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The Securities of Foreign Governments, Political Subdivisions, and Multinational Organizations

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The United States has become an increasingly important source of capital for some foreign governments, their political subdivisions, and certain multinational organizations. The Securities and Exchange Commission (the Commission) has stated that during its 1983 fiscal year, fourteen such issuers registered 5.3 billion dollars worth of securities under the Securities Act of 1933¹ (1933 Act) and that additional issuers registered eight more of these offerings during the first half of the 1984 fiscal year.² This article reviews the applicability of the federal securities laws to offerings by foreign governments and multinational banks.

I. Background and Legislative History

Before Congress enacted the 1933 Act, no formal statutory regulation of the offerings of securities of foreign governments existed. After 1922, underwriters planning to offer securities of foreign governments in the United States developed an informal practice of submitting a memorandum about the contemplated offering to the State Department. After consulting with other relevant departments, the State Department would indicate whether it had any objections to the contemplated offering. The State Department would analyze the proposed offering from the public policy viewpoint. This procedure exerted pressure on foreign governments in default on obligations

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¹ 15 U.S.C. §§ 77a-77bbb (1982).

² SEC Securities Act Release No. 21186 (July 30, 1984). A securities lawyer, experienced in offerings of securities of foreign governments before enactment of the 1933 Act, criticized the provisions of that Act that require the registration of such securities. He argued that delays inherent in registration and increased risks imposed on underwriters would curtail such offerings in the United States. See Dulles, *The Securities Act and Foreign Lending*, 12 FOREIGN AFFAIRS 33, 46 (1933).

to the United States.³ Many foreign governments, especially in Latin America, sold large amounts of their securities in the United States during the 1920s. Many of these bonds were in default by the early 1930s. This situation provoked an outcry for increased regulation of the offerings of securities of foreign governments.

On March 29, 1933, President Roosevelt recommended that Congress pass legislation on investment securities.⁴ On the same day, congressmen introduced identical administration-sponsored bills on securities in each house: S. 875 was introduced by Senator Robinson for Senator Ashurst,⁵ and H.R. 4314 was introduced by Representative Rayburn.⁶

Mr. Huston Thompson, a former Federal Trade Commissioner, was the principal drafter. He based the bill on the Uniform Sale of Securities Act, the contemporary model for blue sky laws. The structure of the bill was substantially different from the legislation that ultimately passed.⁷ Basically, the bills required an issuer to file a registration statement with the Federal Trade Commission (FTC) before it offered or sold its securities to the public. The registration statement was effective immediately upon filing. The FTC could revoke the registration for various reasons, including misrepresentation, an unsound or insolvent condition of the issuer, unsound principles for issuing the securities, or in the public interest. The bill further required that all advertisements relating to the securities offered contain specified information, and that the issuer supply such information to purchasers.

Several provisions of the bill dealt specifically with foreign securities. The drafters distinguished between the securities of foreign private corporations, which the bill treated as securities of domestic issuers, and those of foreign governments and political subdivisions.⁸ An offering made by a foreign government in the United States was exempt from the registration provisions. Any underwriter or selling agent of the securities of the foreign government, however, would have to file and sign the registration statement. The bill did not mandate that advertisements contain specified information, but gave the Commission authority to regulate the content of the advertisements.

³ See 1 L. LOSS, *SECURITIES REGULATION* 351-53 (1961 ed. Supp. 1969).

⁴ H.R. Doc. No. 12, 73d Cong., 1st Sess. (1933).

⁵ See 77 CONG. REC. 937-38 (1933).

⁶ See *id.* at 1006.

⁷ See H.R. 4314, 73d Cong., 1st Sess. (1933); S. 875, 73d Cong., 1st Sess. (1933); and S. REP. NO. 47, 73d Cong., 1st Sess. (1933).

⁸ See *Federal Securities Act: Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 12-13 (1933) (statement of Huston Thompson) [hereinafter cited as *Hearings on H.R. 4314*]; *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 89-90 (1933) (statement of Huston Thompson) [hereinafter cited as *Hearings on S. 875*].

The drafters of the bill explained that United States government demands for certain disclosures might offend foreign governments, and FTC actions could interfere with foreign relations. To enforce the proposed bill, the FTC would informally consult with various agencies and departments, such as the Commerce, Treasury, and State Departments, and the Federal Reserve Board, about offerings by foreign governments. The FTC could then informally request that the issuer not make the offering or revoke the registration of an uncooperative government's securities. The drafters included this procedure in an early draft of the bill but later removed it because they felt that an explicit statement of this procedure would be offensive to foreign governments.⁹

The bill would not have required representatives of the foreign government to sign the registration statement. The United States underwriter, however, would have had this obligation. The drafters included this provision to avoid offending the foreign government, while having a party in the United States who would be liable for misrepresentations in the prospectus.¹⁰

Section 5(b) of the bill, a forerunner to Schedule B of the 1933 Act, listed the information required in a registration statement of a foreign government or its subdivision:

1. Name of borrowing government or subdivision thereof;
2. Purpose or object of the loan;
3. Date and terms of the proposed loan;
4. Date and terms of the underwriting agreement, the names and members of the underwriting syndicate, including all bonuses and commissions paid or to be paid by the foreign borrowing government and all payments or charges paid or to be paid for the privilege of underwriting the loan or for any other purpose in connection therewith;
5. Security pledged or to be pledged for the loan;
6. General financial condition of the borrowing government or subdivision thereof;
7. Whether or not the borrower has ever defaulted on the principal or interest of any other security sold in the United States or other foreign country, and, if so, the amount and circumstances;
8. Proposed method of distributing the securities to be issued under the loan;
9. Proposed price at which security [sic] is to be offered to the public in the United States and elsewhere;
10. Cost thereof to the person, corporation, or association or other entity underwriting or negotiating the loan and the net amount to be returned to the borrowing government or subdivision thereof from the sale of such securities.¹¹

⁹ See *Hearings on H.R. 4314*, *supra* note 8, at 12-14, 28-29, 80-87; *Hearings on S. 875*, *supra* note 8, at 89, 95-96.

¹⁰ See H.R. 4314 and S. 875, *supra* note 7, § 4; *Hearings on H.R. 4314*, *supra* note 8, at 51-52, 118-20; *Hearings on S. 875*, *supra* note 8, at 11-12, 96, 155-62, 283.

¹¹ H.R. 4314 and S. 875, *supra* note 7, § 5(b).

The drafters particularly wanted disclosure if the country planned to use the proceeds of the offering to balance its budget or refund outstanding debt.¹² Based on the hearings, the House decided to require disclosure of collateral agreements between the government and underwriters that would reveal deposits held by the underwriters.¹³

Section 2(h) of the bill and section 2(7) of the 1933 Act define "interstate commerce" with the same language. The bill's definition originally excluded the reference to trade or commerce between any foreign country and any state. The drafter of this section intended to cover only those offerings of foreign securities that occurred in the United States. After some criticism at the hearings, the drafter agreed to revise the provision to the present language that mirrors the language in the FTC statute.¹⁴

The hearings in both houses of Congress revealed the many shortcomings of the bill. Congress expressed recurring concern with the provisions about foreign governments. The main concern was whether the provisions sufficiently protected United States investors because investors in foreign government bonds had incurred significant losses in the past.¹⁵ Securities lawyers expressed the opinion to Congress that requiring the United States underwriter to sign and file the registration statement without requiring a signature by an official of the foreign government would be tantamount to making the underwriter the guarantor of the securities. This would effectively prohibit offerings by foreign governments.¹⁶ At the conclusion of the hearings, the drafters offered to amend the bills to treat the securities of foreign governments as the securities of domestic and foreign corporations.¹⁷

Congress was also concerned about protecting the interests of holders of defaulted foreign government bonds. Senator Hiram Johnson introduced legislation to create a government agency to negotiate with foreign governments whose bonds were in default. His bill became Title II of the bill that was ultimately adopted (the 1933 Act was Title I). The State Department opposed Title II because negotiations over defaulted bonds with the foreign governments

¹² See *Hearings on H.R. 4314*, *supra* note 8, at 12-13, 42.

¹³ *Id.* at 56-57.

¹⁴ *Id.* at 210-12; *Hearings on S. 875*, *supra* note 8, at 79.

¹⁵ In 1934 U.S. investors held three billion dollars of foreign securities that were in default. *Securities Exchange Act Amendments, Hearings on S. 2408 Before the Subcomm. on Securities and Exchange of the Senate Comm. on Banking and Currency*, 81st Cong., 2d Sess. 10 (1950). Apparently, this was a political *cause celebre* since many bills were introduced to Congress in 1933 to regulate the sale of foreign government securities. See 1 L. Loss, *supra* note 3, at 351-58.

¹⁶ See *Hearings on S. 875*, *supra* note 8, at 155-62, 283.

¹⁷ See *Hearings on H.R. 4314*, *supra* note 8, at 219; *Hearings on S. 875*, *supra* note 8, at 83-84.

might conflict or interfere with the foreign policy of the United States. As a compromise, the Conference Committee of the House of Representatives and the Senate amended the bill to provide that only a Presidential declaration could activate Title II.¹⁸

II. Application of The 1933 Act, The 1934 Act, and The 1939 Act

A. Introduction

Several provisions of the federal securities laws apply specifically to securities issued by "a foreign government or political subdivision thereof." This phrase is not defined in the statutes, but its meaning and application are usually clear: sovereign nations are foreign governments and provinces; states and cities are political subdivisions.¹⁹ Interpretative questions, however, can arise. In some situations, the issuer of a debt security is a corporation owned or controlled by a foreign government. The Commission classifies the issuer as a foreign government only if a foreign government guarantees the principal and interest of the offered security. Apparently, the Commission reasons that the securities laws provide foreign governments with accommodations not applicable to domestic and foreign nongovernmental issuers because of the sovereign nature of the issuer and its ability to levy taxes to satisfy the interest and principal payments. These accommodations should be accessible to a foreign government only when its taxing power will decrease the possibility of default, whether directly or indirectly through a guarantee. This test is easy to apply and avoids difficult problems that may arise in countries where many corporations are partially nationalized.

The federal securities laws do not specifically address the securities of an agency of a foreign government. In the few situations in which this issue has arisen, the Commission has focused its analysis on whether the agency is part of the foreign government. Important factors include whether the government's budget includes the agency, whether the agency's securities are part of the national debt, and whether the agency's employees are civil servants.

Some organizations that issue securities serve a governmental function but are not sovereign countries. Several foreign governments are members of these organizations. The staff of the Commission has taken a "no-action" position, treating such organizations like foreign governments.²⁰ These staff letters do not specifically address this analysis. The important criterion seems to be whether the

¹⁸ See Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 42-43 (1959); 1 L. LOSS, *supra* note 3, at 353-54.

¹⁹ The term "foreign government" is defined in rule 405, 17 C.F.R. § 230.405 (1984), under the 1933 Act and rule 3b-4, 17 C.F.R. § 240.3b-4 (1984), and under the 1934 Act to mean "the government of any foreign country or of any political subdivision of a foreign country."

²⁰ See, e.g., Nordiska Investeringsbanken, SEC No-Action Letter (Dec. 30, 1981); Eu-

member countries are obligated to fund the organization in a manner economically similar to guaranteeing the principal and interest of the organization's securities.

B. Disclosure Requirements

1. Overview

Schedule B to the 1933 Act²¹ contains the specific disclosure requirements for a registration statement for the securities of a foreign government and its political subdivisions. A registration statement consists of three parts: the prospectus, which is the selling document that the issuer must deliver to investors; Part II, which contains detailed information that is publicly available but not necessarily distributed; and the exhibits, which are various documents relating to the issuer and the securities.

Schedule B, as supplemented by rules 490-493 of Regulation C,²² requires the disclosure of certain information about the issuer, the offering, and the underwriters. The prospectus must disclose the name of the issuer, whether the issuer or its predecessor has defaulted on either the principal or interest payments of any external security,²³ and receipts, by source, and expenditures, by purpose, for the latest fiscal year and the two preceding fiscal years. Tables showing funded (long-term) debt and floating (short-term) debt are required. The prospectus must present the following information for each issue of debt: date, maturity, character, interest rate, amortization, any security, and whether substitution of such security is permitted. Schedule B does not require this detailed information for any funded debt of which the aggregate amount is less than five percent of the total outstanding funded debt. If the total includes this amount, the registration statement must identify each such issue of debt and may contain a statement on the amortization, retirement, and security substitution provisions of debt that is not registered in Part II instead of the prospectus.²⁴ The SEC staff responsible for

ropean Economic Community, SEC No-Action Letter (Sept. 10, 1980); Central American Bank for Economic Integration, SEC No-Action Letter (Mar. 14, 1973).

²¹ See section 7 of the 1933 Act, 15 U.S.C. § 77g (1982) (relating to information required to be in a registration statement), and section 10(a)(3) of the 1933 Act, 15 U.S.C. § 77j(a)(3)(1982) (relating to information required to be in a prospectus). In SEC Securities Act Release No. 6424 (Sept. 2, 1982), the Commission stated that the facing page of registration statements in conformity with Schedule B should be designated as a Schedule B filing.

²² 17 C.F.R. §§ 230.490 to 230.493 (1984). Rule 494, *id.* at § 230.494, specifies prospectus contents that are to be published in newspapers (a procedure no longer used by underwriters).

²³ It is unclear whether disclosure is required only if a payment of principal or interest is not made on the date it is due, or whether disclosure is required if the original terms of debt are revised (*e.g.*, renegotiation of a syndicated loan, before any missed payments, but in contemplation of them).

²⁴ 17 C.F.R. § 230.492 (1984).

reviewing and commenting on the registration statements of foreign governments²⁵ requires that the issuer prepare the debt tables within ninety days of the effective date of the registration statement to ensure that the information will be reasonably current.

These debt tables can be extremely long for foreign governments that have many outstanding issues of debt. A securities lawyer with much experience in this area has informally suggested that the SEC adopt a rule permitting prospectuses to include a summary table of the information and the information relating to each issue of debt in a table in Part II of the registration statement. It appears that some issuers have prepared prospectuses following that format even in the absence of an SEC rule authorizing such disclosure.

The registration statement must disclose the terms of the offering. This disclosure includes the offering price, the commissions paid to the underwriters, the estimated expenses of the offering,²⁶ the net proceeds to the issuer, and the purposes for which the issuer will use the net proceeds.

The disclosure about the method of distribution must include the names and addresses of the underwriters²⁷ and of any authorized agent in the United States. A copy of any underwriting documents or agreements must accompany the registration statement as an exhibit. The prospectus must disclose the name of counsel who advised on the legality of the issuance of the securities.²⁸ The opinion of such counsel, which must be set forth in English, must set out in full all laws, decrees, and ordinances that authorize the issuance of the security.²⁹

A registration statement discloses much information that Schedule B of the 1933 Act does not expressly require. The other provisions of the federal securities laws are one reason for the additional disclosure.

Section 12(2) of the 1933 Act prohibits selling securities by a prospectus or oral communication "which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading."³⁰ Rule 408 states:

²⁵ All such registration statements are assigned to the Office of International Corporate Finance in the Division of Corporation Finance.

²⁶ The estimated expenses may be included in Part II of the registration statement instead of in the prospectus. *See id.*

²⁷ Only the names of the underwriters who are in privity of contract with the issuer need be disclosed in the prospectus. *See id.* § 230.491. The address of the underwriters may be disclosed in Part II of the registration statement.

²⁸ The address may be disclosed in Part II of the registration statement. *See id.* § 230.492.

²⁹ The opinion must be filed as an exhibit to the registration statement either as part of the initial filing or as an amendment. *See id.* § 230.493.

³⁰ 15 U.S.C. § 771(2) (1982).

In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.³¹

Thus, some securities lawyers advise issuers to disclose all material information in the prospectus to ensure that the statements are not misleading.³²

Another important reason for the expanded disclosure is that governments use the prospectus as a form of advertising or a public relations communication. Additionally, a set of disclosures has become fairly standard over the years. A prospectus for a sovereign entity, typically a national government, usually includes sections on the country, the economy, the monetary system, foreign trade and balance of payments, foreign exchange, public finance, and public debt.

The section about the country typically includes information about bordering countries and identifies various territorial disputes, as well as a map of the country and a smaller map showing the general location of the country on the continent. This section discloses information on the square miles of land and the different types of geographic regions, such as forest, cultivated land, frequently by percentage. It names the capital, the principal cities, and their populations. Also provided are statistics concerning the population of inhabitants per square mile, growth rate, age distribution, percentage division of population between urban and rural, and percentage of population living in concentrated areas.

Further, this part of the prospectus identifies the form of government, such as constitutional monarchy or republic. The section states the date and basic principles of the constitution and explains the term, powers, and selection process of the executive branch of the government. The judicial system is described and whether it is independent of the executive branch is indicated. The description of the legislative body includes the terms of office, the election process, the number of members, and a list of the major political parties and the number of seats won in the most recent elections.

Further included are a list of the major international organizations of which the government is a member and a description of the participation of the government in regional trade and development organizations. Some countries, especially those that are neutral, summarize their foreign policy.

The portion of the prospectus about the economy describes the

³¹ 17 C.F.R. § 230.408 (1984).

³² See Stevenson & Williams, *United States Legal Aspects of International Securities Transactions*, in *A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS* Part III, Folio 5, 38 (Surrey & Wallace eds. 1980).

main features of the economy in recent years, including inflation, balance of payments, capital formation, and consumption. It also summarizes the major factors affecting the economy and explains recent government programs and policies about the economy.

Typically, a gross domestic product (GDP) summary table shows the GDP at current prices, the GDP at constant prices, the percentage of increase over the prior period, and the per capita GDP, for the last five years. Tables also show GDP by major sectors of the economy for the past five years and domestic expenditure for the last five years.

The economy section also lists the total work force in numbers and percent of population, summarizes the government labor policies, and describes the impact of unions. Tables show the labor force, employed and unemployed, and employment by major sectors of the economy for the past five years.

A table that summarizes wages and prices in the economy section gives the following indices for the past five years: the consumer price index, the wholesale price index, the wage and salary index, and the percentage change over prior period for each. This section includes a brief discussion of any relevant government policies and laws, such as a wage price freeze, and any other material features of the economy, such as stated economic plans and state-operated enterprises.

A section on the monetary system describes the administration and functions of the central bank. It discloses the number of various types of financial institutions, such as commercial banks, savings banks, and cooperatives, and describes unique or distinctive financial institutions. A table shows the total outstanding loans for the past five years for each type of institution. Techniques the government uses to implement its monetary policy are enumerated. A table shows the money supply for the past five years aggregated into currency, demand deposits, and time deposits.

The section about foreign trade and balance of payments includes information on the percentage of GDP represented by imports and exports, the growth rates for foreign trade, a discussion of recent trends, and a discussion of tariff policy. A balance of trade table shows exports, imports, percentage increase of exports and imports, balance of trade, and exports as a percentage of imports for the past five years. Another table shows the following indices of foreign trade for the past five years: volume, percentage change (for both exports and imports), terms of trade (ratio of export prices and import prices), and percentage of change in terms of trade. A table presenting imports and exports, by commodity groups, by currency and percentage, for the last five years shows the composition of foreign trade. Recent trends and their causes are discussed, and re-

gional trade associations and customs unions to which the government belongs are listed and recent trends in the geographic distribution are explained. A table shows imports and exports, in currency and percentage, by countries in a geographic area for the past five years. A table of balance of payments for the last five years shows the current account and the capital account, divided into long-term and short-term.

The foreign exchange section states recent exchange rates and any agreements about foreign exchange. A table shows foreign currency per dollar and dollars per unit of foreign currency for the past five years and on a quarterly basis for the most recent year. Another table discloses foreign exchange reserves by showing reserves for the past five years classified in the gold, special drawing rights (SDRs), International Monetary Fund position, and foreign exchange, and classifies the information into convertible and nonconvertible currencies. Official foreign reserves held by the central bank and agreements and arrangements, such as currency swaps, are mentioned. A brief description of any exchange control regulations and the agency administering such controls is included.

The portion regarding public finance notes the date of the end of the fiscal year, summarizes the budgetary process, and states when the budget is submitted to the legislature. It includes a description of accounting and auditing systems, and states how long after the end of the fiscal year the government publishes the accounts. A table shows principal categories for the government's revenues and expenditures for the past five years and the most recent budget.

The public finance section further describes the tax system, including whether it is progressive or regressive, the range of rates, the types of taxes, and the percentage of total revenue each type of tax contributes. Other major categories of revenues and expenditures, such as social security systems are also highlighted.

A description of the department that is responsible for administering the national debt appears in the public debt section. The section summarizes prior history of payments and defaults on the country's debt. A table shows debt for the past five years classified into funded, floating, internal, and external debt. A schedule of repayments of principal and interest classified by currency and different types of debt is present, and, if material, a table showing internal and external amounts of guaranteed debt.

The SEC has not adopted any form for registration statements relating to the offerings of securities of foreign governments. Although Professor Loss has criticized the Commission for failing to adopt such a form, many experienced securities lawyers disagree, reasoning that it would be unduly restrictive because many of the entities filing registration statements in conformity with Schedule B

are distinctive or unique. A form requiring standardized disclosures would not necessarily elicit the most informative disclosure. Registrants and their counsel need the flexibility to develop the disclosure that most accurately describes the registrant. Also, although pursuant to the current practice registrants and their counsel discuss the disclosure with the staff of the Commission in prefiling conferences, the adoption of a form would require the additional procedure of obtaining a formal waiver of its particular requirements from the Commission.

Another difficulty that has impeded the development of a form or forms under Schedule B is the lack of standardized and widely accepted accounting and disclosure practices in the United States for comparable issuers. With respect to corporate issuers, the SEC has adopted special forms for foreign corporations based on the forms and accounting principles applicable to United States companies. Such forms and accounting principles do not exist for the United States Government and its political subdivisions.

As explained above, in some situations an entity whose securities are guaranteed by a foreign government or a political subdivision files a registration statement conforming to Schedule B. Electric utility companies in Canada whose securities are guaranteed by a province are typical examples. In these situations, the SEC requires disclosure about the entity that is the issuer of the debt security and about the government that is the guarantor. The prospectus, in effect, is a dual or combination prospectus. The prospectus contains virtually the same disclosure about the government as would be required if the government were registering its debt securities. The prospectus also contains disclosure about the entity issuing the debt securities that is based upon the disclosure requirements of Form S-1, which is the general registration form available to corporations. The requirement for a dual prospectus of this type is premised on the analysis that the entity and the government each are registering securities: the entity is registering the debt security, and the government is registering the guarantee.³³

The registration statement forms applicable to corporate issuers require the disclosure of financial statements presented in conformity with generally accepted accounting principles.³⁴ The Commission has adopted extensive requirements relating to the form and content of financial statements included in filings with the Commis-

³³ Section 2(1) of the 1933 Act defines the term "security" to include "any note . . . or guarantee of . . . any of the foregoing." Thus the debt securities and the guarantee are considered separate securities for this purpose.

³⁴ Foreign corporations may follow the generally accepted accounting principles of their home country if the material differences from the generally accepted accounting principles in the United States are reconciled. See generally SEC Securities Act Release No. 6360 (November 20, 1980).

sion.³⁵ For the most part, these requirements do not apply to registration statements filed pursuant to Schedule B. The Commission's practice is to require the foreign government to include in the registration statement whatever financial statements it publishes. The Commission may require additional disclosure to explain certain features of such financial statements if it believes United States investors might not understand them.

The Commission's position is premised on both statutory and pragmatic grounds. As discussed above, Schedule B to the 1933 Act, unlike Schedule A which applies to corporate issuers, does not require audited financial statements to be in a registration statement.³⁶ The Commission has also declined to impose a reconciliation requirement as it has for foreign corporate issuers because of the lack of standardized and widely applied accounting principles for comparable issuers. In other words, there is no United States model to which foreign governments can usefully reconcile their financial statements.

The securities of foreign governmental issuers are exempt from the Trust Indenture Act of 1939 (1939 Act) by section 304 (a)(6) thereof.³⁷ Basically, the 1939 Act requires that the indentures of debt securities registered under the 1933 Act contain certain provisions relating primarily to the qualification, duties, and responsibilities of the trustee.

An indenture is a contract, usually quite long, between the issuer of the debt security and the trustee for the benefit of the debt holders.³⁸ Conceptually, an indenture is a device by which debt holders put certain of their rights, such as the right to declare a default and accurate principal and interest payments, in trust to facilitate and coordinate the actions of widely scattered debt holders. Foreign governments tend not to use a trust indenture but rather use a document called a fiscal agency agreement.³⁹ That type of agreement merely specifies the mechanics of issuing the debt securities and paying the principal and interest. A trust is not created and elaborate provisions setting forth the rights and obligations between the fiscal agent, issuer, and holders are unnecessary.

Soon after the enactment of the 1933 Act, it was recognized that

³⁵ These requirements are contained in Regulation S-X, 17 C.F.R. § 210. The financial reporting codification and Staff Accounting Bulletins are also relevant.

³⁶ Section 2-03 of Regulation S-X provides that in certain circumstances the examination of financial statements by foreign government auditors meets the requirement for audited financial statements. Because there is no such requirement in Schedule B, this provision applies to registration statements filed pursuant to Schedule A.

³⁷ 15 U.S.C. § 77ddd(a)(6) (1982).

³⁸ See generally *The Commentaries on Model Debenture Indenture Provisions* (American Bar Foundation, 1971).

³⁹ *E.g.*, *New Zealand* (Registration No. 2-93910, Oct. 1984) (containing a fiscal agency agreement between New Zealand and Citibank N.A. as an exhibit).

investors need information about an issuer of securities periodically to be able to make informed investment decisions regarding the secondary trading in securities. The periodic reporting requirements of the 1934 Act are designed to require issuers regularly to file certain reports with the Commission even if the issuer is not then making a public offering of its securities. The 1934 Act contains three sections that impose the periodic reporting requirements on certain issuers. Section 15(d) of the 1934 Act imposes the periodic reporting requirements on an issuer that has offered and sold its securities pursuant to a registration statement under the 1933 Act if at least three hundred persons hold such securities, but expressly provides that the section does not apply to the securities of foreign governments or the political subdivisions thereof. Section 12(g) of the 1934 Act imposes the periodic reporting requirements on issuers of *equity* securities that meet certain conditions. Foreign governments, of course, issue only *debt* securities so that section does not apply to them.

Finally, section 12(b) imposes the periodic reporting requirements on any issuer that lists its securities on a securities exchange in the United States. This section applies to foreign governmental issuers as well as other issuers. Thus, a foreign government becomes subject to the periodic reporting requirements of the 1934 Act only if it lists its securities on a United States exchange.

A domestic company that is subject to the periodic reporting requirements must file an annual report that is required to disclose information similar to that required to be disclosed in a registration statement under the 1933 Act, quarterly reports, and a current report upon the occurrence of certain events. A foreign government, however, that lists its securities on a United States exchange is exempt from the requirement to file most of these periodic reports. The foreign government must file a registration statement of Form 18 as part of the listing process and thereafter must file an annual report on Form 18-K. These forms require basically the same disclosure as is set forth in Schedule B to the 1933 Act. The Commission has not attempted to develop a form requiring greater disclosure for the same reasons discussed above in relation to the absence of a form under the 1933 Act. As a practical matter, listing usually is accomplished at the same time as a registered public offering so the Form 18 often is identical to the registration statement filed under the 1933 Act. Annual reports on Form 18-K tend to contain far less disclosure than would Schedule B unless the foreign government has filed a shelf registration statement as discussed below.

2. *Shelf Registration*

Since the 1960s, various factors have encouraged the Commis-

sion to increase the disclosure requirements of the periodic reports filed under the 1934 Act to equal those of registration statements filed under the 1933 Act. The increase in requirements allowed registrants to draw from their prior disclosure in periodic reports. During the 1970s and the early 1980s, the Commission adopted and revised special forms and disclosure requirements as a step toward achieving that end. Its efforts culminated in the adoption of the integrated disclosure system. Consequently, corporations that issued "blue-chip" stock and investment grade debt, which were also subject to the periodic report requirements of the 1934 Act, could register their offerings of securities on Form S-3, previously Form S-16. This became important as interest rates and the debt markets became increasingly volatile.

Most foreign governments registering securities with the Commission were repeat issuers, and the Commission rated their debt investment grade. The integrated disclosure system by its terms was not available to foreign governmental issuers. Problems existed in creating an integrated disclosure system for foreign governmental issuers because not all foreign issuers were subject to periodic reporting requirements under the 1934 Act, and the Commission had not adopted a specific disclosure form for Schedule B. Thus, under the integrated disclosure system, issuers of investment grade securities that were United States, or even foreign, corporations could take advantage of short form registration statements and offer their debt securities with streamlined prospectuses and accelerated SEC review. Foreign governments, however, did not have such competitive advantages.

In response to this situation, the Division of Corporation Finance of the Commission issued an interpretive release allowing a shelf registration statement for offerings by certain foreign governments.⁴⁰ The procedure in that release was that a seasoned foreign governmental issuer⁴¹ would file a registration statement containing a basic prospectus, which would disclose the political, economic, and statistical information and other Schedule B information about the government. After review, the staff would declare the registration statement effective. The registration statement would relate to specified amounts of debt securities with undisclosed terms. The government would not make any such debt securities offerings, despite its

⁴⁰ See SEC Securities Act Release No. 6240 (Sept. 10, 1980); Letter to Kingdom of Sweden, SEC No-Action Letter (Sept. 10, 1980).

⁴¹ The Commission interprets a "seasoned" foreign governmental issuer to be one that has offered and sold securities under an effective registration statement within five years and has not had any material defaults on its indebtedness during the past five years. See Letter to Republic of Venezuela, SEC No-Action Letter (Oct. 14, 1980). It is the current practice of the SEC staff to allow the use of the shelf procedure for an offering by an entity whose securities are guaranteed by a seasoned foreign government.

possession of an effective registration statement, until it filed posteffective amendments. One amendment would contain a prospectus supplement disclosing the terms of the debt offered in the particular issue, use of proceeds, and any material new developments. This prospectus supplement would function as a preliminary prospectus because it would omit pricing information. The second posteffective amendment would contain the price and related information. Offers would be made when the first posteffective amendment was filed, and sales could commence after the filing of the second amendment.

As part of the development of the integrated disclosure system, the Commission also developed rule 415⁴² to codify and expand the use of shelf registration statements by nongovernmental issuers. The Commission adopted this controversial rule as a temporary experiment.⁴³ In SEC Securities Act Release No. 6424⁴⁴ the SEC staff changed its interpretive position to allow foreign governments to follow procedures similar to those that corporate issuers follow under rule 415. This typically involves preparation of a basic prospectus containing information about the country, the issuer, and the types of securities that the government may offer in the alternative plans of distribution. The Commission will declare the registration statement containing the basic prospectus effective.

The foreign government will prepare a prospectus supplement for a specific offering, stating which alternative plan of distribution it has selected and the specific terms of the security, such as maturity, interest rate, or call provisions. The prospectus supplement may also contain a description of recent developments.

The issuer files most exhibits to the registration statement before it becomes effective. An issuer cannot file some exhibits, such as underwriting documents, until it files a specific offering. In that case, the issuer files a form of underwriting agreement before the effective date. It files the final agreement as a posteffective amendment after the offering. Similarly, the 1933 Act requires that an ef-

⁴² 17 C.F.R. § 230.415 (1984).

⁴³ See SEC Securities Act Release Nos. 6276 (Dec. 23, 1980) (proposing rule 462A), 6334 (Aug. 6, 1981), 6383 (Mar. 3, 1982), 6423 (Sept. 2, 1982) (accompanied by dissent of former Commissioner Thomas that summarizes concerns expressed by the security industry regarding the rule's economic impact) and 6470 (June 9, 1983); and 6499 (Nov. 17, 1983) (final adoption). For history, background discussion, and evaluation of shelf registration and the SEC position see Banoff, *Regulatory Subsidies, Efficient Markets, and Shelf Registration: An Analysis of Rule 415*, 70 VA. L. REV. 135 (1984); Ketels, *SEC Rule 415—The New Experimental Procedures for Shelf Registration*, 10 SEC. REG. L.J. 318 (1983); Hodes, *Shelf Registration: The Dilemma of the Securities and Exchange Commission*, 49 VA. L. REV. 1106 (1963); Johnson & Coe, *The New Shelf Registration Rule*, 15 REV. SEC. REG. 925 (1982); Ferrara & Kiernan, *SEC Tests Waters with Shelf Registration Release*, Legal Times, Mar. 8, 1982, at 13; Pryor & Smith, *Significant Changes in Primary Stock Distributions in the Last 25 Years*, Nat'l L.J., Aug. 9, 1982, at 21; Pitt & Williams, *Should SEC's "Shelf Rule" Be Shelved?*, Nat'l L.J., May 17, 1982, at 21.

⁴⁴ See *supra* note 21.

fective registration statement contain an opinion of counsel on the legality of the securities registered. Counsel typically prepares a qualified or conditional opinion for filing with the registration statement and, for a particular offering, will prepare the traditional opinion that it files as a posteffective amendment.

C. Sources of Liability

Foreign governmental issuers may be liable under various provisions of the United States federal securities laws.⁴⁵ Section 11 of the 1933 Act is the basic section providing a civil remedy for a false or misleading statement in a registration statement.⁴⁶ In general, section 11 imposes liability on designated categories of persons for material statements in a registration statement that are false or misleading, and for material omissions to state facts required to be stated. The issuer, all underwriters of the offering, and any expert who is named as having prepared or certified any part of the registration statement may be liable under section 11. Such liability is joint and several, and any party who becomes liable under this section may recover contribution from others who would also be liable.⁴⁷

A statute of limitations of three years after "the security was bona fide offered to the public" limits actions under section 11.⁴⁸ Actions are further limited to the period of one year after discovery of the false statement.⁴⁹

A court may require a plaintiff in a section 11 action to post bond to cover payment of the costs, including attorney's fees. The court may compel the plaintiff to pay the costs incurred by the defendant if it finds that the claim was without merit.

The plaintiff in a section 11 action need not show that he purchased securities directly from the defendant. Rather, he must show only that he was a purchaser of one of the securities issued in the registered offering and must bring suit before the statute of limitations has run. The plaintiff normally need not show any reliance on the false statement.

The issuer may avoid liability by showing that the plaintiff knew of the untruth or omission at the time of his acquisition of the security. Otherwise, the issuer's liability under section 11 is absolute.

Section 12(1) of the 1933 Act provides that "any person who offers or sells a security in violation of section 5" shall be liable to

⁴⁵ In addition, civil liabilities may arise under state blue sky laws, which are not discussed herein. See generally R. JENNINGS & H. MARSH, JR., *SECURITIES REGULATION* 1246-1321 (4th Ed. 1977); L. Loss, *supra* note 3 at Chapter 18.

⁴⁶ 15 U.S.C. § 77k.

⁴⁷ *Id.* § 77k(f).

⁴⁸ *Id.* § 77m.

⁴⁹ *Id.*

the purchaser of the security.⁵⁰ Liability under section 12(1) is virtually absolute. The plaintiff need allege and prove only that the defendant was a seller of the security, that the defendant used the mails or some means of transportation or communications in interstate commerce, that the defendant failed to comply with either a registration or prospectus requirement, that the action is not barred by the statute of limitations, and, if the plaintiff is seeking rescission, that the plaintiff made adequate tender. The only defense available to the defendant is that the particular security or transaction was exempt from section 5.

Section 12(2) of the 1933 Act is a broad antifraud provision that is not directly related to the registration requirements of the statute.⁵¹ Section 12(2) provides a purchaser of a security with a civil cause of action against any person who offers or sells the security by means of a prospectus or oral communication that includes an untrue statement of material fact or omits a material fact necessary to make the statement not misleading. A plaintiff may bring a section 12(2) action only against the person who sold him the security. The plaintiff need not show that he relied on the misstatement or omission in purchasing the securities, but must show that he did not know, and could not have known with the exercise of reasonable care, of the untruth or omission. A defendant under section 12(2) who can prove that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, has an absolute defense to the action. This defense limits section 12(2) to intentional or negligent misstatements and omissions. Under section 12(2), the plaintiff may rescind his purchase and get back all the consideration he paid if he still owns the security, or may recover damages if he no longer owns the security.

Perhaps the most pervasive liability and antifraud provision of the federal securities laws is section 10(b) of the 1934 Act.⁵² Section 10(b) makes it unlawful for any person by use of the mails or facilities of interstate commerce "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance" Rule 10b-5 applies to any purchase or sale by any person of any security, whether or not registered on any national exchange. The rule provides no exemptions. The Supreme Court has recognized a private right of action for both purchasers and sellers under rule 10b-5.⁵³ A court must find that a defendant

⁵⁰ *Id.* § 771(1); *see also* § 77e.

⁵¹ *Id.* § 771(2).

⁵² *Id.* § 78j(b).

⁵³ *See Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). In that decision, the Court recognized a private right of action under section 10(b) of the 1934 Act notwithstanding the availability of an express remedy under section 11 of the 1933 Act. *Id.* at 380-87.

had scienter—an intention to deceive, manipulate, or defraud—to hold that defendant liable under section 10(b) and rule 10b-5. In several cases, however, courts have held recklessness sufficient to establish scienter.⁵⁴ A misstatement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. The injured party must have relied upon the misrepresentation or omission and suffered actual damages as a result of that reliance. Under section 10(b) a plaintiff may recover his actual damages, which includes those damages that can be determined with reasonable certainty, but excludes damages that are speculative or punitive in nature.

III. Defenses and Limitations on Liability

A. *Sovereign Immunity*

Foreign governmental issuers may, in certain circumstances, avoid liability under the United States federal securities laws because of their sovereign status. One argument that these issuers use to avoid liability is sovereign immunity.

The Foreign Sovereign Immunities Act of 1976 (FSIA) codifies the grant of sovereign immunity to foreign states and their agencies and instrumentalities.⁵⁵ The FSIA generally⁵⁶ grants immunity subject to five exceptions.⁵⁷ The exception relevant to foreign governmental issuers is found in section 1605(a)(2), which provides that immunity shall not be recognized in cases:

in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.⁵⁸

“Commercial activity” is defined in section 1603(d) as “either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.”⁵⁹ The legislative history indicates that acts are commercial if customarily carried on for profit, or if they are acts that private persons normally perform, as opposed to acts that are sovereign or gov-

⁵⁴ See *McLean v. Alexander*, 599 F.2d 1190, 1197, & n.12 (3d Cir. 1979) and cases cited therein; but see *Herman & McLean*, 459 U.S. at 378 n.4; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976) (reserving the question).

⁵⁵ 28 U.S.C. §§ 1602-1611 (1982).

⁵⁶ *Id.* § 1604.

⁵⁷ *Id.* § 1605.

⁵⁸ *Id.* § 1605(a)(2).

⁵⁹ *Id.* § 1603(d).

ernmental in nature.⁶⁰ Finally, in determining whether an act constitutes commercial activity, a court must be mindful of the fact that "the primary purpose of the FSIA is to restrict the immunity of a foreign state to suits involving a foreign state's public acts."⁶¹ A prior version of the bill that became the FSIA provided that a foreign state would, in the absence of an explicit waiver, retain its sovereign immunity "in any case relating to debt obligations incurred for general government purposes." The House Committee on the Judiciary deleted this provision, stating in its report that "both a sale of bonds to the public and a direct loan from a U.S. commercial bank to a foreign government are activities which are of a commercial nature and should be treated like other similar commercial transactions."⁶²

Although the issuance of securities by a foreign government may be a commercial act for which immunity is not available, when the obligations of foreign sovereign entities have come before the courts, they have nonetheless often invoked sovereign immunity. When plaintiffs have sought to assert a United States securities law violation against a foreign governmental entity, the courts have had to determine which act of the defendant is the basis of the complaint. For example, when a foreign government entity sells securities, and purchasers are then disappointed because the foreign government imposes exchange controls, the imposition of exchange controls may be a governmental act that is immune even if the issuance of securities by the governmental entity is not immune.⁶³ Courts could view other claims by securities holders as barred by immunity if the government's conduct that gives rise to the complaint is of a sovereign rather than commercial nature.

B. *The Act of State Doctrine*

In litigation, questions of sovereign immunity are often closely related to the act of state doctrine and associated notions of comity.

⁶⁰ See H.R. REP. NO. 1487, 94th Cong., 2d Sess. 14, 16, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 6604, 6613-15.

⁶¹ *Texas Trading & Milling Corp. v. Federal Republic of Nigeria*, 647 F.2d 300, 308 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982).

⁶² H.R. REP. NO. 1487, 94th Cong., 2d Sess. 10, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 6604, 6609.

⁶³ For example, in a number of recent cases, courts have considered claims arising from changes in Mexico's currency control regulations and exchange rate policies by holders of certificates of deposit with nationalized Mexican banks. See, e.g., *Callejo v. Bancomer, S.A.*, No. 3-82-1604D (N.D. Tex. Feb. 25, 1984); *Frankel v. Banco Nacional de Mexico, S.A.*, No. 82 Civ. 6457 (S.D.N.Y. May 31, 1983), *appeal dismissed*, No. 83-7543 (2d Cir. July 12, 1983). (It should be noted that these and other courts have held that such certificates of deposit are not "securities," but appeals are still pending.) In *Frankel* the court stated that "[t]here is no doubt that the promulgation of the currency control rules and regulations by the Mexican Government was a public act which only a sovereign could perform. This is precisely the type of governmental activity that cannot be subjected to judicial scrutiny under the doctrine of sovereign immunity as codified in the FSIA." Mem. Dec. at 5.

If the issuer of securities is a nationalized company or other governmental entity that has no role in the actions giving rise to the holders' complaint, courts may view the act of state doctrine as more relevant than sovereign immunity; the issuer may not be immune as a sovereign (the sale of securities may be a commercial activity) but United States courts may not exercise their judgment, because an intervening act of state, such as restrictions on payments in foreign currencies, is the source of the injury suffered by the holders of the securities.

The act of state doctrine precludes a challenge in a United States court to the validity and effect of a sovereign act of a foreign nation performed in its own territory. The Supreme Court stated in *Underhill v. Hernandez*:⁶⁴

Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.⁶⁵

Some acts of foreign sovereigns will be given effect in the United States under this doctrine regardless of whether the acts violate public policy of the forum or international law. In two cases decided in the early 1900s⁶⁶ and again in the landmark 1963 decision in *Banco Nacional de Cuba v. Sabbatino*,⁶⁷ the Supreme Court recognized the validity of a foreign sovereign's expropriation of tangible property located in its own territory.

No authoritative decisions have clearly defined the scope of the doctrine's application to other fact patterns. The Supreme Court and other courts have repeatedly emphasized that the act of state doctrine cannot be codified but rather requires case-by-case application in light of its underlying policies.⁶⁸ The Supreme Court has considered the doctrine in two cases since *Sabbatino*. Although the Court did not apply a majority rationale in either decision,⁶⁹ the cases identify two different policies underlying the doctrine. First, the Court in *Underhill* expressed the idea that comity among sovereigns and the same concerns that justify sovereign immunity prohibit sovereigns from judging the lawfulness of one another's acts. Second, *Sabbatino* indicated that concern for the separation of powers

⁶⁴ 168 U.S. 250 (1897).

⁶⁵ *Id.* at 252.

⁶⁶ *Ricaud v. American Metal Co.*, 246 U.S. 304 (1918); *Oetgen v. Central Leather Co.*, 246 U.S. 297 (1918). See also *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 357-58 (1909).

⁶⁷ 376 U.S. 398 (1964).

⁶⁸ *E.g.*, *Sabbatino*, 376 U.S. at 427-28; *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682, 728 (Marshall, J., dissenting) (1976).

⁶⁹ See *Dunhill*, 425 U.S. 682; *First National City Bank v. Banco Nacional de Cuba*, 406 U.S. 759 (1972).

requires that, under our constitutional scheme, "the courts should abstain from any action that might hinder the executive branch of the government in the conduct of foreign relations."⁷⁰

The act of state doctrine has several exceptions. First, *Sabbatino* suggested that the doctrine might not apply where a clear international agreement prohibits the sovereign act. Second, Congress in the Hickenlooper amendment created an exception for some claims to property seized in violation of international law.⁷¹ Third, the Supreme Court has refused to apply the act of state doctrine in the absence of a "public act of those with authority to exercise sovereign powers."⁷² Fourth, some courts will not recognize a commercial act of a foreign sovereign as an act of state.⁷³

The Second Circuit has recognized another exception where the United States Government informs a court of its desire to see the matter adjudicated despite an act of a foreign state, by a communication called a "Bernstein letter."⁷⁴ The Supreme Court has now apparently rejected this exception to the act of state doctrine, although it remains relevant to a narrow class of cases.⁷⁵ A court would no doubt still consider a Bernstein letter, but it would not bind the court.

A further requirement that courts considering the applicability of the act of state doctrine often impose is that the property or interest affected by the sovereign act be in the territory of the foreign government.⁷⁶ Whether courts will continue to impose this require-

⁷⁰ *Sabbatino*, 376 U.S. at 431-33 (quoting RESTATEMENT (SECOND) OF FOREIGN RELATIONS § 41 comment c (1965)).

⁷¹ 22 U.S.C. § 2370(e)(2) (1961). See RESTATEMENT OF FOREIGN RELATIONS (REVISED) § 429 (Tent. Draft No. 4, 1982). This exception seems particularly unlikely to be relevant to securities issued by a foreign government.

⁷² *Dunhill*, 425 U.S. at 694. See also *Industrial Investment Development Corp. v. Mitsui & Co.*, 594 F.2d 48 (5th Cir. 1979), cert. denied, 445 U.S. 903 (1980); *Mannington Mills, Inc. v. Congoleum Corp.*, 595 F.2d 1287, 1294 (3d Cir. 1979) (grant of patent not "a considered policy determination by a government to give effect to its political and public interests").

⁷³ See *Dunhill*, 425 U.S. at 695. This portion of Justice White's opinion speaks for only four Justices, but courts have greeted the "commercial act exception" warmly. See also *Hunt v. Mobil Oil Corp.*, 550 F.2d 68, 73 (2d Cir.), cert. denied, 434 U.S. 984 (1977).

⁷⁴ In *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 210 F.2d 375 (2d Cir. 1954) (per curiam), the court allowed a claim after the State Department wrote a letter to the plaintiff expressing the executive's policy "to relieve American courts from any restraint upon the exercise of their jurisdiction to pass upon the validity of the acts of Nazi officials." *Id.* at 376.

⁷⁵ *First National City Bank*, 406 U.S. 759. Justice Rehnquist's plurality opinion concluded that an executive suggestion that the claim be heard was binding. *Id.* at 767-68. Six Justices, however, rejected that view. See *id.* at 770 (Douglas, J., concurring); *id.* at 773 (Powell, J., concurring); *id.* at 782-93 (Brennan, J., dissenting). See also *Sabbatino*, 376 U.S. at 436.

⁷⁶ RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW, § 43 (1965). See generally *Crockett, Extraterritorial Expropriations*, 13 IND. L. REV. 655 (1980). If the act is outside the foreign government's territory, it may be respected, but only if it is consistent with United States law and policy, including U.S. application of international law.

ment is, however, in doubt for two reasons. First, some commentators and courts have questioned whether the separation of powers rationale of *Sabbatino* justifies this limitation.⁷⁷ Second, it is difficult to determine the location of intangible property.⁷⁸

Certain acts of foreign sovereigns that may give rise to litigation by holders of securities issued by sovereign entities clearly take place in that foreign country. Acts of state, such as changes in domestic economic policy, reallocation of planned capital investment, and even declarations of war, can profoundly affect an issuer's creditworthiness. Other actions more directly focused on the debt represented by the securities are more difficult to categorize. For example, courts considering the situs of property affected by exchange controls or moratoriums on debt payments have reached a variety of results.⁷⁹

C. *The Articles of Agreement of the International Monetary Fund*

In some cases, the Articles of Agreement of the International Monetary Fund (IMF Articles),⁸⁰ to which the United States is a signatory, may constitute an independent ground on which a court could hold that the obligation to pay interest and principal on a security issued by a foreign government in the denominated currency cannot be enforced in United States courts. The IMF Articles provide that "[e]xchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member."⁸¹ The reason for this provision "is to insure the avoidance of the affront inherent in any attempt by the courts of one member to render a judgment that would put the losing party in the position of either complying with the judgment and violating the exchange controls of

⁷⁷ *Sabbatino*, 376 U.S. at 429. See Henkin, *The Foreign Affairs Power of the Federal Courts: Sabbatino*, 64 COLUM. L. REV. 805, 828 (1964). See also *Maltina Corp. v. Cawby Bottling Co.*, 462 F.2d 1021, 1028 (5th Cir.), cert. denied, 409 U.S. 1060 (1972) ("*Sabbatino* could be interpreted as removing the traditional territorial restriction upon the Act of State doctrine.>").

⁷⁸ As the Fifth Circuit observed, "[t]he situs of intangible property is about as intangible a concept as is known to the law." *Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co.*, 392 F.2d 706, 714 (5th Cir.), cert. denied, 393 U.S. 924 (1968). See *United Bank Ltd. v. Cosmic International, Inc.*, 542 F.2d 868 (2d Cir. 1976); *Garcia v. Chase Manhattan Bank*, 735 F.2d 645 (2d Cir. 1984).

⁷⁹ See *Allied Bank International v. Banco Credito De Cartago*, 566 F. Supp. 1440 (S.D.N.Y. 1983), aff'd on other grounds, 733 F.2d 23 (2d Cir. 1984) (The Second Circuit decision has been withdrawn as of May 21, 1984 pending a rehearing.); *Libra Bank Ltd. v. Banco Nacional de Costa Rica*, 570 F. Supp. 870, 880-82 (S.D.N.Y. 1983); *Weston Banking Corp. v. Turkiye Garanti Bankasi, A.S.*, 57 N.Y.2d 315, 324-25, 442 N.E.2d 1195, 1199, 456 N.Y.S.2d 684, 688 (1982); *French v. Banco Nacional de Cuba*, 23 N.Y.2d 76, 295 N.Y.S.2d 433 (1968).

⁸⁰ Dec. 27, 1945, 60 Stat. 1401, T.I.A.S. 1501.

⁸¹ *Id.* at art. VIII(b).

another member or complying with such controls and refusing obedience to the judgment."⁸² Congress has incorporated this treaty obligation into domestic law.⁸³

The relevance of this provision in the context of dollar-denominated securities issued by a foreign government depends principally on the interpretation of the term "exchange contracts." Under a narrow reading, a court would limit the term to contracts expressly involving the exchange of one currency for another currency.⁸⁴ A number of New York decisions have adhered to this narrow interpretation.⁸⁵ In a 1983 decision, however, the New York Court of Appeals concluded that the IMF Articles did not apply, because the Turkish decrees relied on by defendant could not be read to bar payment on a promissory note denominated in Swiss francs. The court interpreted the term broadly, stating, "[w]ere the currency regulations to ban payment in foreign currencies when a [note] was liquidated, a different case would have been presented."⁸⁶

The broad reading of the provision is that the phrase "exchange contracts" encompasses contracts that in any way affect a country's foreign exchange resources.⁸⁷ The Florida courts⁸⁸ and the courts of other IMF member countries, including France, West Germany, the Netherlands, Austria, Luxembourg, and Hong Kong, have followed this broad view.⁸⁹

⁸² *Banco do Brasil, S.A. v. A.C. Israel Commodity Co.*, 12 N.Y.2d 371, 376, 190 N.E.2d 235, 236, 239 N.Y.S.2d 872, 874 (1963), *cert. denied*, 376 U.S. 906 (1964).

⁸³ 22 U.S.C. § 286h (1982).

⁸⁴ See *Libra Bank*, 570 F. Supp. at 896-902; Nussbaum, *Exchange Control and the International Monetary Fund*, 59 YALE L.J. 421, 426 (1950).

⁸⁵ See *Banco do Brasil*, 239 N.Y.S.2d at 873-74, 190 N.E.2d at 236; *J. Zeevi and Sons, Ltd. v. Grindlays Bank (Uganda) Ltd.*, 37 N.Y.2d 220, 33 N.E.2d 168, 371 N.Y.S.2d 892, *cert. denied*, 423 U.S. 866 (1975).

⁸⁶ *Weston Banking*, 442 N.E.2d at 1200, 456 N.Y.S.2d at 689.

⁸⁷ J. GOLD, *THE FUND AGREEMENT IN THE COURTS: VOLUME II* 216-18 (1982). See F.A. MANN, *THE LEGAL ASPECT OF MONEY* 384-91 (1982) ("This would appear to be in better harmony with the purpose of the Agreement and the true intentions of its authors to be gathered from it."); Williams, *Extraterritorial Enforcement of Exchange Control Regulations Under the International Monetary Fund Agreement*, 15 VA. J. INT'L L. 319, 337-44 (1975) ("Most contemporary authorities reject the first or narrow construction and favor the broad interpretation"); Krispis, *Money in Private International Law*, 120 RECUEIL DES COURS 191, 286-90 (1967) ("[I]t would be unreasonable to hold that Article VIII(2)(b) applies only to contracts for the exchange of currency").

⁸⁸ See, e.g., *Confederation Life Ass'n v. Ugalde*, 164 So.2d 1, 2 (Fla.), *cert. denied*, 379 U.S. 915 (1964). *Ugalde* was followed in other decisions of the Florida Supreme Court. E.g., *Sun Life Assurance Co. of Canada v. Klawans*, 165 So.2d 166 (Fla. 1964); *Crown Life Insurance Co. v. Calvo*, 164 So.2d 813 (Fla.), *cert. denied*, 379 U.S. 915 (1964); *Pan American Life Insurance Co. v. Rajj*, 164 So.2d 204 (Fla.), *cert. denied*, 379 U.S. 920 (1964).

⁸⁹ See *Weston Banking*, 442 N.E.2d at 1202, 456 N.Y.S.2d at 693 n.5 (dissent), and sources cited therein.

IV. The Securities of Certain Multinational Banks

A. Introduction

Securities issued or guaranteed by the International Bank for Reconstruction and Development (IBRD) are exempt from the registration requirements of the 1933 Act and various provisions of the 1934 Act by sections 3(a)(2) and 3(a)(12) respectively.⁹⁰ The Bretton Woods Agreements Act,⁹¹ as initially enacted in 1945, did not contain this exemption for securities. Congress added it in 1949⁹² in response to problems that arose with IBRD's registered public offering in 1947. The Commission took no position on the legislation adding the exemption, because the issue involved weighing the policies of the IBRD against those of the securities laws. The Commission stated that this balancing of interests was best left to Congress.⁹³

B. International Bank for Reconstruction and Development

IBRD is an international, not-for-profit bank created at the Bretton Woods Conference in 1944. Its purpose is to assist in financing the reconstruction of Europe after World War II and the economic development of the underdeveloped countries of the world.⁹⁴ Member nations contribute IBRD's capital. In the 1940s, each nation actually paid only twenty percent of its capital contribution; the remainder was subject to call if IBRD's obligations were in default. IBRD could make loans or guarantees against its capital that had actually been paid in, but not against the other eighty percent. Thus IBRD depended heavily on raising funds through the issuance of securities to make its loans.

IBRD could issue, guarantee, buy, or sell securities only with the approval of the nation within whose territories the transactions were to occur.⁹⁵ The requisite consent of the United States was given by the National Advisory Council on International Monetary and Financial Problems (NAC), which was chaired by the Secretary of the Treasury and consisted of the Secretaries of State and Commerce, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of the Export-Import Bank, and the

⁹⁰ 22 U.S.C. § 286k-1(a) (1982).

⁹¹ Ch. 339, 59 Stat. 52 (1945).

⁹² Ch. 276, 63 Stat. 298 (1949).

⁹³ See *Marketing of Securities of World Bank: Hearing on S. 1664 Before the Subcomm. on Federal Reserve Matters of the Senate Comm. on Banking and Currency*, 81st Cong., 1st Sess. (1949) (especially the testimony of Louis Loss and the May 5, 1949 letter from Chairman Hanrahan to Senator Maybank) [hereinafter cited as *Hearing on S. 1664*].

⁹⁴ See H.R. REP. NO. 708, 81st Cong., 1st Sess. (1949); S. REP. NO. 504, 81st Cong., 1st Sess. (1949).

⁹⁵ IBRD, Articles of Agreement, art. IV, §§ 1(b), 8(i) (1945).

Administrator for Economic Cooperation.⁹⁶

C. The 1947 Offering and Resultant Problems

In July 1947 IBRD publicly sold 250 million dollars of bonds in the United States in an offering registered under the 1933 Act. IBRD later listed the bonds on the New York Stock Exchange and registered them pursuant to section 12(b) of the 1934 Act.

IBRD marketed the bonds in an unusual manner. Instead of using a firm commitment underwriting, IBRD sold its bonds directly using more than 1,700 dealers as selling agents. IBRD thought that this was the most efficient and effective method of selling IBRD securities which it anticipated would be offered frequently and in large amounts in the United States.⁹⁷ This underwriting technique created several problems for IBRD.

The problems did not involve the disclosure obligations of the securities laws but rather several other provisions. As Ansel Luxford, Assistant General Counsel of IBRD, later testified before Congress:

I do not think we objected to the information provisions at all.

* * *

We are asking to be relieved of the incidents to that registration, rather than the registration itself. We will continue to issue a prospectus that will be just as informative as the prospectus that we issued with regard to our last issue. There is no question of that character involved. We are compelled to file quarterly reports under our own Articles of Agreement. I think we are filing more information today publicly than a corporation may be required to file under Securities and 1934 Act. Certainly we are comparable to the municipalities and states. It is not that problem. It is the effects for requirements incident to that that is causing us the difficulty.⁹⁸

The major relevant problems identified during the hearings in the amendment program after the 1947 offerings were as follows:

1. The limitations on publicizing IBRD and on offerings during registration;
2. Prohibitions on communications with the dealers except by means of the preliminary prospectus; this was aggravated by the pre-1954 prohibition on offers during the pre-effective period;
3. Reluctance of dealers to assume section 11 and 12 liabilities for the prospectus in the absence of an underwriter's investigation; and
4. Prohibitions against making sinking-fund purchases while new offerings are being planned due to the Commission's stabilization rules. This was expected to be a problem in view of the

⁹⁶ The Commission had an observer on NAC. H.R. REP. NO. 708, *supra* note 94, at 5.

⁹⁷ *Int'l Bank for Reconstr. and Dev. Securities: Hearings on H.R. 6443 Before the House Comm. on Interstate and Foreign Commerce, 80th Cong., 2d Sess. 2-6 (1948) [hereinafter cited as *Hearings on H.R. 6443*].*

⁹⁸ *Id.* at 69.

large, frequent offerings anticipated by IBRD.⁹⁹

During 1946 and 1947, the Commission's staff worked with IBRD representatives to resolve these problems. Just prior to the 1947 offering, the Commission issued Release Nos. 33-3233¹⁰⁰ and 33-3238¹⁰¹ promulgating rule 144, to relieve the dealers of section 11 liability, and Form S-7, the registration form to be used by IBRD, to minimize these problems.¹⁰²

D. *The Legislation of 1948 and 1949*

The Commission clearly believed that it could grant no further relief to IBRD under existing statutes.¹⁰³ Therefore, IBRD requested Congress to exempt their securities and guarantees from the federal securities laws. Bills were introduced in 1948 but were never enacted.¹⁰⁴ In 1949 identical bills were introduced into the House and Senate,¹⁰⁵ which were passed without substantial amendments.¹⁰⁶

Several Commissioners and staff participated in the hearings. Officially, the Commission was neutral because it felt the issue was one of national policy best left for Congress.

Congress stated that the protection for investors would be sufficient even though the IBRD securities would be exempt because the IBRD could not sell them in the United States without the approval of NAC.¹⁰⁷ Furthermore, Congress gave the Commission the authority to suspend the exemption after consultation with NAC.¹⁰⁸ As Professor Loss pointed out, this exemption is analogous to the exemptions for securities issued with the approval of a court or the Interstate Commerce Commission.¹⁰⁹ Congress exempted these types of securities from the disclosure provisions of the 1933 Act be-

⁹⁹ These problems were discussed throughout the legislative history. A good overview of these concerns may be found in IBRD's memorandum in *Hearings on H.R. 6443*, *supra* note 97, at 3-6.

¹⁰⁰ SEC Securities Act Release No. 33-3233 (June 25, 1947).

¹⁰¹ SEC Securities Act Release No. 33-3238 (July 8, 1947).

¹⁰² Rule 144 and Form S-7, which are not related to the existing rule and form of the same designations, were repealed when Reg. BW was adopted. SEC Securities Act Release No. 3364 (Jan. 9, 1950).

¹⁰³ See *Hearings on H.R. 6443*, *supra* note 97, at 3-6.

¹⁰⁴ See H.R. 6443, 80th Cong., 2nd Sess. (1948); S. 2636, 80th Cong., 2nd Sess. (1948).

¹⁰⁵ H.R. 4332, 81st Cong., 1st Sess. (1949); S. 1664, 81st Cong., 1st Sess. (1949).

¹⁰⁶ See H.R. REP. No. 708, *supra* note 94; S. REP. No. 504, *supra* note 94; *Int'l Bank for Reconstr. and Dev.: Hearing on H.R. 4332 Before the House Comm. on Banking and Currency*, 81st Cong., 1st Sess. (1949) [hereinafter cited as *Hearing on H.R. 4332*]; *Hearing on S. 1664*, *supra* note 93.

¹⁰⁷ H.R. REP. No. 708, *supra* note 94, at 5; S. REP. No. 504, *supra* note 94, at 6.

¹⁰⁸ See 22 U.S.C. § 286k-2 (1982). The Commission is required only to consult with NAC and is not bound by NAC's opinion. See *Hearing on S. 1664*, *supra* note 93, at 6; *Hearing on H.R. 4332*, *supra* note 106, at 6.

¹⁰⁹ See §§ 3(a)(10) & (6) of the 1933 Act, 15 U.S.C. §§ 77c(a)(6) & (10) (1982 & Supp. 1983).

cause it believed that the provisions of other statutes protected investors in those securities.¹¹⁰

E. Distinction From Other Foreign Securities

The Commissioners and staff testifying at the hearings emphasized that the securities laws require the registration of the securities of foreign entities, both companies and governments. The calls on the capital contributions of forty-six nations, including the United States Government to the extent of its capital contribution, guaranteed several distinctions between such securities and the securities of private issuers. Also, NAC must approve the issuance of any IBRD securities in this country.

In 1950 the Commission repealed rule 144 and Form S-7 and adopted exemptive Regulation BW.¹¹¹ This regulation requires the filing of quarterly financial reports and copies of the annual reports to the governing board of the IBRD. This regulation also requires IBRD to file advance reports of any distributions in the United States of its primary obligations. It does not require the filing of any other reports or compliance with either the Trust Indenture Act or the Investment Company Act.¹¹²

The United States has subsequently become a member of the following multinational banks whose function is similar to that of the IBRD: the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank. Congress exempted the securities issued and guaranteed by such banks from the registration requirements of the 1933 Act and the 1934 Act for similar reasons.¹¹³ Accordingly, the Commission has adopted exemptive regulations for the Inter-American Bank¹¹⁴ and the Asian Development Bank.¹¹⁵ Presumably, the Commission will adopt a similar exemptive regulation for securities issued or guaranteed by the African Development Bank.

As initially adopted, all three regulations required that the bank file, at least seven days before a primary distribution of its securities, a report containing certain information regarding the offering with the Commission. By 1981, the seven day notice form had become increasingly burdensome because of the factors described above that led the Commission to adoption of an integrated disclosure system

¹¹⁰ See *Hearings on H.R. 6443*, *supra* note 97, at 106-07.

¹¹¹ 17 C.F.R. § 285.4 (1984). See SEC Securities Act Release Nos. 3364 (Jan. 9, 1950) (initial adoption) and 3528 (Jan. 19, 1955) (amendments).

¹¹² 15 U.S.C. §§ 80a-1 to -64 (1982).

¹¹³ Inter-American Development Bank Act, 22 U.S.C. § 283h(a) (1982); Asian Development Bank Act, 22 U.S.C. § 285h(a) (1982); African Development Bank Act, 22 U.S.C. § 290i(9) (1982).

¹¹⁴ 17 C.F.R. § 286 (1984); SEC Securities Act Release No. 4290 (Oct. 25, 1960).

¹¹⁵ 17 C.F.R. § 286 (1984); SEC Securities Act Release No. 4889 (Dec. 18, 1967).

with short-form registration and shelf registration. The Commission amended the regulations to permit these banks to sell their securities immediately upon filing the required report.¹¹⁶

V. Summary

Foreign governments that issue securities in the United States must comply with certain disclosure requirements of the Securities Acts of 1933 and 1934. Under the 1933 Act, a "foreign government or political subdivision thereof" must comply with Schedule B, which requires the filing of a registration statement containing fairly detailed information regarding the terms of the offer. The Commission, however, has not promulgated a form for Schedule B filings. Thus, to comply with other provisions of federal securities laws and to enhance the registration statement's value as an advertising device, foreign governmental issuers usually disclose more information than Schedule B requires.

The 1934 Act requires foreign governmental issuers that have their securities listed on a United States stock exchange to make certain disclosures. These disclosures are made on Form 18, which tracks the disclosure requirements of Schedule B. Recently, the Commission's Division of Corporate Finance, in an interpretative release, permitted use of shelf registration statements for certain foreign governmental issuers.

Foreign governments that issue securities in the United States can be subject to liability under various provisions of the federal securities laws. Section 11 of the 1933 Act provides a civil remedy for false or misleading statements in a registration statement. Under section 12(1) of the 1933 Act, any person who offers or sells securities in violation of section 5 of the Act is liable to the purchaser of the securities. Section 12(2) of the 1933 Act is a broad antifraud provision that provides a purchaser of securities with a civil cause of action against any person who offers or sells securities by means of a prospectus or oral communication containing a misstatement or omission of a material fact. Finally, and most significantly, section 10(b) of the 1934 Act prohibits the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any securities.

The sovereign status of a foreign governmental issuer may permit the issuer to raise the several defenses to a claim of a federal securities law violation. First, the foreign governmental issuer can assert immunity under the FSIA. Section 1605(a) of the FSIA, however, removes this immunity for "commercial activities" of a foreign government. Second, under certain circumstances, the act of state

¹¹⁶ SEC Securities Act Release Nos. 6347 (Sept. 24, 1981) (adoption), and 6322 (June 25, 1981) (proposed).

doctrine may be raised as a defense. Third, the Articles of Agreement of the International Monetary Fund may constitute an independent basis for immunity if it can be established that the Articles' exemption for "exchange contracts" applies to the issuance of securities. Finally, securities issued or guaranteed by the International Bank for Reconstruction and Development are exempted from the registration requirements of the 1933 Act and various provisions of the 1934 Act.

