MARC I. STEINBERG*
DARYL L. LANSDALE, JR.**

Regulation S and Rule 144A: Creating a Workable Fiction in an Expanding Global Securities Market

I. The Need for a Uniform Regulatory Framework

Technological advances and the ever growing desire for inexpensive capital have resulted in the internationalization of the securities markets.[1] During the past two decades, for example, the international bond market has grown at an impressive rate.[2] Consistent with this development, international bond issues also have increased at an expeditious pace.[3] This globalization of the securities markets gives rise to a host of regulatory issues.[4]

---

*Rupert and Lillian Radford Professor of Law, Southern Methodist University School of Law. Of Counsel, Winstead Sechrest & Minick, P.C., Dallas, Texas.

**Associate, Fulbright & Jaworski L.L.P., San Antonio, Texas.

The authors would like to thank Ralph Janvey, Esq., Phillip M. Renfro, Esq., and Samuel Wolff, Esq., for their comments and Douglas W. Arner for his research assistance.

1. *See, e.g.*, Andrea F. Bradley, *Regulation S: Tempest in a Safe Harbor*, 25 REV. SEC. & COMMODITIES REG. 185 (1992); Michael R. Gibbons, Comment, *SEC Proposed Regulation S: After Twenty-Five Years of Drifting, A New Safe Harbor for Foreign Offerings*, 21 U. MIAMI INTER-AMER. L. REV. 357, 358 (1989-1990).

2. SEC REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS AND THE HOUSE COMMITTEE ON ENERGY AND COMMERCE, INTERNATIONALIZATION OF THE SECURITIES MARKETS II-35 (1987) (commenting that the international bond market grew at a compound annual rate of 21% from 1976 to 1986).

3. *Id.* at II-36 (stating that international bond issues increased from $38.3 billion in 1980 to $225.4 billion in 1986).

4. For works addressing the variety of issues arising from the globalization of the securities markets, see, e.g., Symposium, *The Internationalization of the Securities Markets*, 4 B.U. INT'L L.J. 5 (1986); Symposium, *The Internationalization of the Securities Markets*, 11 MD. J. INT'L L.

In the globalization context, a key issue is the applicability of the registration requirements of the Securities Act of 1933 (Securities Act or 1933 Act) to transactions occurring outside the territorial boundaries of the United States.[5] In an attempt to clarify the extraterritorial application of the registration requirements of the Securities Act, the Securities and Exchange Commission (SEC or the Commission) promulgated Regulation S.[6] This effort seeks to ease undue regulatory burdens on issuers and those seeking to resell, thereby fostering a more efficient international securities market.[7] The adoption of Regulation S constitutes one of the SEC's more important steps towards expanding global trading. The Commission's promulgation of Rule 144A[8] also promotes this goal and remains a vital component of the SEC's regulatory framework in the globalization setting.

Rule 144A sets forth a nonexclusive safe harbor from the registration requirements of section 5 of the Securities Act[9] for the resale of securities to specified institutions by persons other than the issuer of such securities.[10] Rule 144A has helped increase the demand and marketability in the United States of securities issued by foreign entities.[11] The relationship between Regulation S and Rule 144A and their role in facilitating a market for foreign securities in the United States is addressed later in this article. To provide the necessary background, the discussion that follows focuses on Regulation S and the regulatory scheme that existed prior to its adoption.

II. Regulatory Framework Prior to Regulation S

Section 5 of the Securities Act requires that, absent an exemption, all offers and sales of securities must be registered with the SEC.[12] To meet the registration requirements of section 5, a registration statement must be filed with the SEC. The registration statement is an expansive and complex document requiring extensive disclosures.[13] The registration requirements set forth in section 5 are triggered by

& TRADE 157 (1987); Symposium, *Internationalization of the Securities Markets*, 9 U. MICH. Y.B. INT'L LEGAL STUD. 1, 1-412 (1988); Roberta S. Karmel, *SEC Regulation of Multijurisdictional Offerings*, 16 BROOK. J. INT'L L. 3 (1990).

5. *See generally* Harold S. Bloomenthal, *Distributions Outside the U.S.—Regulation S*, 10 SEC. & FED. CORP. L. REP. 161 (1988).

6. *See* Offshore Offers and Sales, Securities Act Release No. 6863, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524 (Apr. 24, 1990).

7. *See generally* Samuel Wolff, *Offshore Distributions Under the Securities Act of 1933: An Analysis of Regulation S*, 23 L. & POL'Y INT'L BUS. 101 (1991-1992).

8. 17 C.F.R. § 230.144A (1994); see Securities Act Release No. 6862, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (Apr. 23, 1990) (Rule 144A adopting release).

9. 15 U.S.C. § 77e (1981); *see infra* notes 124-54 and accompanying text.

10. Securities Act Release No. 6862, *supra* note 8.

11. *See SEC Staff Says Rule 144A Is Attracting Foreign Issuers to U.S. Capital Markets*, 23 Sec. Reg. & L. Rep. (BNA) 1589 (1991).

12. *See* authorities cited *supra* note 9.

13. *See* MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 30 (1989); Carl W. Schneider et al., *Going Public: Practice, Procedure and Consequences*, 27 VILL. L. REV. 1 (1981).

the use of "any means or instruments of transportation or communication in interstate commerce or of the mails" in connection with the offer or sale of a security.[14] The term "interstate commerce" is defined to include "trade or commerce in securities . . . between any foreign country and any state."[15] A literal reading of section 5 therefore would subject all securities transactions between domestic issuers and extraterritorial purchasers (as well as foreign issuers and U.S. purchasers) to the registration requirements of section 5.[16] However, when the Commission first formally considered the applicability of section 5 to international securities transactions in the early 1960s, it declined to extend section 5 this far.[17] Rather, in Securities Act Release 4708,[18] the SEC took the position that the registration requirements under section 5 were primarily intended to protect domestic investors.[19] Following this policy, the Commission stated that extraterritorial offerings[20] by domestic issuers (and as later extended to foreign issuers) would not be subject to the registration requirements of section 5 so long as "the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States."[21] In the years subsequent to the issuance of Release 4708, practitioners requested no-action letters asking the SEC to set forth the parameters of this release.[22] The regulatory framework that evolved was based on these no-action letters.[23]

The underlying concern of the regulatory framework as set forth in Release 4708 was that securities issued by U.S. issuers " 'came to rest' abroad" and that such securities as part of a distribution did not flow back to the United States or to U.S. nationals.[24] The exact procedures to effectuate this result, as detailed

14. 15 U.S.C. § 77e (1981).

15. Securities Act § 2(7), 15 U.S.C. § 77b(7) (1981).

16. *See* Securities Act Release No. 6863, *supra* note 6, at 80,664; *see also* Don Berger, *Offshore Distribution of Securities: The Impact of Regulation S*, 3 TRANSNAT'L LAW. 578 (1990).

17. "The commission . . . historically has recognized that registration of offerings with only incidental jurisdictional contacts should not be required." Securities Act Release No. 6863, *supra* note 6, at 80,664.

18. Securities Act Release No. 4708, 29 Fed. Reg. 9828 (July 9, 1964).

19. *Id.*

20. Securities Act Release No. 4708 covered both debt and equity securities. *Id.*

21. *Id.*; *see* Wolff, *supra* note 7, at 111 (stating that the SEC "staff subsequently applied Release 4708 principles to foreign issuers"), *citing*, Securities Act Release No. 6779, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,242, at 89,124 n.9 (1988).

22. Berger, *supra* note 16, at 580; *see* Alan L. Beller & Gail S. Berney, *Eurobonds*, 19 REV. SEC. & COMMODITIES REG. 39, 42 (1986).

23. *See, e.g.*, Procter & Gamble Co., SEC No-Action Letter (Feb. 21, 1985); InfraRed Assoc., Inc., SEC No-Action Letter (Sept. 6, 1985); Fairchild Camera & Instrument International Finance N.V., SEC No-Action Letter (Dec. 15, 1976); Raymond International Inc., SEC No-Action Letter (June 28, 1976); Pan American World Airways, Inc., SEC No-Action Letter (June 30, 1975); Singer Co., SEC No-Action Letter (Sept. 3, 1974).

24. Securities Act Release No. 6863, *supra* note 6, at 80,664; Berger, *supra* note 16, at 580. The term "U.S. nationals" included: (1) estates and trusts when the income was subject to U.S. federal income tax; (2) citizens, residents, or nationals of the United States; or (3) corporations, partnerships or other entities formed under U.S. laws. *See* Beller & Berney, *supra* note 22, at 43 n.15.

in the no-action letters, differed depending on the type of security being offered.[25] For example, to avoid the registration requirements of section 5 when issuing nonconvertible debt securities offshore, sales were not allowed to be made in the United States or to U.S. nationals[26] for the ninety days following the completion of the offshore distribution.[27] Other procedures the issuer had to satisfy in order to engage in an exempt offshore offering of nonconvertible debt securities included: (1) written disclosure by the issuer to investors describing the prohibition against offers and sales in the United States or to U.S. nationals for the ninety-day period; (2) agreements with underwriters and dealers requiring such to comply with the ninety-day restricted period; (3) statements in confirmations of sales to other dealers describing the ninety-day restricted period; (4) statements in "all sold" telexes[28] by members of the underwriting syndicate confirming that all securities were sold outside the United States and not to U.S. nationals; and (5) at closing, delivery by the issuer to a depositary of a temporary global security exchangeable for definitive securities at the end of the ninety-day period following the completion of the offering and upon certification by the investor as to non-U.S. beneficial ownership.[29]

To issue convertible debt[30] under the procedures set forth by the no-action letters issued subsequent to Release 4708, the issuer had to meet all requirements applicable to issuing straight debt discussed above.[31] Furthermore, the issuer had to contract with investors that conversion would not take place until one year after the completion of the distribution. Upon conversion, the issuer was prohibited from paying consideration to the security holder for soliciting such exchange.[32]

To secure the benefits of Release 4708 when issuing an offshore equity security, the issuer had to undertake numerous measures, including: (1) ensuring that the selling agent agreed not to offer or sell the securities in the United States or Canada or to citizens thereof for twelve months after the completion of the offering; (2) including a legend on the prospectus that the securities could not be offered or sold in North America or to North American persons for a period of twelve months after the completion of the offering; (3) having the purchaser certify that he or she is not (a) a North American person or (b) an agent of such person,

25. *See* Gibbons, *supra* note 1, at 361.

26. *See* Securities Act Release No. 6863, *supra* note 6.

27. *See, e.g.*, Procter & Gamble Co., SEC No-Action Letter, *supra* note 23.

28. An "all-sold" telex is a telex to the lead manager of an underwriting syndicate from a member of the syndicate notifying the lead manager that the member has sold its entire allotment of securities. *See* Beller & Berney, *supra* note 22, at 43.

29. *See* Arbie R. Thalacker, *Reproposed Regulation S*, 683 PLI/CORP. 799 (1990).

30. Generally, convertible debt is a security issued as an ordinary debt security but which can be exchanged, after a specified period, for the issuer's equity securities. *See* BARRON'S LAW DICTIONARY 99 (2d ed. 1984).

31. *See* Gibbons, *supra* note 1, at 364.

32. *Id. See* Wolff, *supra* note 7, at 124-25.

and agree to the offering restrictions; (4) passing a bylaw requiring its directors to refuse to register transfers of the shares to North American persons before the end of the twelve-month period; and (5) placing a legend on the stock certificates reflecting the restrictions enumerated in (2) above.[33] As is readily apparent, the procedures to avoid the application of section 5 in an equity offering were more stringent than those placed on debt securities. As the securities markets became more globalized in the 1980s, critics charged that these cumbersome procedures were in desperate need of change.[34] The change finally came in 1990 with the promulgation of Regulation S and Rule 144A.

III. Regulation S

A. Policy Underlying Regulation S

In adopting Regulation S the SEC expressly superseded Release 4708 and the no-action and interpretive letters relating thereto.[35] In Regulation S the SEC embraced a territorial approach to the extraterritorial application of the Securities Act.[36] This approach is based on the notion that the registration requirements of the Securities Act are intended to protect the U.S. capital markets and all investors in such markets, whether U.S. or foreign nationals. Regulation S represents a change in emphasis, from attempting to protect U.S. persons irrespective of where they are located, to protecting the integrity of the U.S. capital markets.[37] For registration purposes,[38] the Commission decided to rely upon the laws in the jurisdictions in which the transactions occur rather than the U.S. Securities Act. The Commission stated: "The territorial approach recognizes the primacy of the laws in which a market is located. As investors choose their markets, they choose the laws and regulations applicable in such markets."[39] Adherence to

33. *See* Gibbons, *supra* note 1, at 363.

34. *See* Bevis Longstreth, *Global Securities Markets and the SEC*, 10 U. Pa. J. Int'l Bus. L. 183 (1988).

35. Securities Act Release No. 6863, *supra* note 6, at 80,662. However, the Commission made clear that offers and sales previously made in reliance upon Securities Act Release 4708 and the no-action and interpretive letters relating thereto would not be adversely affected by the adoption of Regulation S. *Id.*

36. *Id.* at 80,665.

37. *See* Thalacker, *supra* note 29, at 799.

38. Regulation S is directed at registration. The U.S. securities laws have a broader reach with respect to the antifraud provisions, such as section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). For case law, see, e.g., Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252 (2d Cir. 1989); Zoelsch v. Arthur Andersen & Co., 824 F.2d 27 (D.C. Cir. 1987); Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975). As the Second Circuit stated in *Consolidated Gold Fields*, "the antifraud provisions of American securities laws have broader extraterritorial reach than American filing requirements." 871 F.2d at 262. Note, moreover, that the state blue-sky laws remain applicable. *Id.*

39. Securities Act Release No. 6863, *supra* note 6, at 80,665.

this approach is premised on the principles of comity[40] and the expectations of participants in the global markets.[41] The territorial approach thus forms the basis of the Regulation S regulatory framework.

B. THE REGULATION S REGULATORY FRAMEWORK—GENERAL PRINCIPLES

Regulation S comprises four rules: Rules 901,[42] 902,[43] 903,[44] and 904.[45] Rule 901 contains a general statement that reflects the SEC's new territorial approach. Rule 901(a) states that only offers and sales of securities inside the United States are subject to section 5.[46] This statement reflects a shift from the policy underlying Release 4708 (namely, that section 5 was to protect all U.S. citizens no matter where such persons lived or invested[47]) to a basically geographical approach under Regulation S.[48]

The primary inquiry under the new regulatory scheme, as stated in Rule 901, is whether the offer and sale of securities occurs "outside the United States."[49] If the offer and sale[50] are outside the United States within the meaning of Rule 901, the registration provisions of section 5 are not applicable; if the offer or sale occurs within the United States, the registration provisions (absent the perfection of an exemption) are applicable.[51] However, determining whether an offer and sale have occurred outside the United States is not necessarily an easy matter to resolve.

The SEC provides that whether an offer and sale are made outside the United States is to be determined on an ad hoc basis.[52] To clarify when an offer and sale will be considered outside the United States, Regulation S provides two

40. The doctrine of comity emphasizes restraint by nations in international affairs. *See* LASSA K. OPPENHEIM, INTERNATIONAL LAW; A TREATISE 34 (H. Lauterpacht ed., 8th ed. 1955); Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927 (1994).

41. *See* authorities cited *supra* note 40.

42. 17 C.F.R. § 230.901 (1994) [hereinafter Rule 901].

43. 17 C.F.R. § 230.902 (1994) [hereinafter Rule 902].

44. 17 C.F.R. § 230.903 (1994) [hereinafter Rule 903].

45. 17 C.F.R. § 230.904 (1994) [hereinafter Rule 904].

46. Rule 901(a), *supra* note 42.

47. Under Securities Act Release 4708, offers and sales to U.S. citizens living abroad were subject to the requirements of section 5. *See* Berger, *supra* note 16, at 581.

48. *Id.*; *see supra* notes 36-41 and accompanying text.

49. Securities Act Release No. 6863, *supra* note 6, at 80,665.

50. The Commission has made clear that to qualify as "outside the United States" under Rule 901, both the offer and sale must be made outside the United States. *Id.* at 80,666.

51. Rule 901, *supra* note 42. It is important to note that Regulation S only deals with the applicability of the registration requirements of section 5 of the Securities Act to international securities transactions. Securities Act Release No. 6863, *supra* note 6, at 80,665. The scope of the extraterritorial application of the antifraud rules is not limited by Regulation S. Moreover, the state blue-sky laws remain applicable. *See id.*; authorities cited *supra* note 38.

52. Securities Act Release No. 6863, *supra* note 6, at 80,665.

nonexclusive safe-harbor provisions in Rules 903 and 904. If the offer and sale satisfy the conditions of either of the safe-harbor provisions, such transaction will be deemed to have occurred outside the United States and outside the reach of section 5. Since perfecting a safe harbor provides an issuer assurance that the registration provisions of the Securities Act will not apply, the remaining discussion of Regulation S focuses on the safe-harbor provisions.[53]

C. Regulation S—Safe Harbors

Regulation S comprises two safe-harbor provisions: (1) an issuer safe harbor (Rule 903) and (2) a safe harbor for resales (Rule 904). All offers and sales, whether made in reliance on the issuer or the resale safe harbor, must satisfy two general conditions. In addition, the issuer must satisfy specific conditions that are set out in each safe-harbor provision.

1. *General Conditions*

The general conditions applicable to all offers and sales, whether based on the issuer or resale safe harbor, are that: (1) the offer or sale is made in an "offshore transaction";[54] and (2) no "direct selling efforts"[55] take place in the United States in connection with the distribution or resale of the securities.[56] To engage in an offshore transaction there can be no offer or sale to a person in the United States[57] and either of two additional requirements must be satisfied.[58] The first of the alternative requirements is that the buyer is outside the United States, or the seller reasonably believes that the buyer is outside of the United States, at the time the buy order is originated.[59] If an employee of an entity formed under the laws of the United States places the buy order while abroad, the requirement

53. Issuers who do not comply with the safe-harbor provisions may argue that they are outside the United States under a facts and circumstances test. However, issuers will generally do so only if they have inadvertently failed to satisfy the conditions of the safe harbor and are left with this tactic as a last resort. *See* Harold S. Bloomenthal, Going Public and the Public Corporation § 4A.01[4] (1994).

54. Rule 902(i), *supra* note 43.

55. Rule 902(b), *supra* note 43.

56. Rule 903(a), (b), *supra* note 44; *see* Joseph McLaughlin, *"Directed Selling Efforts" Under Regulation S and the U.S. Securities Analyst*, 24 Rev. Sec. & Commodities Reg. 117 (1991). These two conditions are herein referred to as "general conditions."

57. Reversing the approach in Securities Act Release 4708, Regulation S defines "U.S. Person" as "any natural person resident in the United States," rather than a U.S. citizen regardless of location. Rule 902(o)(1)(i), *supra* note 43; *see* Beller & Berney, *supra* note 22, at 43. Therefore, selling to a U.S. citizen living abroad will not automatically prevent the transaction from being considered an offshore transaction. *Id.* However, Rule 902(i) makes clear that offers and sales specifically targeted at identifiable groups of U.S. citizens abroad, such as members of the armed forces, will not be offshore transactions. Rule 902(i)(2), *supra* note 43. The phrase "offshore transaction" is defined in Rule 902(i). *Id.*

58. Rule 902(i)(1)(ii)(A), *supra* note 43.

59. *Id.*

that the buyer be outside the United States is satisfied.[60] The second alternative means of satisfying the offshore-transaction requirement is to execute the transaction on a designated offshore securities market.[61] However, if the seller or its agent knows that the transaction has been prearranged with a buyer in the United States, the second alternative will not be satisfied.[62]

The second general condition that must be satisfied in order for an offer and sale to be considered outside the United States is that there be no direct selling efforts in the United States.[63] For purposes of the issuer safe harbor, neither the issuer, distributors, nor their respective affiliates may engage in direct selling efforts in the United States. Failure to adhere to this condition will result in loss of the safe harbor for all participants in the offering.[64]

Directed selling efforts are defined as any activity that could reasonably be expected to have the effect of conditioning the market in the United States for any of the securities being offered in reliance on Regulation S.[65] Specifically, placing advertisements with television or radio stations reaching the United States or in publications with a general circulation[66] in the United States, mailing printed material to U.S. investors, or conducting promotional seminars in the United States are considered direct selling efforts.[67] Rule 902(b), however, excludes certain types of advertising from the definition of direct selling efforts. These exceptions include advertisements that are required under either U.S. or foreign law and "tombstone" advertisements[68] placed in publications that have less than 20 percent of their total circulation in the United States.[69] Additionally, sellers are permitted to visit and inspect real estate and other facilities located in the United States without engaging in direct selling efforts.[70]

60. Securities Act Release No. 6863, *supra* note 6, at 80,667. This holds true when the buyer is an investment company or its investment advisor. *Id.*

61. Rule 902(a) specifically identifies the markets that the SEC considers to be designated offshore securities markets. *See* Rule 902(a), *supra* note 43.

62. Rule 902(i)(1)(B)(2), *supra* note 43.

63. Rule 903(b), *supra* note 43.

64. *Id.*

65. Rule 902(b), *supra* note 43.

66. A definition of publications with a general circulation in the United States is provided in Rule 902(4), *supra* note 43.

67. Rule 902(b), *supra* note 43.

68. In order to qualify as a "tombstone" ad that will not be considered conditioning the U.S. market for a foreign offering, the ad must meet the specific requirements set forth in Rule 902(b)(iii), *supra* note 43.

69. Rule 902(b), *supra* note 43.

70. *Id.* The Commission distinguished "solicitation" as that term is used in considering the need for registration as a broker-dealer under the Securities Exchange Act from directed selling efforts under Regulation S. Securities Act Release No. 6863, *supra* note 6, at 80,670. The SEC stated that while limited activities directed at a single customer or prospective investor may be offers for purposes of Regulation S or solicitations for purposes of the broker-dealer registration requirements, they generally will not be considered direct selling efforts because of their limited effect. *Id.* at 80,671. With respect to the "notice" permitted, SEC Rule 135c should be consulted. *See* C.F.R. § 230.135c (1994).

2. *Issuer Safe Harbor—Rule 903*

The issuer safe harbor is applicable not only to the actual issuer, but also to the issuer's distributors, their respective affiliates, and persons acting on behalf of the foregoing.[71] The safe harbor may be utilized by both U.S. and foreign issuers offering securities outside the United States. Similar to the regimen prevailing under Release 4708 and SEC no-action letters issued in connection therewith,[72] the conditions that must be satisfied to meet the issuer safe harbor differ depending on the type of securities being offered.[73] For purposes of Regulation S, the SEC separates securities into three categories: Category I, Category II, and Category III. The categorization of securities is based on the likelihood that the securities will flow back to the United States.[74] As the probability that the securities will flow back to the United States increases, the procedural requirements necessary to avoid registration become more difficult.[75] Under the Regulation S regulatory scheme, Category I securities are subject to the least regulatory restraints and Category III securities to the most.

Category I securities are securities of "foreign issuers"[76] for which there is no "substantial U.S. market interest,"[77] securities offered and sold in "overseas

71. Rule 903, *supra* note 44. Therefore, references to the term "issuer" hereinafter will refer to the issuer, its distributors, and any of their respective affiliates, or any person acting on behalf of the foregoing.

72. See *supra* notes 18-33 and accompanying text.

73. See Securities Act Release No. 6863, *supra* note 6, at 80,671.

74. *Id.*

75. *Id.*; *see* John R. Cogan & Thomas C. Kimbrough, *Regulation S Safe Harbors for Offshore Offers, Sales and Resales*, 4 INSIGHTS No. 8, at 3 (1990).

76. The definition of "foreign issuer" is contained in Rule 902(f). Basically, a foreign issuer may be a foreign government, a national of any foreign government, or a corporation or other entity formed under the laws of a foreign country. *See* Rule 902(f), *supra* note 43.

77. Whether a substantial U.S. market interest exists depends on the type of security being offered. Generally, if the foreign issuer is offering equity securities, a substantial U.S. market interest is deemed to exist at the commencement of the offering if: (1) the securities exchanges and inter-dealer quotation systems in the United States in the aggregate constitute the single largest market for such securities; or (2) 20% or more of the trading of the class of securities took place on a securities exchange or inter-dealer quotation system located in the United States and less than 55% of such trading took place in a foreign securities market. Rule 902(n), *supra* note 43.

A substantial U.S. market interest in a foreign issuer's debt securities is deemed to exist upon commencement of the offering if: (1) 300 or more U.S. persons are the aggregate record holders of the issuer's debt securities, its nonparticipating preferred stock, and its asset-backed securities; (2) U.S. persons hold $1 billion or more of the outstanding indebtedness of the foreign issuer; or (3) U.S. persons hold 20% or more of the outstanding debt securities of the foreign issuer. Rule 902(n)(2), *supra* note 43.

Definitions for U.S. market interest in warrants, nonparticipating preferred stock, and asset-backed securities are provided in Rule 903. The other members in the issuer's chain of distribution, such as the underwriter and its affiliates, may rely on the written representation of the issuer that it has a reasonable belief that there is no substantial U.S. market interest in its securities. *See* Securities Act Release No. 6863, *supra* note 6, at 80,674.

directed offerings,"[78] securities backed by the full faith and credit of a "foreign government,"[79] and securities sold pursuant to certain employee benefit plans.[80] Because the SEC concluded that these securities were the least likely to flow back to the United States, it put only minimal procedural requirements upon them.[81] Accordingly, to satisfy the issuer safe harbor, an issuer of Category I securities need only satisfy the general conditions described above: (1) an offshore transaction; and (2) no direct selling efforts in the United States.[82] Under the Category I issuer safe harbor, sales to U.S. investors overseas generally are permissible.[83] Nonetheless, participants should be cognizant of preliminary note 2 to Regulation S, which excludes from the regulation's protection any plan or scheme to evade the registration provisions of the Securities Act.[84] In sum, prior to the promulgation of Regulation S, the applicability of the federal securities laws to offerings falling under Category I was unclear.[85] Today, Regulation S clarifies the reach of the Securities Act's registration requirements in this context and sets forth relatively minimal regulatory burdens with respect to such offerings.[86]

Offerings falling within the second issuer safe harbor, Category II, are those by foreign and U.S. companies that are subject to the Exchange Act's reporting requirements as well as offerings of debt securities by nonreporting foreign issuers.[87] To qualify for the Category II issuer safe harbor the issuer must satisfy

78. Two types of offerings can qualify as "overseas directed offerings." *See* Rule 902(j), *supra* note 43. One is an offering of a foreign issuer's securities directed to residents of a single country other than the United States. *Id.* The other is an offering of nonparticipating preferred stock, nonconvertible debt securities, and asset-backed securities of a domestic (U.S.) issuer directed to a single foreign country. *Id.* Under this latter type of offering, the principal and interest of the securities must be denominated in non-U.S. currency. *Id.* When any participant in the issuer's syndicate knows or is reckless in not knowing that a substantial portion of the offering will be sold or resold outside that country, the offering will not qualify as an overseas directed offering. *See* Rule 904(c), *supra* note 45.

79. "Foreign government" is defined as "the government of any foreign country . . . provided that such person would qualify to register securities under the Act on Schedule B." Rule 902(e), *supra* note 43.

80. Rule 903(c), *supra* note 44. An offering made to employees of either a domestic or foreign issuer pursuant to a qualified employee benefit plan may be made under Category I as long as certain conditions are met. The specific conditions set forth in Rule 903(c) are similar to those contained in no-action letters relating to Release 4708. *See* Securities Act Release No. 6863, *supra* note 6, at 80,675 n.102.

81. Securities Act Release No. 6863, *supra* note 6, at 80,672.

82. *See supra* notes 54-70 and accompanying text.

83. *See* Rule 903, *supra* note 44. *But see supra* note 57.

84. *See* Preliminary Note 2 to Regulation S; SEC Release No. 6863, *supra* note 6, at 80,673.

85. *See* Gibbons, *supra* note 1, at 361.

86. *See supra* notes 76-83 and accompanying text.

87. Rule 903(2), *supra* note 44. This category also includes foreign issuers offering nonparticipating preferred stock and asset-backed securities. *Id.*

not only the general conditions,[88] but must also comply with certain selling restrictions.[89]

Two types of selling restrictions apply to offerings of securities falling within Category II: (1) "transactional restrictions" and (2) "offering restrictions." The transactional restrictions prohibit offers and sales of such securities in the United States or to a "U.S. person"[90] during a restricted period lasting forty days.[91] Additionally, a distributor selling the securities prior to the end of the restricted period to certain securities professionals (such as dealers) is required to send a "confirmation or other notice"[92] to such professionals advising them that they are subject to the same restrictions on offers and sales applicable to the distributor.[93]

For purposes of comparison, this forty-day restricted period in Category II offerings is less onerous than the twelve-month and ninety-day restricted periods that applied, respectively, to offerings of equity and debt securities under Release 4708. Moreover, Regulation S, unlike the regimen under Release 4708, declines to require that purchasers certify their non-U.S. status. Another distinction is that, in offerings utilizing the Category II safe harbor, the issuer no longer must contract or pass bylaws prohibiting its directors from effecting transfers to North American persons before the end of the applicable restricted period (as was required under Release 4708).[94]

In addition, the issuer and its entire distribution syndicate must adhere to certain "offering restrictions" (which basically are procedures) to meet the Category II and Category III issuer safe harbors.[95] These offering restrictions are procedures that impact the entire offering process and that seek to ensure compliance with the conditions imposed.[96] Nonetheless, they are somewhat less burdensome than

88. *See supra* notes 54-70 and accompanying text.

89. The SEC placed these selling restrictions on Category II securities offerings due to the Commission's belief that Category II securities are more likely to flow back to the United States than are the securities included in Category I. *See* Securities Act Release No. 6863, *supra* note 6, at 80,675.

90. Rule 903(c)(2), *supra* note 44. A "U.S. person" as defined in Rule 902(o) focuses not on U.S. citizenship, as was the case under the no-action letters relating to Release 4708, but on U.S. residency. Securities Act Release No. 6863, *supra* note 6, at 80,676. Therefore, in general, U.S. investors, distributors, and the like residing overseas may engage in their respective activities without the issuer losing the Regulation S safe-harbor protection. *Id. But see supra* note 57.

91. Rule 903(c)(2)(iv), *supra* note 44. The forty-day restricted period begins to run on the later of the date of the offering's closing or the date the first offer of securities is made to persons other than distributors. *See* Rule 902(m), *supra* note 43.

92. "Confirmation or other notice," as used in Rule 903(c)(2)(iv), allows various types of notice to fulfill the distributors' notice requirement. *See* Securities Act Release No. 6863, *supra* note 6, at 80,678. This confirmation includes notice given over the telephone or computer-generated notice given on a screen, provided the seller keeps written records that notice was provided. *Id.*

93. Rule 903(c)(2)(iv), *supra* note 44.

94. *See* Gibbons, *supra* note 1, at 363.

95. Securities Act Release No. 6863, *supra* note 6, at 80,679.

96. *Id.*

those that prevailed under Release 4708. Generally, as currently formulated, the procedures require that all distributors[97] agree in writing that all offers and sales during the applicable restricted period be made only in accordance with a Regulation S safe harbor or pursuant to registration under the Securities Act or an exemption therefrom.[98] Furthermore, the issuer, distributors, and their respective affiliates must include statements in all offering materials that the securities have not been registered under the Securities Act and may not be offered or sold in the United States or to U.S. persons unless the securities are registered or an exemption from registration is perfected.[99]

The final safe-harbor category, Category III, applies to all securities not within Categories I or II. This category includes offerings of nonreporting U.S. issuers and equity securities of nonreporting foreign issuers when there is a substantial U.S. market interest in such securities.[100] The SEC imposes the most rigorous restrictions on offerings falling within this category due to the Commission's position that these securities have the highest probability of flowing back to the United States.[101]

As is the case in the first two categories of securities, the general conditions that the offer and sale be made in an offshore transaction and that there be no direct selling efforts in the United States or to a U.S. person are applicable to Category III securities.[102] Moreover, the offering restrictions relating to Category II offerings discussed above also are applicable to offerings under Category III.[103] However, the transactional restrictions applicable to Category III offerings are more demanding than those required under Category II.[104]

The transactional restrictions applicable to Category III offerings are somewhat similar to the restrictions existing under Release 4708 prior to the promulgation of Regulation S.[105] Due to the Commission's belief that debt offerings of Category III securities are less likely to flow back to the United States, the SEC imposes less stringent transactional restrictions upon them than it does upon equity securities.[106]

---

97. "Distributor" is defined as "any underwriter, dealer, or other person who participates, pursuant to a contractual arrangement, in the distribution of the securities." Rule 902(c), *supra* note 43.

98. Rule 902(h)(1), *supra* note 43.

99. Rule 902(h)(2), *supra* note 43. The statements of the restrictions must be made on the cover or inside cover page of any prospectus or offering circular, in the underwriting section of any prospectus or offering circular, and in all advertisements of the offering. Rule 902(h)(2)(i),(ii) & (iii), *supra* note 43.

100. Securities Act Release No. 6863, *supra* note 6, at 80,679.

101. *Id.*; *see* Lynn Bai, *U.S. Registration Requirements for Multi-National Offerings* (pts. 1 & 2), 25 REV. SEC. & COMMODITIES REG. 131, 144 (1992), 25 REV. SEC. & COMMODITIES REG. 151, 157 (1992).

102. *See supra* notes 54-70 and accompanying text.

103. *See supra* notes 95-99 and accompanying text.

104. Securities Act Release No. 6863, *supra* note 6, at 80,679.

105. *Id.*; *see supra* notes 12-34 and accompanying text.

106. Securities Act Release No. 6863, *supra* note 6, at 80,679.

Debt securities offered pursuant to Category III are subject to a forty-day restricted period, as opposed to the ninety-day restricted period required under Release 4708.[107] During this period the securities may not be sold to U.S. persons or for the account (or benefit) of U.S. persons.[108] As was the procedure under Release 4708, the debt securities must be represented by a temporary global security, which is not exchangeable for definitive securities until the forty-day restricted period has expired.[109] When the global security is exchanged for the definitive security, certification must be effected that a non-U.S. person owns the security or that a U.S. person purchased securities in a transaction that was exempt from the registration requirements of the Securities Act.[110] If a distributor or other person receiving a selling concession sells prior to the expiration of the forty-day restricted period, it must send a "confirmation or other notice" to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to the distributor.[111]

The transactional restrictions applicable to equity offerings under the third issuer safe harbor—Category III—are even more demanding than the restrictions applicable to debt securities in the same category. Rule 903(c)(3)(iii) prohibits equity securities offered under Category III from being sold to a U.S. person or for the account (or benefit) of a U.S. person for a period of one year.[112] Furthermore, the purchaser of the security must certify that it is not a U.S. person and is not acquiring the securities for the account (or benefit) of any U.S. person.[113] In addition, the purchaser must agree to resell only if it adheres to one of three conditions, namely, that such resale is made in accordance with Regulation S, pursuant to a registration statement, or under an exemption from registration.[114] If a U.S. issuer is utilizing the Category III safe harbor, it must place a legend on the securities offered stating that all transfers are prohibited except as set forth above.[115] Finally, the issuer is required, either by contract or pursuant to a provision in its bylaws, articles, or charter, to refuse to register any transfer not in accordance with the foregoing.[116] Hence, the restrictions on offerings of equity securities under the Category III issuer safe harbor are nearly identical to those that existed under Release 4708. This consistency reflects the SEC's strong belief that offshore Category III offerings of equity securities are more likely to flow back to the United States.

107. Rule 903(c)(3)(ii)(A), *supra* note 44.
108. *See* Rule 902(m), *supra* note 43.
109. Rule 903(c)(3)(ii)(B), *supra* note 44.
110. *Id.*
111. Rule 903(c)(iv), *supra* note 44. Nondistributors are not required to provide such notice. *See* Securities Act Release No. 6863, *supra* note 6, at 80,680.
112. Rule 903(c)(3)(iii)(A), *supra* note 44.
113. Rule 903(c)(3)(iii)(B)(1), *supra* note 44.
114. Rule 903(c)(3)(iii)(B)(2), *supra* note 44.
115. Rule 903(c)(3)(ii)(B)(3), *supra* note 44.
116. Rule 903(c)(3)(iii)(B)(4), *supra* note 44.

3. *Resale Safe Harbor*

The resale safe harbor generally is available only to security holders who are not issuers, affiliates of an issuer, distributors, or affiliates of a distributor. Nonetheless, under certain circumstances, officers and directors of an issuer and securities professionals may use the resale safe harbor.[117] By satisfying all conditions of the resale safe harbor, the registration requirements of the Securities Act can be avoided.[118] In general, other than securities professionals[119] and officers and directors of an issuer, persons may sell in reliance on the resale safe harbor simply by satisfying the general conditions applicable to Regulation S transactions: (1) a resale in an offshore transaction and (2) without direct selling efforts in the United States.[120]

An officer or director may rely on the resale safe harbor if, in addition to meeting the general requirements, the officer or director is an affiliate solely by virtue of his or her position and no special selling compensation is paid in the resale transaction.[121] With respect to securities professionals, they may not knowingly offer or sell securities to U.S. persons during the applicable restricted period.[122] If the securities professional is selling to another securities professional, a trade confirmation or other notice must be sent to such purchaser reciting the applicable restrictions.[123]

4. *Facilitating Global Trading*

By promulgating Regulation S the SEC has acknowledged the existence of a global economy and the important role of international securities transactions. While not a panacea, Regulation S establishes a uniform U.S. framework with respect to international securities offerings. Moreover, Regulation S decreases some of the ambiguity that existed under the prior regulatory regimen. Regulation S, aside from creating a more flexible approach with fewer regulatory burdens, has been used in conjunction with Rule 144A to increase investment in foreign issuers and to expand international securities trading in general. The following discussion focuses on the interaction between Rule 144A and Regulation S in the global securities market.

---

117. Without this exception, officers and directors would be considered affiliates and therefore would be unable to utilize the resale safe harbor. *See infra* notes 120-21 and accompanying text.

118. *See* Rule 904, *supra* note 45.

119. Persons who are considered securities professionals include: "dealers and persons receiving a selling concession, fee or other remuneration in respect of the securities offered or sold, which may include subunderwriters." Securities Act Release No. 6863, *supra* note 6, at 80,680. *See infra* notes 122-23 and accompanying text.

120. Rule 904(a), (b), *supra* note 45; see *supra* notes 54-70 and accompanying text.

121. Rule 904(c)(2), *supra* note 45.

122. Rule 904(c)(1), *supra* note 45.

123. Rule 904(c)(1)(ii), *supra* note 45. The applicable restrictions are that the securities may be offered and sold during the restricted period only in accordance with the provisions of Regulation S, if the securities are registered, or pursuant to an available exemption from the registration requirement. *Id.*

IV. Regulation S and Rule 144A

The SEC promulgated Rule 144A generally for two purposes: (1) to increase the efficiency and liquidity of securities issued in transactions exempt from the federal securities laws; and (2) to allow institutional investors to invest more easily in foreign issuers.[124] Rule 144A principally provides a nonexclusive safe-harbor exemption from the registration requirements of section 5 of the Securities Act for resales to qualified institutional buyers of securities that were originally issued in exempt transactions.[125]

Regulation S has been used in conjunction with Rule 144A to attract foreign issuers to the United States and to create an active trading market for such securities.[126] Prior to the promulgation of Rule 144A, it often was difficult for U.S. investors to resell securities issued by foreign issuers in the United States. This problem existed because foreign issuers frequently offer and sell their securities to U.S investors in transactions that are exempt from the Securities Act's registration requirements.[127] Securities sold in exempt transactions are "restricted"[128] and generally are subject to prohibitions on resale for a two-year period following their initial placement, and then only in limited quantities and subject to other conditions.[129] However, the promulgation of Rule 144A has partially alleviated this illiquid situation. By allowing the resale of restricted securities to qualified institutional buyers, Rule 144A has created a resale market for foreign securities.[130] Now, the restricted securities of a foreign issuer may be resold to qualified institutional buyers after they are privately placed.[131]

In order to facilitate the secondary trading of these restricted securities between

124. Resale of Restricted Securities, Securities Act Release No. 6862, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523, at 80,637-40 (Apr. 23, 1990).

125. *Id.* at 80,639-40. Discussion of Rule 144A beyond issues relating to the rule's facilitation of a global securities marketplace are beyond this article's scope. *See generally* HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 11.01 (1993-1994); C. Steven Bradford, *Rule 144A and Integration*, 20 SEC. REG. L.J. 37 (1991); Bevis Longstreth et al., *Rule 144A: A Closer Look*, 4 INSIGHTS No. 8, at 16 (1990); Robert F. Quaintance, *Getting Comfortable with "Public-Style" Rule 144A Offerings*, 7 INSIGHTS No. 9, at 8 (1993); Daniel W. Rumsey, *Rule 144A and Other Developments in the Resale of Restricted Securities*, 19 SEC. REG. L.J. 157 (1991); Lawrence R. Seidman, *SEC Rule 144A: The Rule Heard Round the Globe—Or the Sounds of Silence?* 47 BUS. LAW. 333 (1991); Kellye Y. Testy, Note, *The Capital Markets in Transition: A Response to New SEC Rule 144A*, 66 IND. L.J. 233 (1990).

126. *See SEC Staff Says Rule 144A Is Attracting Foreign Issuers to U.S. Capital Markets*, 23 Sec. Reg. & L. Rep. (BNA) 1589 (1991) [hereinafter *SEC Staff*].

127. *See* Edward F. Greene & Alan L. Beller, *Rule 144A: Keeping the U.S. Competitive in the International Financial Markets*, 4 INSIGHTS No. 6, at 3, 6 (1990).

128. Generally, restricted securities are "securities acquired directly or indirectly from an issuer or its affiliate in a nonpublic offering, or securities subject to the Regulation D resale limitations." STEINBERG, *supra* note 13, at 257.

129. *See SEC Staff*, *supra* note 126; *see also* authorities cited *supra* note 125.

130. *See* authorities cited *supra* note 125.

131. *See* Securities Act Release No. 6862, *supra* note 8, at 80,639-40; *infra* notes 136-53 and accompanying text. Note that such securities, after they are sold to qualified institutional buyers pursuant to Rule 144A, continue to be "restricted securities."

institutional investors, the SEC approved the National Association of Securities Dealers' PORTAL trading system.[132] This computerized trading system is designed to allow institutional investors qualifying under Rule 144A to actively trade such securities while avoiding the registration requirements of the Securities Act.[133] Hence, the increased liquidity in the U.S. markets of the securities of foreign issuers has created an active following for the securities of overseas issuers.[134]

A. Rule 144A as a De Facto Exemption from Section 5 of the Securities Act

As previously discussed, the initial sale into the United States of securities issued by foreign entities frequently has been pursuant to an exemption from the registration requirements of the Securities Act. Viewed flexibly, Rule 144A and Regulation S provide an alternate method for the securities of foreign issuers to reach the United States by means of the exemption route. This method involves foreign issuers selling securities offshore pursuant to the Regulation S safe harbor to such parties as foreign institutions or to U.S. broker-dealer affiliates located overseas. Using Rule 144A as an exemption from the Securities Act, such parties promptly resell the securities to qualified institutional investors in the United States.[135]

Stated another way, the party seeking to resell in the United States either must register the securities or find an exemption from the Securities Act.[136] Today, with increased regularity, Rule 144A is being invoked as the requisite exemption. By treating Rule 144A as an exemption, the party reselling does not violate either the "directed selling efforts" or "offshore transaction" requirement of

132. Self Regulatory Organization, Securities Exchange Act Release No. 27,956 (Apr. 27, 1990). The PORTAL market has not yet experienced the heavy volume that the National Association of Securities Dealers (NASD) expected when Rule 144A and PORTAL were approved by the SEC in 1990. *See Portal Amendment Would Convert Rule 144A System to More Open Structure*, SEC. WK., Mar. 16, 1992, at 3. However, the PORTAL system may reach its potential due to efforts by the NASD to increase the volume of Rule 144A securities in the PORTAL system. *Id.* As of August 1994, the NASD had processed over a thousand applications for designations as a PORTAL security. Securities Exchange Act Release No. 34,562, 59 Fed. Reg. 44,210 (1994).

133. SEC. WK., *supra* note 132, at 3; *see* authorities cited *supra* note 125.

134. *See* 23 *SEC Staff*, *supra* note 126; Alan J. Berkeley & Jean E. Minarick, *Rule 144A: Institutional Trading of Privately Placed Securities*, 703 PLI/CORP. 47 (1990); authorities cited *supra* note 125.

135. According to one source:

> Perhaps the most significant feature of the new rules from the perspective of foreign issuers is that they will open up new avenues for securities sold outside the U.S., even securities sold in an offshore public offering, to be resold in the United States without delay or traditional private placement offering restrictions.

Edward A. Perell & James A. Kiernan III, *Regulation S and Rule 144A: A Non-U.S. Issuer's Perspective*, IFLR/CORP. FIN. SP. SUPP., Sept. 1990, at 13, 19; *see also* Berkeley & Minarick, *supra* note 134, at 69. The initial sell to the dealer must qualify under Regulation S. *Id.*

136. *See supra* notes 12-16 and accompanying text.

Regulation S.[137] In sum, by using Rule 144A in conjunction with Regulation S, such parties can resell securities issued by foreign (or domestic) issuers pursuant to Regulation S to institutional investors qualifying under Rule 144A without adhering to the registration requirements of the Securities Act or the private placement rules' restrictions on resale.[138] Implementation of this technique thereby eliminates the need for foreign (as well as domestic) issuers to comply with transactional exemptions, such as the section 4(2) or Rule 506 of the Regulation D exemption,[139] in order to have their securities actively traded in the United States.

Irrespective that this development serves as a key incentive for foreign issuers to enter the U.S. markets,[140] recent statements by SEC officials indicate concern. For example, the Director of the SEC's Division of Corporation Finance has asserted that Rule 144A, rather than providing a broad exemption from Securities Act registration, is more limited.[141] She stated: "Before you can use Rule 144A, you must have a good '33 Act [registration] exemption."[142] If the SEC were to apply this proposition in the context of Regulation S offerings, it would certainly limit the marketability of foreign securities in the United States.

When offering securities offshore pursuant to Regulation S, issuers are neither required to meet the registration requirements of the Securities Act nor secure an exemption therefrom. However, to resell such securities into the United States,

137. *See* authorities cited *supra* notes 125, 134.

138. *See* Berkeley & Minarick, *supra* note 134, at 47; Perell & Kiernan, *supra* note 134, at 19; *see also* Edward F. Greene & Janet F. Plache, *U.S. Private Placements and Rule 144A*, PLI, TWENTY-FIFTH ANNUAL INSTITUTE ON SECURITIES REGULATION 357, 385 (1993). The authors opine that the section 4(2) exemption may be invoked under certain circumstances with respect to overseas sales to broker-dealers, stating: "There is an emerging consensus among issuers and the private bar that an issuer's § 4(2) exemption is valid if the issuer sells securities to broker-dealers that are under a contractual restriction to sell only to qualified institutional buyers, without any need to impose additional transfer procedures. . . ." *Id.*

139. *See generally* Greene & Plache, *supra* note 138, at 385. MARC I. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 5.03 (1994); Mark A. Sargent, *The New Regulation D: Deregulatory, Federalism and the Dynamics of Regulatory Reform*, 68 WASH. U. L.Q. 225 (1990).

140. *See SEC Staff, supra* note 126; authorities cited *supra* note 125. *See generally* Edward F. Green & Jennifer M. Schneck, *Recent Problems Arising under Regulation S*, 8 INSIGHTS No. 8, at 2 (1994).

141. *SEC Staff to Clarify Reg. S, Rule 144A, Quinn says*, 24 Sec. Reg. & L. Rep. (BNA) 67 (1992).

142. *Id.* (brackets in original); *see* Fed. Sec. L. Rep. (CCH) No. 1602, at 7-8 (describing speech given by SEC Commissioner Richard Y. Roberts); 26 Sec. Reg. & L. Rep. (BNA) 366 (1994) (remarks of Elisse Walter, deputy director of SEC's Division of Corporation Finance); *see also Rule 144 and Related Issues*, 19 CORP. COUNS. No. 2, at 6 (1994) (citing alleged abuses in the Regulation S/Rule 144A context); 26 Sec. Reg. & L. Rep. (BNA) 1387 (1994) (statement of SEC Commissioner Richard Y. Roberts that SEC may adopt revisions to Regulation S and that enforcement actions in the Regulation S setting may be forthcoming). The Director's view as set forth in the text also finds support in the literature. *See* Greene & Beller, *supra* note 127, at 6 (stating that in connection with the Rule 144A resale, frequently "Section 4(2) provides the exemption for the issuer's initial sale"); Leslie N. Silverman & Daniel A. Braverman, *Regulation S and Other New Measures Affecting the International Capital Markets*, 23 REV. SEC. & COMMODITIES REG. 179, 187 (1990) (stating that "the initial sale by an issuer to the distributors will still have to qualify separately for an exemption from the registration requirements of the Securities Act").

the securities must either be registered with the SEC or an exemption must be perfected. As discussed above, today Rule 144A is frequently invoked as the requisite exemption from section 5's registration requirements to resell to qualified institutional buyers in the United States. If the proposition as set forth by certain SEC officials is adopted, Rule 144A could no longer be used in this manner as an exemption to resell in the United States securities issued offshore pursuant to Regulation S.[143]

B. A Workable Fiction in an Expanding Global Securities Market

As previously discussed, to sell securities in the United States one must either register the securities or find an exemption from the Securities Act.[144] The exemption may be a transactional exemption perfected by a foreign issuer or a resale exemption secured by a third party. The new financing technique described above entails the resale of securities to the United States and utilizes Rule 144A as the requisite exemption from the Securities Act. Arguably, neither Regulation S nor Rule 144A, by themselves or together, provides the exemption from registration that is required to resell in the United States.

The analysis supporting this position is as follows: Rule 144A may be viewed principally as a resale safe harbor for restricted securities.[145] Such a safe harbor when employed in this context requires an issuer to secure a transactional exemption, such as one pursuant to section 4(2) or Rule 506 of Regulation D, as a precondition to its use as an exemption from registration in the resale transaction. Regulation S merely governs the applicability of the registration requirements of the Securities Act to international transactions and does not provide the issuer with a transactional exemption from the registration requirements of the Securities Act.[146] Since Regulation S is not a transactional exemption and the issuer in such an overseas offering is not required to perfect such an exemption (and often does not), the exemption provided in Rule 144A is technically not enough by itself to avoid the registration requirements of the 1933 Act under this scenario when no other transactional exemption has been secured.

Hence, under such an analysis, this resale transaction technique utilized in the Regulation S/Rule 144A context technically may violate the registration requirements of the Securities Act. While Rule 144A may be viewed as only a conditional resale safe harbor that standing alone does not provide an exemption from the

143. *See* Rule 903, *supra* note 44; *supra* notes 71-116 and accompanying text. Although a number of commentators may disagree with such a reading of recent SEC statements regarding Regulation S/Rule 144A, taken at face value, these statements signify that the Commission and/or its staff view a separate exemption as necessary in this context. *See* Harold S. Bloomenthal, *The SEC and Internationalization of Capital Markets: Herein of Regulation S and Rule 144A—Part II*, 18 DEN. J. INT'L L. & POL'Y 343, 396-97 (1990); Wolff, *supra* note 7, at 142-44.

144. See *supra* notes 12-16 and accompanying text.

145. For the definition of "restricted security," see STEINBERG, *supra* note 13, at 257.

146. *See* authorities cited *supra* note 51.

1933 Act's registration requirements, it may be argued that the rule should be treated as an exemption when used in connection with a resale into the United States of securities issued by a *foreign* issuer that utilized Regulation S. Additional support for this proposition in the Rule 144A context comes from the fact that Rule 144A requires purchasers to be qualified institutional buyers. Such buyers generally are deemed by the SEC to be capable of fending for themselves.

1. *United States Issuer Resales*

Two types of resale transactions may occur after a Regulation S offering. First, after a U.S. issuer has sold securities offshore pursuant to Regulation S, the offshore investor seeks to resell into the United States. Second, after a foreign issuer has issued securities pursuant to Regulation S, the purchaser wishes to resell into the United States. There may be insufficient justification to allow Rule 144A to be invoked as an exemption when a U.S. issuer is involved. To do so would permit a U.S. issuer's securities immediately to reenter the United States after the Regulation S offering terminates. With other exemptions available to a domestic issuer, permitting the exemption framework to be bypassed arguably should be considered a "scheme to evade the registration provisions of the Act."[147] Given this conclusion, the question arises whether sufficient cause exists to accord preferential treatment to foreign issuer resales in this particular setting. That is, should Rule 144A be available as an exemption allowing the securities of foreign issuers (sold pursuant to Regulation S) to be resold in the United States (or more specifically whether resale into the United States by way of Regulation S and Rule 144A should be allowed in this context)? Because investor protection may be adequately secure due to the express requirement that the purchaser must be a qualified institutional buyer (along with the SEC's perception that such buyers can fend for themselves and the applicability of the antifraud provisions), the underlying policy of Rule 144A and Regulation S promoting a global securities marketplace arguably indicates that it should.

2. *Foreign Issuer Resales*

A premise underlying Rule 144A is that qualified institutional purchasers are financially sophisticated, such that the protection provided by the Securities Act registration and related requirements are not necessary.[148] This level of sophistication, along with the continued application of the Securities Acts' antifraud provi-

147. Preliminary note 2 to Regulation S, Rule 902, *supra* note 43; *see also Rule 144 and Related Items*, 19 CORP. COUNS. No. 2, at 6 (1994):

> In addition to large issuers which have utilized Regulation S, it appears that several smaller, speculative issuers are selling securities at, say, a 20% discount from market value to "investors" who are then coming back within a few months (i.e., after the 40-day period) to U.S. brokers attempting to resell these securities into the United States securities markets.

148. Securities Act Release No. 6862, *supra* note 124, at 80,638.

sions, may call for a more flexible approach in order to facilitate the implementation of enhanced global trading of foreign securities in the United States. Clearly, adhering to this position would be consistent with Rule 144A's underlying policy that qualified institutional investors are not in need of the protection provided by Securities Act registration.[149] If Rule 144A cannot be used as an exemption under these circumstances, absent further action by a subject foreign issuer,[150] securities issued by such an issuer under Regulation S may not be resold into the United States for a prolonged period of time.[151] Moreover, under this construction,[152] such securities ordinarily may not be resold in a Rule 144A transaction because no initial transactional exemption was secured. Given the practical realities, forbidding Rule 144A from being used as an exemption for the resale of securities issued by foreign entities unduly restricts this country's participation in the global securities marketplace. Nonetheless, particularly when securities are sought to be resold in the United States pursuant to Rule 144A immediately after the Regulation S offering terminates, it should be recognized that the views advanced by SEC officials (as set forth above) have merit and should be considered with care.[153]

V. Conclusion

While arguments have been offered on both sides, the ultimate decision on the availability of Rule 144A as an exemption in connection with resales into the United States of securities issued pursuant to Regulation S rests with the SEC. If the SEC denies the use of Rule 144A as an exemption from registration

149. *Id.*

150. *See generally* Ronald R. Adee, *Offerings by Foreign Private Issuers, in* SECURITIES UNDERWRITING (Kenneth J. Bialkin & William J. Grant eds., 1985); Joseph McLaughlin, *Listing Foreign Stocks on U.S. Exchanges: Time to Confront Reconciliation?*, 24 REV. SEC. & COMMODITIES REG. 91 (1991); Regis E. Moxley, *The ADR: An Instrument of International Finance and a Tool of Arbitrage*, 8 VILL. L. REV. 19 (1962); Mark A. Saunders, *Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 FORD. INT'L L.J. 48 (1993).

151. *See* Securities Act § 4(1), 15 U.S.C. § 77d(1) (1981); Rule 144, 17 C.F.R. § 230.144 (1994); *supra* notes 141-42 and accompanying text.

152. *Id.*

153. Requiring a traditional exemption from registration as a precondition to a Rule 144A resale in this context is supported by the SEC's territorial approach. The SEC's territorial approach is premised on the belief that the registration requirements of the Securities Act, and presumably the exemptions therefrom, are intended to protect the U.S. capital markets along with U.S. persons. Moreover, the approach recognizes that investors choose their markets and the laws and regulations applicable to such markets. If Rule 144A is allowed to be used in this context, those securities resold in the United States after the Regulation S offering terminates, along with subsequent resales pursuant to Rule 144A, would not have met an exemption from registration or have been registered under the Securities Act. With the potential for heavy volume trading in Rule 144A securities through the PORTAL system, there would be an active market in the United States for securities that had neither been registered pursuant to section 5 of the Securities Act nor perfected an exemption therefrom. According to these SEC officials, such a result would not be in concert with the purposes underlying Regulation S or Rule 144A. *See* Securities Act Release No. 6863, *supra* note 6, at 80,665; *supra* notes 141-42 and accompanying text.

in the Regulation S context with respect to the securities of foreign issuers, the progress that the Commission has generated in advancing U.S. participation in the international securities markets will be impeded. Nevertheless, the SEC's promulgation of Rule 144A and Regulation S represents the Commission's recognition of a global securities market and is a step toward decreasing undue regulatory restraints as well as facilitating uniformity in international securities transactions.