience of [ADRs] - dividends paid in US dollars, proxy distribution, information flow, and full access to rights offerings.

144A [ADRs] accompanied by a Sponsored Level-I [ADR] facility, may provide additional market demand to counter flowback and satisfy U.S. demand.

In order to facilitate resales under 144A, non-U.S. issuers are urged to establish a 12g3-2(b) information exemption with the SEC. This exemption is [the same requirement] for [an over-the-counter] Level I [ADR] program. Consequently, if a Sponsored program is not established a company will run the risk of unsponsored programs being established.

III. THE APPLICATION OF THE SECURITIES EXCHANGE ACT OF 1934 TO ADRs

A. Registration Requirements

The Exchange Act requires the registration of a class of securities with the SEC if the foreign private issuer's securities will be listed on a U.S. stock exchange¹³⁴ or quoted on NASDAQ,¹³⁵ or if the issuer's assets exceed U.S.\$1 million and the foreign private issuer has a class of equity securities (other than an exempted security) held of record by 500 or more persons.¹³⁶ Thus, all foreign private issuers must register securities listed on an exchange or quoted on NASDAQ. Form 20-F may be used by foreign private issuers to register depositary shares under the Exchange Act if either the depositary or the legal entity created by the agreement for ADRs signs the registration statement describing the ADRs and the depositary shares.¹³⁷

Pursuant to its broad exemptive power, the SEC has provided certain exemptions from the registration requirements of Section 12(g) of the Exchange Act.¹³⁸ For example, foreign pri-

In some instances, [ADRs] enjoy more favorable dividend withholding tax treatment. As a result, holders of [ADRs] may receive a higher dividend payout on pay date.

Certain ordinary shares, such as those for U.K. companies, are not eligible for deposit into CEDEL. As a result, they can not trade through PORTAL or take full advantage of 144A.

The depositary bank can assist in ensuring that privately placed [ADRs] do not leak into the U.S. public market.

Id.

134. Exchange Act § 12(b), 15 U.S.C. § 781(a) (1988).

135. SEC REPORT, *supra* note 2, at III-69. The SEC has equated the quotation of securities on NASDAQ with the trading of securities on a national securities exchange. *Id.* This position is based on the voluntarism principle. Although in the early years of NASDAQ, foreign securities could be included in NASDAQ without the active participation of the foreign private issuer, today the consent of the foreign private issuer is required. Thus, the SEC has taken the regulatory position that the information available for NASDAQ listed companies should be essentially the same as the information available for exchange listed companies. Sec. Act Rel. No. 6493, *supra* note 71, at 86,293-95; *see also*, 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGISTRATION, § 5.06, at 5-54 (Harold S. Bloomenthal ed., 1987) (stating, "foreign issuers who had not qualified to have their securities quoted on NASDAQ prior to October 6, 1983, in order to qualify for NASDAQ quotations, will have to register the security under the Exchange Act"). Foreign securities quoted only in the pink sheets remain exempt under the "information supplying exemption." Sec. Act Rel. No. 6493, *supra* note 71, at 86,294.

136. Exchange Act § 12(g)(1)(B), 15 U.S.C. § 781(g)(1)(B) (1988).

137. *See* 17 C.F.R. § 249.220f(a) (1992).

138. Exchange Act § 12(g)(3), 15 U.S.C. § 781(g)(3) (1988). Pursuant to this au-

vate issuers meeting a 500 shareholder threshold are not required to register the security unless at least 300 of the shareholders are U.S. residents.¹³⁹ A foreign private issuer is also exempt from the registration requirements of Section 12(g), if on the last day of its most recent fiscal year, the foreign private issuer had total assets not exceeding U.S.\$5 million and the foreign private issuer's securities were not quoted on NASDAQ.¹⁴⁰

Moreover, the SEC exempts foreign private issuers from registering under Section 12(g) of the Exchange Act if certain minimum information is supplied to the SEC by the foreign private issuer or a government official or agency of the country of the foreign private issuer's domicile or in which the foreign private issuer is incorporated or organized.¹⁴¹ To qualify for the Rule 12g3-2(b) exemption, commonly called the "information supplying exemption," the following requirements must be met:

thority, the SEC adopted Rule 12g3-2, codified at 17 C.F.R. § 240.12g3-2 (1992), which provides that depositary shares be registered on Form F-6. 17 C.F.R. § 240.12g3-2 (1992). The underlying deposited securities, however, are not exempt from Section 12(g) of the Exchange Act. Exchange Act Rule 12g3-2(c), 17 C.F.R. § 240.12g3-2(c) (1992).

139. Exchange Act Rule 12g3-2(a), 17 C.F.R. § 240.12g3-2(a) (1992). For purposes of determining whether the applicable shareholder thresholds are met, ADR holders are counted as holders of the deposited security. Exchange Act Rule 12g5-1(b)(1), 17 C.F.R. § 240.12g5-1(b)(1) (1992). With respect to shares of the foreign private issuer that are held in "street name" by a broker or banker, the counting procedure varies from the procedure applicable to domestic issuers. 17 C.F.R. § 240.12g3-2(a) (1992). For domestic issuers, securities generally are deemed held of record by each person who is identified as the owner of the securities on the books of the issuer. Exchange Act Rule 12g5-1(a), 17 C.F.R. § 240.12g5-1(a) (1992). The beneficial owners of the securities are only counted as the record owners where the issuer knows or has reason to know that the "street name" arrangement is being used to circumvent the Exchange Act. Exchange Act Rule 12g5-1(b)(3), 17 C.F.R. § 240.12g5-1(b)(3) (1992). With respect to foreign private issuers the "street name" concept is generally ignored because the SEC requires that securities so held be counted as held by the number of separate accounts for which the securities are held. Exchange Act Rule 12g3-2(a), 17 C.F.R. § 240.12g3-2(a) (1992).

140. Exchange Act Rule 12g-1, 17 C.F.R. § 240.12g-1 (1992) *reprinted in* 5 Fed. Sec. L. Rep. (CCH) ¶ 26,826 at 20,288.

141. Exchange Act Rule 12g3-2(b), 17 C.F.R. § 240.12g3-2(b) (1992). The information required to be furnished pursuant to the rule is of a type which is:

material to an investment decision such as: the financial condition or results of operations; changes in business; acquisitions or dispositions of assets; issuance, redemption or acquisitions of their securities; changes in management or control; the granting of options or the payment of other remuneration to directors or officers; and transactions with directors, officers or principal security holders.

Id. § 240.12g3-2(b)(3).

(1) The information supplied under the Rule, since the beginning of the foreign private issuer's fiscal year, must include information that the issuer:

(A) has made or is required to make public pursuant to the law of the country of its domicile or in which it is incorporated or organized, (B) has filed or is required to file with a stock exchange on which its securities are traded and which was made public by such exchange, or (C) has distributed or is required to distribute to its security holders.¹⁴²

(2) The SEC must be furnished with a list identifying the information quoted in paragraph (1) and stating when and by whom this information was required to be made public, filed with an exchange, or distributed to shareholders.¹⁴³

(3) During each subsequent fiscal year, the SEC must be furnished promptly with whatever additional information is responsive to the requirements of the Rule and which is made public in the foreign private issuer's home country jurisdiction.¹⁴⁴

(4) The SEC must also be furnished with revised lists reflecting any amendments to information supplied pursuant to the Rule.¹⁴⁵

(5) In connection with a foreign private issuer's initial submission of information, the SEC must be furnished with the following information, to the extent the information is known or can be obtained without unreasonable effort or expense:

[T]he number of holders of each class of equity securities resident in the United States, the amount and percentage of each class of outstanding equity securities held by residents in the United States, the circumstances in which such securities were acquired, and the date and circumstances of the most recent public distribution of securities by the issuer or an affiliate thereof.¹⁴⁶

The information supplied pursuant to the Rule 12g3-2(b) exemption must be in English.¹⁴⁷ The information is not deemed

142. *Id.* § 240.12g3-2(b)(1)(i) (1992).

143. *Id.* § 240.12g3-2(b)(1)(ii) (1992).

144. *Id.* § 240.12g3-2(b)(1)(iii) (1992).

145. *Id.* § 240.12g3-2(b)(1)(iv) (1992).

146. *Id.* § 240.12g3-2(b)(1)(v) (1992).

147. *Id.* § 240.12g3-2(b)(4) (1992). Press releases and all other direct shareholder communications must be furnished to the SEC in the English language. *Id.* English versions or summaries of other documents are permitted. *Id.* If no English translations

"filed" with the SEC or otherwise subject to the liabilities of Section 18 of the Exchange Act.¹⁴⁸

Finally, subject to certain exceptions, the exemption afforded under this Rule is not available for securities of a foreign private issuer that (1) has had, during the eighteen-month period prior to the date on which exemption is claimed thereunder, any securities registered under Section 12 or a reporting obligation under Section 15(d) of the Exchange Act; (2) issued in a transaction to acquire securities or assets of another issuer that had securities registered under Section 12 or a reporting obligation (suspended or active) under Section 15(d) of the Exchange Act; or (3) represented by ADRs quoted on NASDAQ.¹⁴⁹

B. *Reporting Requirements*

Foreign private issuers with securities listed on a national securities exchange or NASDAQ, and those that have conducted a registered public offering of the securities in the United States¹⁵⁰ have various additional periodic filing obligations under the Exchange Act. The two basic periodic reports filed by foreign private issuers under the Exchange Act are annual reports on Form 20-F and periodic reports on Form 6-K.¹⁵¹

Form 20-F must be filed within six months following the end

were prepared, a brief description in English of any of the documents may be furnished. *Id.*

148. *Id.* Section 18 provides generally for liabilities for false or misleading statements contained in documents filed pursuant to the Exchange Act. 15 U.S.C. § 78r (1988).

149. 17 C.F.R. § 240.12g3-2(d)(1)-(3) (1992).

150. See Exchange Act §§ 12(g), 13(a), 15(d), 15 U.S.C. §§ 78l(g), 78m(a), 78o(d) (1988); see also, SEC REPORT, *supra* note 2, at III-69 (discussing reporting requirements and procedures for foreign private issuers). To avoid duplicative reporting, the requirement to file periodic reports pursuant to Section 15(d) is automatically suspended for as long as a foreign private issuer has any securities registered under Section 12 of the Exchange Act. Exchange Act § 15(d), 15 U.S.C. § 78o(d) (1988). In addition, the reporting obligation for securities not listed on an exchange or traded on NASDAQ may be suspended, except for the fiscal year in which a Securities Act registration statement becomes effective or is required to be updated, if the class of securities is held by less than 300 U.S. residents or less than 500 U.S. residents where the total assets of the foreign private issuer have not exceeded U.S.\$5 million on the last day of each of such issuer's three most recent fiscal years. Exchange Act Rule 12h-3, 17 C.F.R. § 240.12h-3 (1992).

151. See Exchange Act General Instructions, Form 20-F *reprinted in* 4 Fed. Sec. L. Rep. (CCH) ¶ 29,701, at 21,749; see also Exchange Act Form 6-K, 17 C.F.R. § 249.306 (1992) *reprinted in* 4 Fed. Sec. L. Rep. (CCH) ¶ 30,972.

of the foreign private issuer's fiscal year¹⁵² and must disclose information concerning the foreign private issuer's business properties, management, securities and finances.¹⁵³ Although the financial statements required to be filed with Form 20-F must have an informational content substantially similar to that required of domestic issuers, the financial statements, with certain exceptions, need not be prepared in accordance with U.S. GAAP if they are presented in accordance with the generally accepted accounting principles of the foreign private issuer's domicile and a reconciliation of the differences in measurement items is provided.¹⁵⁴

Periodic reports on Form 6-K require foreign private issuers to furnish the SEC with information similar to that required by Rule 12g3-2(b) under the Exchange Act.¹⁵⁵ The report must be filed promptly after the material required is made public.¹⁵⁶ The information and documents furnished to the SEC on Form 6-K are not deemed to be filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section.¹⁵⁷

Depository shares registered on Form F-6 are exempt from Section 12(g) of the Exchange Act.¹⁵⁸ Accordingly, no annual or other periodic reports must be filed for the depository shares under Section 15 of the Exchange Act.¹⁵⁹ For ADRs, which are registered under Section 12 of the Exchange Act, the foreign private issuer is also exempted from filing periodic reports on Form 6-K with the SEC.¹⁶⁰

152. 17 C.F.R. § 249.220(8)(b).

153. See Form 20-F, 17 C.F.R. § 249.220f (1992).

154. *Id.*

155. Exchange Act Form 6-K, General Instructions *reprinted in* 4 Fed. Sec. L. Rep. (CCH) ¶ 30,971, at 21,951. Form 6-K requires a foreign private issuer generally to furnish information which it (i) is required to make public in the country of its domicile or in which it is incorporated or organized pursuant to the laws of that country; or (ii) has filed with a foreign stock exchange on which its securities are traded and which was made public by that exchange; or (iii) has distributed to its security holders. *Id.*

156. *Id.*

157. *Id.*

158. 17 C.F.R. § 240.12g3-2(c) (1992). However, the underlying deposited securities are not exempted expressly from Section 12(g) of the Exchange Act by this provision. *Id.*

159. *Id.* § 240.15d-3 (1992). To qualify for the exemption, the depository must furnish the SEC with information required by Item 4(a) of Form F-6. *Id.*

160. *Id.* § 240.13a-16(a)(2) (1992).

IV. *SEC FOCUS ON ADRs: PROSPECTS FOR THE FUTURE*

Recognizing the desirability of encouraging foreign private issuers to access U.S. capital markets by issuing ADRs, the SEC issued a release under the Securities Act seeking public comment on the operation and regulation of the ADR market.¹⁶¹ Specifically, the SEC sought comments on whether changes were necessary or appropriate to the Securities Act registration process for ADRs. Concurrently with the issuance of the release seeking public comments, the SEC proposed rules that were designed to reduce the impediments to foreign private issuers making securities offerings in the United States.¹⁶² These proposed rules would: (i) eliminate the need for foreign private issuers to file quarterly financial statements to continuously offer securities throughout the year in the United States;¹⁶³ (ii) permit foreign private issuers to prepare interim financial information without complying with U.S. GAAP;¹⁶⁴ and (iii) promote the inclusion of U.S. shareholders in exchange,¹⁶⁵ rights,¹⁶⁶ and tender offers.¹⁶⁷

Two of the more important changes which would result from the adoption of these proposed rules are: (i) the elimination of the so-called "black out" periods in which an offering could not become effective or during which continuous offerings would be suspended,¹⁶⁸ and (ii) the authorization of foreign private issuers to utilize in SEC filings interim financial reports without reconciliation with GAAP.¹⁶⁹ The issues which these two proposed changes were intended to address are discussed in detail below.

161. 1991 SEC REPORT, *supra* note 7.

162. See 56 Fed. Reg. 27,564 (1991) (to be codified at 17 C.F.R. pts. 230, 239, 240) (proposed June 14, 1991); see also, 56 Fed. Reg. 27,562 (1991) (to be codified at 17 C.F.R. pts. 210, 239, 240) (proposed June 14, 1991); 56 Fed. Reg. 27,582 (1991) (to be codified at 17 C.F.R. pts. 200, 230, 239, 240, 260) (proposed June 14, 1991).

163. See 56 Fed. Reg. 27,562, at 27,562 (proposing amendments to reporting requirements for foreign private issuers).

164. *Id.* at 27,563.

165. See 56 Fed. Reg. 27,582, at 27,582-84 (proposing rules on international tender and exchange offers).

166. See 56 Fed. Reg. 27,564, at 27,564 (proposing amendments to Form F-3).

167. See 56 Fed. Reg. 27,582, at 27,582-83 (proposing rules on international tender and exchange offers).

168. See 56 Fed. Reg. 27,562, at 27,562 (proposing amendments to rules applicable to age of financial statements).

169. *Id.* at 27,563.

Rule 3-19¹⁷⁰ of Regulation S-X establishes requirements for the age of financial statements of foreign private issuers included in SEC filings. Rules 3-19(b) and (c), as currently in effect, require that on the effective date of a Securities Act registration statement:

- (1) Financial statements in the filing must be as of a date within six months of the effective date, and
- (2) The audited year-end financial statements are required to be included in the filing if the effective date falls more than five months after the registrant's fiscal year end.¹⁷¹

Rules 3-19(b) and (c) do not require foreign private issuers to file interim financial information. However, the effect of these rules is that foreign private issuers must submit financial statements more often than semi-annually to conduct registered offerings at certain times and to engage in continuous offerings of their securities pursuant to a shelf registration statement filed with the SEC pursuant to Rule 415 under the Securities Act without interruption.¹⁷² This imposes a substantial additional financial burden on foreign private issuers whose home countries do not require quarterly financial reporting.¹⁷³ Therefore, most foreign private issuers choose not to conduct offerings during the "black out" periods in which interim financial statements are necessary.¹⁷⁴

To promote offerings and facilitate continuous offerings by foreign private issuers, the SEC has proposed amending Rules 3-19(b) and (c).¹⁷⁵ The amendment would eliminate "black out" periods if the foreign private issuer provides: (i) audited fiscal year financial statements within six months following the end of the fiscal year, and (ii) unaudited interim financial statements within four months following the end of the semi-annual period.¹⁷⁶ Additionally, the proposed rules would extend Securities Act and Exchange Act registration statement updating requirements for foreign private issuers by four months for interim

170. 17 C.F.R. § 210.3-19 (1992).

171. 17 C.F.R. § 210.3-19(b) (1992).

172. See 56 Fed. Reg. 27,562, at 27,562 (proposing amendments to rules applicable to age of financial statements).

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

unaudited financial statements and by one month for annual audited financial statements.¹⁷⁷ These proposed amendments to Rules 3-19(b) and (c) are a needed step towards the standardization of financial reporting requirements for foreign private issuers in the global capital market.

Rule 3-19(f) of Regulation S-X states that financial reports which are made available to shareholders, exchanges and others more frequently than required by Rules 3-19(b) and (c) must be included in any registration statement filed with the SEC by a foreign private issuer.¹⁷⁸ These additional financial reports must be reconciled with GAAP.¹⁷⁹

The SEC has proposed amending Rule 3-19(f) to provide that GAAP reconciliation of these interim statements would not be necessary if certain narrative disclosures were made.¹⁸⁰ These narrative disclosure requirements would provide that the interim financial statements of foreign private issuers may describe and disclose the quantified effects of any material variation in accounting that was not previously disclosed and quantified in the reconciliation for an annual or semi-annual period.¹⁸¹ Thus, in effect, only material accounting variations with respect to unusual events would need to be described in such interim financial statements.¹⁸²

The SEC has stated that the purpose of this proposed amendment is to "overcome one disincentive to more frequent reporting of interim financial information."¹⁸³ The amendment to Rule 3-19(f) has been criticized for not going far enough to induce foreign private issuers to provide interim reports more often.¹⁸⁴ While it is true that the amendment by itself is unlikely

177. *Id.*

178. *See* 56 Fed. Reg. 27,562, at 27,563 (proposing amendments to rules applicable to age of financial statements).

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. Letter from Richard Dieter, Arthur Andersen & Co., to Securities and Exchange Commission 2-3 (July 12, 1991) (responding to SEC's request for comments on proposed amendment to Rule 3-19) (on file with the *Fordham International Law Journal*); *see also*, Letter from Arthur J. Simon, Gardner, Carton & Douglas, to Securities and Exchange Commission 4-5 (July 10, 1991) (responding to SEC's request for comments on proposed amendment to Rule 3-19) (on file with the *Fordham International Law Journal*); and Letter from Frederick C. Rich, Sullivan & Cromwell, to Securities and Ex-

to induce foreign private issuers to issue interim financial statements more frequently, the proposed amendment would make the preparation of such interim financial statements less costly, and thus, provide an effective incentive to foreign private issuers to issue such statements on a more timely basis.

These rule proposals suggest that the SEC is responding to the U.S. public's growing desire to purchase foreign securities.¹⁸⁵ Additionally, as a result of the U.S. public's eagerness to invest in foreign securities, other financial institutions have appeared in the ADR market to act as depositaries. These new depositaries should bring about increased competition and serve to lower costs associated with establishing ADR facilities.¹⁸⁶ The establishment and marketing efforts of these new depositaries should also increase awareness among foreign private issuers concerning opportunities in the ADR market.

CONCLUSION

In the future, significant, positive changes in the rules and regulations which govern ADRs are anticipated. As a result of the SEC's recognition of the globalization of world capital markets, foreign private issuers will be afforded an even greater opportunity to increase their participation in U.S. markets through the issuance of ADRs. The proposed rules, and other changes in the regulatory regime for ADRs that are certain to follow, serve as an opportune occasion for the SEC to broaden the access of foreign private issuers to our marketplace. Such access would reinforce the position of U.S. markets in the global financial arena and facilitate the development of a worldwide marketplace for capital formation.

change Commission 4 (July 15, 1991) (responding to SEC's request for comments on proposed Rule 3-19 amendments) (on file with the *Fordham International Law Journal*).

185. See Harold Schimkat, *The SEC's Proposed Regulations of Foreign Securities Issued in the United States*, 60 *Fordham L. Rev.* 203 (1992) (suggesting that SEC should permit "foreign companies to issue securities in U.S. public markets without having to comply with SEC disclosure requirements").

186. See Susan Antilla, *Wall Street: New Shaker in the ADR Business*, *N.Y. TIMES*, Aug. 1, 1993, at 13, col. 3.