Denver Journal of International Law & Policy

Volume 19
Number 2 *Winter*

Article 4

May 2020

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INTERNATIONAL CAPITAL MARKETS SECTION

The SEC and Internationalization of Capital Markets: Herein of Regulation S and Rule 144A — Part II

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§1 INTRODUCTION

Part I of this Article[1] focused on Regulation S and Rule 144A as a step in achieving the Securities and Exchange Commission's goal of facilitating "a truly global market system."[2] Regulation S is a safe harbor for offshore distributions. Rule 144A is intended to provide an efficient, liquid market among large institutional investors (securities portfolios in excess of $100 million) for securities issued in exempt offerings or in reliance on Regulation S. Part II in concept was to look at the new regimen in operation by considering discrete offshore distributions and hybrid offshore-onshore distributions. Regulations S[3] and Rule 144A[4] were then proposed regulations which the Commission has since adopted.[5] The

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1. Bloomenthal, *The SEC and Internationalization of Capital Markets: Herein of Regulation S and Rule 144A*, 19 DEN. J. INT'L L. & POL'Y 83 (1989).

2. See press release relating to SEC, "Policy Statement on Regulation of International Securities Markets," 53 Fed. Reg. 46,963, 46,964.

3. Securities Act Release No. 6779 [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,242 (June 10, 1988), proposing Regulation S [hereinafter Proposing Release]; Securities Act Release No. 6838 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,426 (July 11, 1989), reproposing Regulation S [hereinafter Reproposing Release].

4. Securities Act Release No. 6806 [1988-89 Transfer Binder] Fed. Sec. Law Rep. (CCH) ¶ 84,335 (Oct. 25, 1988), proposing Rule 144A [hereinafter Rule 144A Proposing Release]; Securities Act Release No. 6839 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,427 (July 11, 1989), reproposing Rule 144A [hereinafter Rule 144A Reproposing Release].

5. Securities Act Release No. 6863 [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524 (Apr. 24, 1990) [hereinafter Adopting Release] (citations to rules in the Adopting Release hereinafter referred to by rule number only); Securities Act Release No. 6862 [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (Apr. 23, 1990) [hereinafter Rule

Commission, concurrently with the adoption of Regulation S and Rule 144A, approved a proposal of the National Association of Securities Dealers (NASD) to operate PORTAL, a screen-based market, limited to qualified institutional investors (as defined by Rule 144A) for both initial private placements and subsequent trading in Rule 144A eligible securities.[6] The somewhat different regulatory landscape from that described in Part I necessitates a description of the new regimen as a prelude to considering its operation based on assumptions as to some of the more likely scenarios involving offshore distributions. Because so much of the new "law" (particularly with respect to Regulation S) is in the Adopting Release explaining Regulation S rather than the Regulation, it does not suffice to merely point out the changes to Part I. Accordingly, this Article is intended to stand on its own without the necessity of referring back to Part I. Section 14, however, sets forth six likely scenarios of different offshore distributions with a number of variations and some readers may prefer starting with those scenarios, relying on the cross-references to develop a more detailed understanding of Regulation S, Rule 144, and the interrelationship of the two.

§2 THE GENERAL STATEMENT (NON-SAFE HARBOR) APPROACH

Regulation S sets forth a General Statement of the fundamental underlying conceptual rationalization of the regulation which is deceptively simple. Offers and sales "that occur outside the United States" are not deemed an offer or sale for purposes of the registration provisions (Section 5) of the Securities Act.[7] The General Statement is the operative provision of Regulation S in that it provides the link to Section 5. The proposed and reproposed Regulation included a number of "relevant considerations" to be taken into account in determining whether an offer or sale would be deemed to have occurred outside of the United States. The Commission eliminated all of these criteria from the Regulation as adopted because "of the commenters' [sic.] assessment that the list would not be helpful."[8] The General Statement, nonetheless, provides an alternative to the safe harbors. Although one would ordinarily prefer to rely on a safe harbor, if there has been an inadvertent failure to comply with a nuance of the safe harbor, one can fall back on the language of the General Statement. In that event, the "relevant considerations" of the proposed and reproposed rule may continue to be relevant as an indicia of what the Commission regarded as pertinent at the time the rule was proposed. Most of the previously enumerated criteria are incorporated in a specific fashion in the issuer-distributor safe harbors. If, for example, eq-

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144A Adopting Release] (citations to rules in the Rule 144A Adopting Release hereinafter referred to by rule number only).

6. *See* Securities Exchange Act Release No. 27,956, 55 Fed. Reg. 18,777 (1990). PORTAL is an acronym for Private Offerings, Resales, and Trading through Automated Linkage.

7. Rule 901.

8. Adopting Release, *supra* note 5, at 80,666.

uity securities of a non-reporting issuer are resold within ten months to U.S. persons, arguably the fact that the category 3 safe harbor imposes a twelve month restricted period evidences the fact that the securities have not come to rest offshore.[9] The safe harbors, however, are not exclusive and one could fall back on the General Statement and could point to the fact that the Rule 147(e) safe harbor relating to the Section 3(a)(11) intrastate exemption has only a nine month restricted period.[10]

The basic reason why Release 4708 and now Regulation S is necessary to assure that the registration provisions of the Securities Act will not be applicable to an offshore distribution is the broad jurisdictional base of the Securities Act.[11] In many basically local offerings by a foreign issuer, however, there may be no jurisdictional means utilized. Such offerings, without more, probably do not need the safe harbor or, in any event, will conform with the category 1 safe harbor even if no deliberate effort is made to do so.[12]

The principal thrust of Regulation S is to provide safe harbors for various types of offshore distributions which, if followed, assure that the offering will be deemed to have occurred outside of the United States and, therefore, not subject to the registration provisions of the Securities Act. There are from one perspective (and this is the perspective generally taken in the releases) two safe harbors — the issuer-distributor safe harbor embodied in Rule 903 and the resale safe harbor set forth in Rule 904. The issuer-distributor safe harbor, however, has three separate categories so from another perspective (and one often employed in this Article) there are four safe harbors.

§3 DEFINITION OF A U.S. PERSON

The concept of a U.S. person plays an important role in all safe harbor contexts except a distribution within the category 1 safe harbor. Under Regulation S, U.S. persons, in a departure from old concepts, means a "person resident in the United States."[13] Thus, the appropriate consideration is residence rather than citizenship; a U.S. citizen who is a resident of France is not a U.S. person and a French citizen who is a resident of the United States is a U.S. person.[14] A corporation or partner-

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9. *See* §5[d].

10. Rule 147(e), 17 C.F.R. §230.147(e) [hereinafter "Rule 147(e)"]. *Cf.* Busch v. Carpenter, 827 F.2d 653 (10th Cir. 1987) (Section 3(a)(11) exemption available under the circumstances notwithstanding fact that securities resold in an interstate transaction after seven months).

11. Section 2(7) of the Securities Act, 15 U.S.C. §77(b)(7), defines commerce, which in turn establishes the jurisdictional basis for invoking Section 5, to include commerce between a state and any foreign country.

12. *See* §5[a].

13. Rule 902(o)(1)(i).

14. Transient visitors in the United States are not U.S. persons. Adopting Release, *supra* note 5, at 80,676 n.115. Offers and sales, however, to such transients while in the United States are transactions in the United States and generally the Regulation S safe

ship organized under the laws of the United States is a U.S. person.[15] An agency or branch of a U.S. entity located outside the United States is not a U.S. person if (1) it operates for valid business reasons and not for the purpose of investing in unregistered securities *and* (2) is engaged in the business of banking or insurance which subjects it to substantive banking or insurance regulation in the country in which it operates.[16] A corporation or partnership organized under the laws of a country other than the United States is not a U.S. person even if owned by U.S. persons provided it is not formed "principally for the purpose of investing in securities not registered under the Act." But even if formed for this purpose, it will not be a U.S. person if it is owned exclusively by accredited investors as defined in Rule 501(a) of Regulation D who are not natural persons, estates, or trusts.[17] This is a dramatic departure from the past which permitted almost any corporate institutional investor to organize a foreign entity as a partnership or corporation for the purpose of purchasing unregistered securities offshore without being deemed a U.S. person.[18] A branch or agency of a foreign entity is a U.S. person if located in the United States.[19] An estate or trust in which any executor, administrator, or trustee is a U.S. person[20] and a non-discretionary custodial account or similar account held by a dealer or other fiduciary for the account of a U.S. person are also considered U.S. persons.[21] A discretionary custodial account or similar account held by a dealer or other fiduciary located in the United States is a U.S. person unless it is held for a non-U.S. person in which event it is a non-U.S. person.[22] Regulation S, as initially proposed, would have overturned a previous no-action letter to the effect that a U.S. broker-dealer with discretion to act for a non-U.S. person would be a non-U.S. person when acting in that capacity.[23] After receiving comments, the Commission revised proposed Regulation S and as adopted, consistent with *Baer*. Regulation S provides that any discretionary or similar account (other than an estate or trust) held by a dealer or other professional U.S. fiduciary for the benefit of a non-U.S. person is a non-U.S. person.[24]

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harbor cannot be relied upon for such transactions. *Id.*

15. Rule 902(o)(1)(ii).

16. Rule 902(o)(6).

17. Rule 902(o)(1)(viii).

18. The Reproposing Release stated: "A U.S. institutional investor should be able to choose to establish an entity outside the United States, and should not expect the registration provisions to apply to purchases made by that foreign entity." Reproposing Release, *supra* note 3, at 80,217. Thus, upon reproposal, the Commission appeared to endorse a concept that investors could "opt-out" of Section 5 by incorporating offshore.

19. Rule 902(o)(5).

20. Rule 903(o)(1)(iii), (iv).

21. Rule 902(o)(1)(vi).

22. Rule 902(o)(1)(vii), 902(o)(2).

23. *See* Baer Securities Corp., SEC No-Action Letter (Oct. 12, 1979).

24. Rule 902(o)(2).

All the safe harbors require that the transaction be offshore.[25] The fact that a discretionary account managed by a U.S. broker-dealer or investment adviser for a non-U.S. person is a non-U.S. person would not have greatly facilitated offshore purchases by them for their foreign clients without maintaining some type of office offshore. Regulation S, as adopted, addresses this problem by providing that offers and sales of securities to persons excluded from the definition of a U.S. person under Rule 902(o)(2) (discretionary accounts held for the benefit of non-U.S. persons) shall be deemed to be made in "offshore transactions."[26] A U.S. person permitted to purchase securities of foreign issuers, under certain circumstances pursuant to Regulation S (e.g., if issued in reliance on the category 1 safe harbor) must maintain an offshore presence, but such presence can be minimal.[27]

§4 GENERAL CONDITIONS

[a] *Offshore Transactions*

The safe harbors for issuers and distributors are divided into three categories, distinguishable by the offering and transactional restrictions imposed. All three categories, however, must comply with the two general conditions:

1. The offers and sales must be made in an offshore transaction.[28]

2. There can be no directed selling efforts in the United States in connection with the offering.[29]

To be an offshore transaction:[30]

1. The offer must not be made to a person in the United States.

2. The buyer at the time the buy order is originated must be outside the U.S., or the seller *and* any person acting on its behalf "reasonably believes" that the buyer is outside the United States at the time the order is originated.

The fact that transactions are effected on a foreign stock exchange has significance in a variety of contexts under the Regulation as such transactions generally are offshore transactions.[31] Foreign stock exchanges, unlike U.S. exchanges, trade many securities in various categories that are not technically listed, but, nonetheless, trade under the auspices of the exchange. Regulation S introduces the concept of a "Designated Offshore Securities Market" ("DOSM") which encompasses,

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25. *See* §4[a].
26. Rule 902(k)(3).
27. *See infra* note 45.
28. Rule 903(a).
29. Rule 903(b).
30. Rule 902(i).
31. *Id.*

as well as the officially listed securities, securities traded under the auspices of the exchange. Regulation S designates sixteen of the principal stock exchanges located outside the United States and the Eurobond market as regulated by the Association of International Bond Dealers as DOSM's.[32] The Commission delegated to the Division of Corporation Finance, in consultation with the Director of the Division of Market Regulation,[33] the authority to add other foreign securities markets having taken into account several nonexclusive factors. Such factors included the fact that the market is organized under foreign law; is subject to oversight by a governmental or self-regulatory body to which transactions are reported on a regular basis; and there is an existing body of law that establishes oversight standards.[34] The Adopting Release designates the stock exchanges without discriminating between securities admitted to an official listing and securities admitted for dealings.[35] The intent to cover organized but unlisted trading on these markets is apparent from the general criteria and because the Reproposing Release specifically referred to the Unlisted Securities Market as a market that would meet such criteria.[36]

If the transaction involves a resale made in reliance on Rule 904,[37] and if the transaction is executed in, on, or through the facilities of a DOSM, the transaction is offshore even if the buyer places the order from the United States provided the transaction was not pre-arranged with a buyer in the United States.[38] Although primary offerings are not generally made on an exchange, for the situations in which such offerings take place on an exchange, the transaction must be "in, on, or through a physi-

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32. Rule 902(a)(1). The sixteen designated exchanges are the Amsterdam, Australian, Brussels, Frankfurt, Hong Kong, International (London), Johannesburg, Luxembourg, Milan, Montreal, Paris, Stockholm, Tokyo, Toronto, Vancouver, and Zurich. Not included, among others, are Geneva and other Swiss exchanges, Singapore, Mexico City, Copenhagen, Austria, and Spain.

33. Rule 30-1.

34. Rule 902(a)(2).

35. The International Stock Exchange in London, for example, is actually three markets—the listed market, the Unlisted Securities Market ("USM"), and the Third Market. The Frankfurt Stock Exchange has a market for trading in listed securities (Amtlicher Handel) and a regulated market in unlisted securities (Geregelter Market). There is a trend among European stock exchanges to develop an organized market for trading in second tier securities that are regulated by the exchange but not officially admitted to listing.

36. Reproposing Release, *supra* note 3, at 80,211 n.24. The Adopting Release, however, is somewhat confusing in this respect as it refers to incorporating exchange and non-exchange markets into one definition without recognizing that the exchange markets may represent more than one market. *See* Adopting Release, *supra* note 5, at 80,667.

37. *See* §6.

38. Rule 902(i)(1)(ii)(B)(2). Thus, if a U.S. broker acting for a U.S. customer places by telephone or telephone facsimile an order for execution on the DOSM with a foreign broker, the transaction would be deemed offshore. The acceptance by the Commission of transactions by U.S. persons executed through the facilities of a DOSM as an offshore transaction, if not pre-arranged, reflects the Commission's pragmatic approach to the concept of "territoriality."

cal trading floor of an established securities exchange," as distinguished from the broader term DOSM.[39] The Rule requires that such transactions take place on the floor of a stock exchange which would appear to preclude transactions on an exchange using a screen based system of market makers rather than a trading floor.

To be effected on a DOSM, the sale must be executed outside the United States under the auspices of and supervision of the market by or through a member of such market or other person authorized to effect such sales thereon.[40] Trades executed between sessions are deemed to be on that market if reported to the exchange and included in exchange trading volume.[41] If the foreign exchange has a linkage with the U.S. exchange, whether the transaction is deemed to be offshore will be determined as such linkages are developed in the future based on the nature of the linkage, the procedures used for order routing, and the manner in which the linkage is used. The only relevant current linkage, that between the Montreal and Boston Stock Exchanges, provides at best only supplemental execution capability. As a result, most orders are executed in the market in which they are placed. The Commission, accordingly, will treat an order placed on the Montreal Exchange but executed on the Boston Exchange as one deemed to have been executed on the Montreal Exchange.[42]

A U.S. person permitted to purchase securities of foreign issuers under certain circumstances pursuant to Regulation S (e.g., if issued in reliance on the category 1 safe harbor) can effect a transaction offshore only if it maintains an offshore presence, but such presence can consist of a single employee. In order for a transaction off an exchange to be "offshore," the offer must be made to a person not in the United States and the buyer must be outside the United States at the time the order is originated.[43] The U.S. person cannot appoint a foreign agent to receive offers for it, but can[44] place the order through an authorized employee located outside the United States without regard to where it makes the investment decision leading to the transaction. If the buyer is an investment company, the order to buy could be placed by an employee of the investment company or its investment adviser provided that such an employee places the order while outside the United States.[45] If a U.S. person has a discretionary account with a foreign broker-dealer or investment adviser, the sale to the fiduciary, although for the account of the U.S.

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39. Rule 902(i)(1)(B)(1).

40. Adopting Release, *supra* note 5, at 80,667.

41. *Id.* at 80,667 n.41.

42. *Id.*

43. Rule 902(k)(1)(A).

44. *See* Adopting Release, *supra* note 5, at 80,666-67.

45. *Id.* Similarly, a U.S. institutional investor that organizes a foreign entity to permit it to purchase offshore distributions as a non-U.S. person will have to keep at least one employee offshore to place buy orders.

person, would not be a sale to a U.S. person.[46] Such a fiduciary, nonetheless, would be acting as the buyer's agent in placing the order or effecting the transaction. Query, whether such a transaction is an offshore transaction since the buyer is not offshore at the time the order is placed? Although the question of who is a U.S. person and whether the transaction is offshore are two separate questions, to the extent Regulation S is based on the expectations of the parties as to the governing law it would be an exercise in sophistry not to regard the fiduciary as the purchaser under these circumstances. Unsolicited buy orders transmitted from the United States and received by dealers outside the United States are not "offshore."[47] The requirement that execution and delivery take place outside the United States, included in the original proposals, was dropped from Regulation S as adopted.

To the limited extent that U.S. persons can be purchasers in offshore distributions without affecting the safe harbor, including situations in which affiliates of U.S. institutional investors are established as non-U.S. entities, there is a related problem of how such persons can become aware of offshore opportunities without there being any directed selling efforts in the U.S. For resales to Rule 144A qualified institutional buyers, however, there will be no problem since they can purchase in an onshore transaction and the seller can rely on the Rule 144A exemption even if the securities are within a Regulation S restricted period.[48] In such event, the buyer has acquired restricted securities under Rule 144.[49] If one of the distributors buys a tranche of the offshore distribution and resells it in the United States pursuant to Rule 144A, or if the security otherwise makes its way into a Rule 144A U.S. trading system such as the NASD's PORTAL Market,[50] there will be no directed selling effort problem.[51] A foreign broker-dealer, however, in making recommendations to a prospective Rule 144A buyer in the United States could recommend the securities only under very restricted circumstances in accordance with Rule 15a-6 without being registered as a broker-dealer.[52] In such event, the

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46. *Id.* at 80,677. The provisions of Rule 902(o)(2), which provide that professional U.S. fiduciaries acting on a discretionary basis for non-U.S. persons are non-U.S. persons, do not work in reverse to make professional foreign fiduciaries U.S. persons as to discretionary accounts managed for U.S. persons; hence, the sale to such foreign professional fiduciaries is a sale to a non-U.S. person.

47. Proposing Release, *supra* note 3, at 89,234.

48. The offering restrictions preclude resales in the United States or to U.S. persons unless the securities are registered or exempt from registration under the Securities Act. Rule 902(h)(2). Rules 144A(b)-(c) provide an exemption for such resales. The ability to resell in the United States pursuant to Rule 144A during the restricted period is a dramatic departure from prior law.

49. Rule 144A Adopting Release, *supra* note 4, Preliminary Note 6; Rule 144(a)(3), 17 C.F.R. §230.144(a)(3) [§230.144 hereinafter refered to as Rule 144].

50. *See* §11 for a discussion of the PORTAL Market.

51. *See infra* note 78.

52. Securities Exchange Act Release No. 27,017 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,428 (July 11, 1989) (adopting Rule 15a-6). Rule 15a-6, 17 C.F.R. §240.15a-6

transaction would have to be executed by a registered broker-dealer.[53] A foreign broker-dealer with a registered U.S. affiliate may find it practical to engage in such transactions, but Rule 15a-6 will discourage most others from soliciting such business. If the security trades on a foreign stock exchange or in a designated offshore securities market, any U.S. person could purchase these securities which were initially distributed pursuant to Regulation S in such aftermarket. If, however, the security is in a Regulation S restricted period, and the seller or the broker acting on its behalf knows that the transaction has been pre-arranged with a buyer in the United States, it will not be deemed an offshore transaction.[54]

[b] *Directed Selling Efforts*

Directed selling efforts include any activity undertaken by the issuer, the distributor, an affiliate of any of them, or any person acting on their behalf in connection with an issuer and distributor safe harbor.[55] For the seller or an affiliate of or person acting for the seller, any effort made in connection with a resale safe harbor is encompassed.[56] A restricted, direct selling effort includes any effort 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."[57] The following excerpt from the Adopting Release is relevant:[58]

> Under the issuer safe harbor, directed selling efforts in the United

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[hereinafter "Rule 15a-6"].

53. If a foreign dealer chooses to conduct its U.S. business through a registered U.S. affiliate, as many of them do, such registration does not extend to the activities of personnel of the parent located outside the United States. The parent would have to register with the Commission in order to conduct business directly in the United States. In addition, a broker-dealer operating offshore, but soliciting transactions from U.S. investors in the United States by phone or otherwise, is subject to the broker-dealer registration provisions. Rule 15a-6 is a very limited conditional exemption from this general scheme. A foreign broker-dealer may furnish research reports to major U.S. institutional investors under limited and restricted circumstances. The Rule also allows direct solicitation of major and other institutional investors provided a registered U.S. dealer effects the transaction. Such transactions, however, are subject to many restrictions that include, for institutional investors that are not in the major category, the participation of an associated person of a U.S. registered dealer in all oral conversations with the institutional investor. A major institutional investor is one that has total assets of $100 million or more. The Rule also permits a foreign broker-dealer to solicit and effect transactions with a registered broker or dealer, whether such registered a broker-dealer is acting as a principal or as an agent, or a bank acting as a broker-dealer. The restrictions and conditions of Rule 15a-6 are so numerous and onerous it is unlikely that they will dramatically affect the manner in which foreign broker-dealers sell securities to U.S. investors or the manner in which U.S. institutional investors access the market for foreign securities. *See generally* Securities Exchange Act Release. No. 27,017, *supra* note 52.

54. Rule 902(i)(1)(B).

55. Rule 903(b).

56. Rule 904(b).

57. Rule 902(b).

58. Adopting Release, *supra* note 5, at 80,668 (emphasis added).

> States may not be made during the period the issuer, the distributors, their respective affiliates or persons acting on behalf of any of the foregoing, are offering and selling the securities and, for offerings under the second and third safe harbor categories, *during the restricted period as well.*

The proscribed market conditioning includes: mailing printed material relating to the offering to U.S. investors, conducting promotional seminars in the United States, or placing advertisements with radio or television stations broadcasting into the United States.[59] The Adopting Release describes directed selling efforts as follows:[60]

> "Directed selling efforts" are those activities that could reasonably be expected, or are intended, to condition the market with respect to the securities being offered in reliance upon the Regulation. This provision precludes, inter alia, marketing efforts in the United States designed to induce the purchase of the securities purportedly being distributed abroad. Activities such as mailing printed material to U.S. investors,[n. 49][61] conducting promotional seminars in the United States,[n. 50][62] or placing advertisements with radio or television stations broadcasting into the United States or in publications with a general circulation in the United States, which discuss the offering or are otherwise intended to condition, or could reasonably be expected to condition, the market for the securities purportedly being offered abroad, constitute directed selling efforts in the United States.

The Rule specifically precludes one from placing an advertisement relating to the offering in a publication, "with a general circulation in the United States."[63] A publication with a general circulation in the United States is one printed primarily for distribution in the U.S or that had during the preceding 12 months an average circulation in the U.S. of 15,000 or more per issue.[64] If the publication is published primarily for distribution outside the United States and has a separate U.S. edition that separately meets the definition of a publication with a general circulation in the United States, only the U.S. edition will be considered such a publication if the foreign publication (excluding the United States edition) would not be a U.S. publication under the general definition.[65] The

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59. *Id.*

60. *Id.* (footnotes from original text included).

61. [n.49] *Cf.* In the Matter of First Maine Corp., 38 SEC 882 (1959) (Advertisements including information regarding prospective offerings violated Section 5(c) of the Securities Act); SEC v. Commercial Investment and Development Corporation of Florida, 373 F. Supp. 1153 (S.D. Fla. 1974) (Newsletter distributed to existing shareholders touting a proposed public offering violated Section 5(c) of the Securities Act).

62. [n.50] *Cf.* SEC v. The Firestone Group, Ltd., [1969-70 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,728, 99,191 (D.D.C. 1970) (Promotional seminars conducted in violation of Section 5(c) of the Securities Act).

63. Rule 902(b)(1).

64. Rule 902(k).

65. Rule 902(k)(2).

advertisement under such circumstances can appear in the home publication provided it does not appear in the U.S. publication. In this regard, the Adopting Release states as follows:[66]

> Publications with a general circulation in the United States, as defined in the Regulation, include all publications printed primarily for distribution in the United States, and all publications that, on average during the preceding 12 months, have had a circulation in the United States of 15,000 copies or more per issue. Where a foreign publication produces a separate edition that in itself has a general circulation in the United States, only the U.S. edition will be considered a publication with a general circulation in the United States if the affiliated non-U.S. editions together do not meet the definition when the U.S. edition is disregarded.

In any event, a publication necessary to meet the requirements of foreign or U.S. law, or under the rules and regulations of a U.S. or foreign regulatory or self-regulatory authority, will not be deemed "directed selling efforts" if it includes no more than is legally required and includes a statement that the securities have not been registered under the Securities Act and cannot be offered or sold in the United States or to a U.S. person unless registered or pursuant to an applicable exemption.[67] Regulation S as adopted also permits certain tombstone ads to appear in certain publications with a general circulation in the United States without being deemed "directed selling efforts."[68] The publication's U.S. circulation must be less than 20% of its aggregate circulation in and out of the United States. The tombstone ad must include a legend similar to that required for legally required publications[69] and include only limited information comparable, but not identical, to Rule 134.[70] The following excerpts from the Adopting Release are pertinent:[71]

> The definition of directed selling efforts specifically excludes several forms of advertisements. First, an advertisement will not be deemed a directed selling effort under the Regulation if publication of the advertisement is required by foreign or U.S. law or the rules or regulations of a U.S. or foreign regulatory or self-regulatory authority, such as a stock exchange, provided that the advertisement contains no more information than legally required and includes a statement to

66. Adopting Release, *supra* note 5, at 80,668.

67. Rule 902(b)(2).

68. Rule 902(b)(4).

69. *See supra* note 67.

70. The information is limited to: (a) the issuer's name; (b) the amount and title of securities offered; (c) a brief description of the issuer's business; (d) the price of the securities; (e) the yield of debt securities; (f) name and address of person placing advertisement and their participation in the distribution; (g) the names of the managing underwriters; (h) dates, if any, of commencement and conclusion of sales; (i) if a rights offering, subscription ratio, record date, subscription price, dates on which rights were issued and expire; and (j) any legend required by law or any foreign or U.S. regulatory or self-regulatory authority.

71. Adopting Release, *supra* note 5, at 80,669 (footnotes from original text included).

the effect that the securities have not been registered under the Securities Act and may not be offered or sold in the United States (or to a U.S. person, if the advertisement relates to an offering under the second or third issuer safe harbor categories) absent registration or an applicable exemption from the registration requirements.

Second, to ameliorate the effect of the Regulation on a foreign publication's advertising practices where the United States accounts for a limited portion of its circulation, the definition of directed selling efforts excludes tombstone advertisements in a publication if less than 20% of its circulation, calculated by aggregating its U.S. and comparable non-U.S. editions,[n. 55][72] is in the United States. To qualify, a tombstone advertisement must: (i) include a legend to the effect that the securities have not been registered under the Securities Act and may not be offered or sold in the United States (or to a U.S. person, if the advertisement relates to an offering under the second or third issuer safe harbor categories) absent registration or an applicable exemption from the registration requirements; and (ii) include no more information than: the issuer's name; the amount and title of the securities being sold; a brief indication of the issuer's general type of business; the price of the securities; the yield of the securities, if debt securities with a fixed (non-contingent) interest provision; the name and address of the person placing the advertisement and whether such person is participating in the distribution; the names of the managing underwriters; the dates, if any, upon which the sales commenced and concluded; whether the securities are offered by rights issued to security holders and, if so, the class of securities entitled to subscribe, the subscription ratio, the record date, the dates (if any) upon which the rights were issued and expired, and the subscription price; and any legend required by law or any foreign or U.S. regulatory or self-regulatory authority.[n. 56][73]

Whether the dissemination in the United States of broker-dealer's quotations for securities offered offshore in reliance on Regulation S constitutes directed selling efforts will be determined "on an individual interpretative basis."[74] Quotations in the PORTAL market will not be deemed directed selling efforts.[75] A third party system that distributes quotations of foreign broker-dealers primarily in foreign countries are not deemed "directed selling efforts" if: (1) securities transactions cannot be executed

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72. [n.55] The Financial Times, for example, publishes an international edition that circulates in the United States and a "comparable" U.K. edition. The U.K. and international editions are comparable in that the only differences between them are that pages of news items of primarily local interest in the U.K. and multi-page prospectuses directed solely to U.K. residents are removed from the international edition and minor textual changes are made from the U.K. edition to clarify references for international readers. Thus, the circulation of the international edition and the circulation of the U.K. edition would be aggregated.

73. [n.56] *See* Rule 902(b)(4). Such information is similar to information that would be permitted for advertisements made in compliance with Securities Act Rule 134.

74. Adopting Release, *supra* note 5, at 80,671.

75. *Id.*

with persons in the United States through the system, and (2) participants in the offering and foreign broker-dealers and other participants in the system do not initiate contacts with U.S. persons or persons within the United States beyond those contacts exempted under Rule 15a-6.[76] The following excerpts from the Regulation S Adopting Release are pertinent:[77]

> The dissemination in the United States of a broker-dealer's quotations for a security being offered and sold in reliance on the Regulation could be deemed a directed selling effort. Questions regarding this aspect of "directed selling efforts" typically will be decided on an individual interpretive basis.[n. 71][78] Current U.S. distribution of foreign broker-dealers' quotations by third-party systems, e.g., systems operated by foreign marketplaces or by private vendors, that distribute such quotations primarily in foreign countries will not be deemed directed selling efforts or an offer, provided that: (i) securities transactions cannot be executed between foreign broker-dealers and persons in the United States through the systems; and (ii) the issuer, distributors, their respective affiliates, persons acting on behalf of any of the foregoing, foreign broker-dealers and other participants in the systems do not initiate contacts with U.S. persons or persons within the United States, beyond those contacts exempted under Rule 15a-6.[n. 72][79] The direct dissemination of a foreign market maker's quotations to U.S. persons or persons within the United States, such as through a private quotation system controlled by a foreign broker-dealer, will, consistent with Rule 15a-6, be viewed as both an offer and a directed selling effort under Regulation S given that such dissemination is done directly and exclusively for the purpose of inducing purchases of the securities.

There is much interpretative advice that appears in the Releases rather than the Regulation about what will or will not be construed to be "directed selling efforts." The distribution of routine product advertising, normal communications between an issuer and its stockholders, and the dissemination of routine information of the type normally published by a company and unrelated to securities selling effort generally would not be considered directed selling efforts.[80] Press releases regarding financial results or the occurrence of material developments relating to the issuer

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76. Rule 902(b)(6). *See also* Rule 15a-6, *supra* note 52.

77. Adopting Release, *supra* note 5, at 80,671 (footnotes from original text included).

78. [n.71] Quotations on the PORTAL system will not be deemed to result in directed selling efforts for purposes of Regulation S.

79. [n.72] *See* Rule 902(b)(6). In the context of the broker-dealer registration requirements, Exchange Act § 15(a)(1), 15 U.S.C. § 78(o)(a)(1), the staff has given assurances that enforcement action for failure to register would not be recommended when market makers' quotations are merely collected and distributed in the United States by a foreign exchange and substantial U.S. contacts or solicitations of U.S. investors are lacking. *See* Exchange Act Release No. 27,017, 54 Fed. Reg. 30013, 30018 n.63 and accompanying text, (July 11, 1989).

80. Adopting Release, *supra* note 5, at 80,670.

generally are not deemed to be directed selling efforts.[81] If, however, an issuer without a history of disseminating routine corporate information suddenly undertakes such activities or commences product advertising shortly before or during an offshore distribution, "the activities might constitute directed selling efforts."[82] The Adopting Release is informative in this regard:[83]

> The Regulation . . . is not intended to inhibit routine activities conducted in the United States for purposes other than inducing the purchase or sale of the securities being distributed abroad, such as routine advertising and corporate communications.[n. 61][84] The dissemination of routine information of the character and content normally published by a company, and unrelated to a securities selling effort, generally would not be directed selling efforts under the Regulation. For example, press releases regarding the financial results of the issuer or the occurrence of material events with respect to the issuer generally will not be deemed to be "directed selling efforts."[n. 62][85] Similarly, the Regulation is not intended to limit or interfere with news stories or other bona fide journalistic activities, or otherwise hinder the flow of normal corporate news regarding foreign issuers. Access by journalists for publications with a general circulation in the United States to offshore press conferences, press releases and meetings with company press spokespersons in which an offshore offering or tender offer is discussed need not be limited where the information is made available to the foreign and U.S. press generally and is not intended to induce purchases of securities by persons in the United States or tenders of securities by U.S. holders in the case of exchange offers. A Preliminary Note to such effect has been added to the Regulation as adopted.

Literally, the restrictions on directed selling efforts would preclude selling efforts in connection with a concurrently registered or Regulation D offering in the United States. The proposing Release, however, assures that this is not so, stating: "Legitimate selling activities carried out in the U.S. in connection with an offering of securities registered under the Securities Act or exempt from registration . . . would not constitute directed selling efforts with respect to offers and sales made under Regulation

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81. *Id.*

82. *Id.*

83. *Id.* (footnotes from original text included).

84. [n.61] *Cf.* Securities Act Release Nos. 4697, 29 Fed. Reg. 7317 (May 28, 1964), and 5009, 34 Fed. Reg. 16,870 (Oct. 7, 1969) (addressing the Commission's view that Section 5(c) of the Securities Act is not intended to restrict normal communications between an issuer and its stockholders).

85. [n.62] 53 Fed. Reg. 22,667. *See also* Securities Act Release Nos. 3844, 22 Fed. Reg. 8359 (Oct. 8, 1957), and 5009. However, where a company did not have a history of disseminating routine corporate communications or product advertising and disseminated such information shortly before or during an offshore offering, the activities might constitute directed selling efforts.

S."[86] This is reaffirmed in the Adopting Release.[87] The Adopting Release states generally that "legitimate selling activities" related to a registered offering or offering exempt under Sections 3 or 4 of the Securities Act will not constitute directed selling effort with respect to offers and sales made under Regulation S.[88] This would include selling activities in connection with Rule 144A and Section 4(2) transactions.[89]

The prohibitions against directed selling efforts in the United States is not intended to restrict issuers or distributors from initiating sales communications to non-U.S. persons from the United States.[90] Activities conducted outside the United States relating to a foreign distribution not targeted for the United States such as advertising in newspapers or magazines with no general circulation in the United States; granting interviews; or conducting promotional seminars outside the United States do not constitute directed selling efforts in the United States.[91] The Adopting Release states as follows:[92]

> The Regulation generally will not interfere with activities conducted outside the United States, if such activities are legal and customary in the foreign jurisdiction. Such activities may relate to a foreign distribution[n. 65][93] or to the ordinary course of an issuer's business. In this regard, activities carried out abroad such as advertising in newspapers or magazines with no general circulation in the United States or granting interviews or conducting promotional seminars outside the United States and not targeted to the United States will not preclude reliance on the Regulation's safe harbor.

The "regulations" relating to market letters and recommendations appear in the Adopting Release and are similar to Rule 139 relating to what constitutes an "offer" for purposes of Section 5(c) with respect to domestic offerings. If the distributor or its affiliate publishes information, an opinion, or recommendation relating to a reporting company, such publication will not constitute directed selling efforts if (1) contained in a publication that is distributed with reasonable regularity in its normal course of business; (2) it includes similar information, opinions or recom-

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86. Proposing Release, *supra* note 3, at 89,131. The Proposing Release also states: "[I]t is the general view [of the staff] that exempt or registered domestic offerings and offshore offerings meeting the conditions of the proposed rules should not be integrated." *Id.* at 89,126.

87. Adopting Release, *supra* note 5, at 80,668.

88. *Id.* at 80,670.

89. *Id.*

90. *Id.* at 80,670 n.65.

91. *Id.* at 80,670.

92. *Id.* (footnote from original text included).

93. [n.65] Several commenters expressed concern that, given the prohibition against directed selling efforts, U.S. issuers or distributors would be unable to rely upon the Regulation if they initiated sales communications to non-U.S. persons from the United States. The prohibition against directed selling efforts made in the United States does not preclude such activities.

mendations in the same issue relating to a substantial number of companies in the same industry or sub-industry, or contains a comprehensive list of securities recommended by the publisher; (3) it is given no materially greater space or prominence than other securities; and (4) it is no more favorable than the opinion or recommendation published in the last issue addressing the issuer or the securities.[94] If the issuer is a non-reporting company, whether it is a "directed selling effort" will depend upon the particular facts since such information, opinions, or recommendations, "can be expected to be more significant due to the possible absence of other publicly available information about the issuer."[95] The Adopting Release states as follows:[96]

> Distribution or publication in the United States of information, opinions or recommendations concerning the issuer or any class of its securities could constitute directed selling efforts, depending upon the facts and circumstances.[n. 57][97] Directed selling efforts will not be deemed to exist, however, if the information, opinion or recommendation of a distributor or its affiliate with respect to a reporting issuer: (i) is contained in a publication that is distributed with reasonable regularity in its normal course of business, and includes similar information, opinions or recommendations in that issue with respect to a substantial number of companies in the issuer's industry or sub-industry, or contains a comprehensive list of securities recommended by such entity; (ii) is given no materially greater space or prominence in such publication than that given to securities of other issuers; and (iii) with respect to an opinion or recommendation, is no more favorable to the issuer than the opinion or recommendation published by the entity in its last issue addressing the issuer or its securities.[n. 59][98] When the issuer is not a reporting issuer, the effect on the market of publication or distribution of information, opinions or recommendations about the issuer or its securities can be expected to be more significant due to the possible absence of other publicly available information about the issuer. Distributors and their affiliates should exercise even greater caution in publication or distribution of information, opinions or recommendations concerning non-reporting issuers or their securities.

The Adopting Release states that an, "isolated, limited contact with the United States generally will not constitute directed selling efforts, "but could constitute an offer in the United States that would keep the

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94. *Id.* at 80,669.

95. *Id.*

96. *Id.* (footnotes from original text included).

97. [n.57] Such activity also could be deemed an offer in the United States which would violate the offshore transaction requirement.

98. [n.59] This situation is similar to the safe harbor from Sections 2(10) and 5(c) concepts of "offer for sale" and "offer to sell" established in Rule 139 under the Securities Act, 17 C.F.R. §230.139 (1990), for brokers or dealers participating in a distribution who publish or distribute information, opinions, or recommendations about the issuer or any class of its securities.

particular transaction from being an offshore transaction.[99] What difference does it make if the failure to comply with the conditions of Regulation S involve directed selling efforts in the United States or an offer to a U.S. person? The answer to this question is again to be found in the Adopting Release and not the Regulation. Directed selling efforts in the United States by an issuer, distributor, their affiliates, or persons acting on their behalf will make the primary offering (issuer-distributor) safe harbors unavailable to any person in connection with the offering.[100] On the other hand, making an offer in the United States or to a U.S. person that does not constitute directed selling efforts will make the safe harbors unavailable for any offer or sale under Regulation S by that person, but not to other participants in the distribution.[101]

The scope of directed selling efforts under Regulation S is not coextensive with a "solicitation" under Rule 15a-6 relating to whether foreign broker-dealers have to register under the Exchange Act. Under Rule 15a-6, efforts to induce a single transaction, telephone calls to a customer and transmission of information, opinions, or recommendations to particular individuals may constitute a solicitation.[102] Although "limited activities directed at a single customer or prospective investor may be offers for the purpose of Regulation S or solicitation for purposes of Rule 15a-6, they generally will not constitute directed selling efforts for purposes of Regulation S because of their confined effect."[103] The Adopting Release has this to say about such solicitations:[104]

> As noted in the Proposals, the scope of directed selling efforts under Regulation S is not coextensive with activities constituting "solicitation," as that term is used in considering the need for registration as a broker-dealer under the Securities Exchange Act of 1934.[n. 68][105] In a recent Release regarding the applicability of U.S. broker-dealer registration requirements to foreign entities, and adopting Exchange Act Rule 15a-6,[n. 69][106] the concept of solicitation was defined by the Commission as "including any affirmative effort by a broker or dealer intended to induce transactional business for the broker-dealer or its affiliates."[n. 70][107] Among the examples of solicitation noted in that Release were efforts to induce a single transaction, telephone calls from a broker-dealer to a customer encouraging use of the broker-dealer to effect transactions, and transmission of information, opinions, or recommendations to particular investors in the United States, whether directed at individuals or groups. While limited activities directed at a single customer or prospective investor may be offers for

99. Adopting Release, *supra* note 5, at 80,670.
100. *Id.* at 80,681.
101. *Id.*
102. *See* Rule 15a-6, *supra* note 52.
103. Adopting Release, *supra* note 5, at 80,671.
104. *Id.* at 80,670 (footnotes from origianl text included).
105. [n.68] 15 U.S.C. §§ 78a *et seq.*
106. [n.69] 17 C.F.R. §240.15a-16.
107. Securities Exchange Act Release No. 27,017, *supra* note 52.

> purposes of Regulation S or solicitation for purposes of Rule 15a-6, they generally will not constitute directed selling efforts for purposes of the Regulation because of their confined effect.

The "directed selling efforts" definition does not preclude investigation of investment opportunities offered and sold offshore. Bona fide site visits to real estate, plants, or other facilities located in the United States and tours thereof conducted for a prospective investor by an issuer, distributor, any of their respective affiliates, or a person acting on behalf of any of the foregoing, are not directed selling efforts. The Rule, as adopted, specifically provides that directed selling efforts do not include bona fide visits for prospective investors of the issuer's physical facilities in the United States.[108] The Rule also complements other provisions designed to permit U.S. broker dealers and other professional fiduciaries who are non-U.S. persons as to purchases for discretionary accounts held for the benefit of non-U.S. persons by providing that contact with such persons "solely in their capacities as holders of such accounts" are not to be deemed "directed selling efforts."[109]

The issuer, distributor, and their affiliates are precluded from engaging in directed selling efforts during the entire restricted period.[110] The resale safe harbor restricts directed selling efforts in the United States only by the selling security holder and persons acting for him.[111] If, however, the resale takes place during the restricted period, the issuer and distributor are also precluded from engaging in directed selling efforts. Their selling efforts, however, presumably, do not affect the availability of the resale safe harbor, but may result in making the issuer-distributor safe harbor unavailable for the distribution notwithstanding the fact it has already been completed. Although the concept of directed selling efforts leaves plenty of room for normal financial public relations, as is described above, there is a line that cannot be crossed, especially with regard to a non-reporting issuer.[112] Since the restricted period for equity securities (12 months)[113] is also longer than any other restricted period, the most stringent limitations on directed selling efforts are also applicable for the longest period of time. The issuer and distributor completing an offshore distribution in reliance on Regulation S should be aware that the restrictions on directed selling efforts continue throughout the restricted period.

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108. Rule 902(b)(5).
109. Rule 902(b)(3).
110. *See supra* note 58 and accompanying text.
111. *See* §6[a].
112. *See* text accompanying notes 96-98.
113. *See* §5[d].

§5 THE ISSUER-DISTRIBUTORS SAFE HARBORS

[a] *Category 1 — Offerings of Foreign Securities and Overseas Directed Offerings*

An offshore distribution can be made by certain foreign issuers, and in one limited situation by a domestic issuer, in reliance on Regulation S without any restrictions other than the general conditions. Issues in category 1 are as follows:

> 1) A distribution by any foreign issuer of any security if there is no substantial U.S. market interest ("SUSMI") in the class of securities to be offered or sold, if equity securities are offered or sold; no SUSMI in the underlying securities if warrants are offered or sold; no SUSMI in either the convertible securities or underlying securities if convertible securities are offered or sold; and no SUSMI in its debt securities, if debt securities are offered or sold.[114] The Proposing Release indicated that it is appropriate to include these securities in Category 1 because of, "the lesser probability of flowback where there is no pre-existing U.S. market interest for the securities of a foreign issuer . . . ."[115]
>
> 2) An "overseas directed offering" ("ODO") is also in category 1, without regard to whether there is a SUSMI.[116] An ODO, as is described below, includes one limited type of offering by a U.S. issuer.
>
> 3) An offering of securities backed by the full faith and credit of a foreign government.[117]
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> 4) Securities offered and sold by the issuer or its affiliates to employees pursuant to an employee benefit plan established and administered in accordance with the law of a country other than the United States, customary practices and documentation of such a country and that meet a number of other conditions.[118]

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114. Rule 903(a)-(b), 903(c)(1)(i).

115. Proposing Release, *supra* note 3, at 89,136. *See also id.* at 89,125 n.19 and accompanying text (resales abroad under Release 4708 permitted where issuers were not reporting companies "and had no active market for their securities in the United States"); *Id.* at 89,125 n.16 (sales to U.S. citizens in France permitted under Release 4708 where no "issuers had an active public market for its securities in the United States" other than short-term debt); *Id.* at 89,125 n.21 and accompanying text (resales on Bourse permitted under Release 4708 in "absence of an active market for the securities in the United States").

116. Rule 903(a)-(b), 903(c)(1)(ii).

117. Rule 903(a)-(b), 903(c)(1)(iii). The inclusion of these securities upon adoption of the Regulation apparently signifies the Commission's determination either that these securities are not likely to flow to the United States after issuance offshore, or that such flowback is not a matter of great concern from a policy point of view. Both premises are questionable. The sale of foreign sovereign debt securities involves typical investor protection issues. Historically many foreign sovereigns have defaulted on debt issues. There is also considerable demand for foreign sovereign debt securities in the United States.

118. Rule 903(a)-(b), 903(c)(1)(iv). The conditions include: (a) issuance in compensatory circumstances for bona fide services not rendered in connection with the offer and sale of securities in a capital-raising transaction; (b) the interests in the plan are transferable only by will or the laws of descent or distribution; (c) the issuer takes reasonable steps to

A foreign issuer includes a foreign government[119] and a national of any foreign country.[120] A corporation or other entity incorporated or organized under the laws of a foreign jurisdiction is a foreign corporation unless 50% of its outstanding voting securities are held of record[121] by persons with a U.S. address *and* any of the following factors are present: (a) more than 50% of the assets of the issuer are located in the United States; (b) the business of the issuer is administered principally in the United States; or (c) the majority of the executive officers OR directors are U.S. citizens or residents.[122] An issuer organized under the laws of the United States is not a foreign issuer even if 100% of its stock is owned by non-U.S. citizens or residents. Query whether the sale of stock by a foreign issuer, the proceeds from which are to be invested in a wholly owned U.S. subsidiary, would be deemed a technical compliance to which Regulation S would not provide a safe harbor under Preliminary Note 2 because it is a scheme to avoid the registration provisions?[123]

Regulation S includes specific criteria for determining whether there is a substantial U.S. market interest ("SUSMI") in a security. There is a SUSMI with respect to a class of equity securities of a foreign issuer if (1) the U.S. market for such security (which includes the securities exchanges and inter-dealer quotation systems)[124] was the single largest market for such class of security during the issuer's prior fiscal year (or since the issuer's incorporation, if a shorter period) or (2) if 20% or more of trading in the class of equity securities during such period occurs in the U.S. market as defined for the purpose of (1) above *and* less than 55% of trading in such securities took place during that period through the facilities of the securities markets of a single foreign country.[125] If debt securities are

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preclude offers and sales of interests in the plan to U.S. residents other than employees on temporary assignment in the United States; and (d) documentation used offering interests in the plan include a statement that the securities have not been registered under the Securities Act and cannot be sold in the United States unless registered or an exemption from registration is available.

119. Rule 902(f)(1)(i). A foreign government includes the government of any foreign country or of any political subdivision of a foreign country provided such person would qualify to register securities under Schedule B of the Securities Act. Rule 902(e). Since Section 7 of the Securities Act defines foreign government that can use Schedule B essentially in the same fashion and Rule 405 adopted under the Securities Act uses the identical definition, presumably, the reference to Schedule B is to incorporate no-action letters relating to what constitutes a political subdivision.

120. Rule 902(f)(1)(ii).

121. Held of record is determined in accordance with Rule 12g5-1, 17 C.F.R. § 240.12g5-1 (1990).

122. Rule 902(f)(1)(iii), 902(f)(2).

123. *Cf.* Rule 140, 17 C.F.R. § 230.140 (1990), which provides that an issuer which offers its securities for the purpose of purchasing the securities of another issuer is regarded as being engaged in the distribution of the securities of the other issuer for the purpose of defining an underwriter under Section 2(11) of the Securities Act.

124. Inter-dealer quotation systems include the pink sheet and other inter-dealer markets in the United States and are not limited to automated inter-dealer quotation systems.

125. Rule 902(n)(1).

offered, there is a SUSMI if *all* of the debt securities, non-convertible preferred stock not entitled to participate in residual earnings or assets, and certain asset backed securities of the issuer are held of record by 300 or more U.S. persons, *and* $1 billion or more in principal amount of all such debt securities is held of record by U.S. persons, *and* 20% of the outstanding debt calculated in the same manner is held of record by U.S. persons.[126] The safe harbor is available to the foreign issuer if it "reasonably believes" at the commencement of the offering that (a) there is no SUSMI in the class of securities to be offered or sold if equity securities are offered or sold; (b) there is no SUSMI in its debt securities if debt securities are offered or sold; (c) there is no SUSMI in the underlying securities if warrants are offered or sold; and (d) there is no SUSMI in either the convertible security or the underlying security if a convertible security is offered or sold.[127] The criteria for determining SUSMI come close to requiring that the U.S. be the primary market. As to debt, there would be no SUSMI if there was less than $1 billion of debt even if the U.S. were the only market. The Commission's purpose in using SUSMI as a criterion for category 1 is to assess the likelihood of flowback.[128] Whether SUSMI exists is critically important because it is a factor in determining which safe harbor category an issuer is entitled to use. In addition to the latitude allowed for trading which is not regarded as substantial, the use of "record ownership" in Rule 902(n)(2) may not fully advance the objective of identifying a significant trading market. This is so since, particularly in the case of foreign issuers, many securities owned by U.S persons may be held of record by foreign depositaries, fiduciaries and the like. The Commission's assumptions about SUSMI and flowback of securities may or may not prove to be correct but obviously are not cautious ones.

An "overseas directed offering" ("ODO") is defined to include an offering by a foreign issuer, "directed into a single country other than the United States to the residents thereof," and that is made in accordance with local laws and customary practices and documentation of such country.[129] The Rule as adopted differs from the proposals that would have limited an ODO to corporations incorporated or organized under the laws

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126. Rule 902(n)(2). The amount included for preferred stock is based on the greater of liquidation preference or par value and the amount for asset backed securities is based on the principal amount or principal balance of the securities. Rule 902(n)(2)(ii). Commercial paper exempt under Section 3(a)(3) of the Securities Act is not included in making such determination. Rule 902(n)(3). A 1987 no-action letter may have signaled this position. In French Privatization Program, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,439, at 77,434 (April 17, 1987), the staff granted a no-action letter under Release 4708, noting that "none of the issuers will have an active public market for its securities in the United States at the time of the privatization other than a market for its non-convertible debt securities with maturities less than one year." The Commission apparently concluded that the market for short term debt securities is distinct from the market for other debt securities.

127. Rule 903(c)(1)(i).

128. *See* Proposing Release, *supra* note 3, at 89,136.

129. Rule 902(j)(1).

of the country in which the offering was made. Under the Rule as adopted, a Japanese issuer, for example, could make an offering in reliance on the category 1 safe harbor if limited to Switzerland. The Rule also includes as an ODO an offering of non-convertible debt securities, non-convertible, non-participating preferred stock, or certain asset backed securities of a U.S. issuer provided the principal and interest of the securities (or par value, as applicable) are not denominated in U.S. dollars and are neither convertible into nor linked to U.S. dollars (other than through swaps that are commercial in nature) in a manner that in effect converts the securities to U.S. dollar-denominated securities. Thus, a U.S. issuer could offer non-convertible debt securities in reliance on the category 1 safe harbor if such securities were offered exclusively in the United Kingdom and the principal and interest was denominated in sterling. The Reproposing Release distinguished ODO's from a multijurisdictional offering and noted that if, "a substantial portion of the offering would be immediately resold outside the domestic market," it would not conform with the definition.[130] Although ODO's were defined somewhat differently under the Proposals, the qualification remains appropriate.

The Commission in the Proposing Release abandoned the qualification made in Release 4708 that the Release was not applicable to distributions made in Canada. Regulation S treats distributions in Canada on the same basis as other distributions made outside the United States.[131] The absence of a "substantial U.S. market interest" and the restrictions on directed selling efforts in the U.S. are the means Regulation S employs to deal with the prior concerns that Canada might be used as a conduit for the sale of unregistered securities in the United States. The Proposing Release qualified the category 1 safe harbor, however, by noting that, "trading of a substantial amount of such securities in the United States shortly after they had been offered overseas would indicate a plan or scheme to evade the registration provisions,"[132] and Preliminary Note 2 to Regulation S provides that the safe harbor is not available notwithstanding technical compliance if the transaction is part of a plan or scheme to evade the registration provisions. The category 1 safe harbor is unique in certain respects, including the following:

> 1. It does not preclude the sale of such issue to a U.S. person provided the transaction is offshore.[133] The general conditions[134] preclude an offer from being made in the United States and preclude directed selling efforts in the United States. They do not preclude a sale to U.S. persons if the offer and sale take place outside the United States. The transactional restrictions set forth the restrictions on sales to U.S. persons and, as is discussed below, transactional restrictions

130. Reproposing Release, *supra* note 3, at 80,214-15.
131. Proposing Release, *supra* note 3, at 89,129 n.64.
132. *Id.* at 89,136.
133. *See* §4[a] for a discussion of offshore transactions.
134. *See* §4 for a discussion of the general conditions.

are not applicable to a distribution of securities within the category 1 safe harbor. In an ODO, U.S. persons would be effectively precluded from purchasing the security since they are not residents of the country in which the offering is made. A U.S. citizen residing in the country in which the ODO is made, could purchase such securities as that person is not a U.S. person for purposes of Regulation S.[135]

2. Neither the issuer nor the distributor has to adopt any offering or transactional restrictions. However, there may be a "catch-22" since a distribution in Canada, for example, may result, if there are no restrictions on resales to U.S. persons, in an immediate market developing in the United States. The contention could then be made that there was a scheme to evade the registration provisions.[136] In an ODO, which most Canadian offerings would be, there may be SUSMI, in which event immediate resales in the United States markets appear likely. If the Commission adopts proposed Forms F-9 and F-10 for certain Canadian issuers, such issuers may want to consider registering the offering in the United States.[137]

Notwithstanding the fact that once the distribution is completed there is no specific restriction on resales in the United States, the combined effect of Sections 4(1) and 4(3) may preclude any dealer from selling the security without registration or an appropriate exemption in the United States for 40 days.[138] Since it may be difficult to complete an offshore transaction with a U.S. person,[139] the advantages of category 1 are meaningful primarily because the absence of offering and transactional restrictions eliminate some of the inefficiencies of a category 2 offering and, in the context of an ODO of equity securities by a non-reporting foreign issuer with SUSMI, it avoids the onerous category 3 restrictions.[140] Similarly, to the extent a non-reporting U.S. issuer can make an ODO, it will avoid the category 3 restrictions.

[b] *Offering Restrictions*

Offerings by issuers or distributors not within the category 1 safe harbor are subject to offering and transactional restrictions imposed on the issuer, the distributors, and affiliates of the issuer. Offers and sales within the Rule 904 resale safe harbor are subject to transactional restric-

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135. *See* §3.

136. *See supra* note 132.

137. *See* Securities Act Release No. 6841 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,432 (July 24, 1989).

138. This may be true because the Section 4(1) exemption is for transactions not involving an issuer, underwriter, or *dealer* and the Section 4(3) dealer exemption does not become effective until 40 days after the first date the security was bona fide offered by or through an underwriter. Although the Section 4(3) forty-day exclusion from the dealer exemption generally has not been applied to securities issued pursuant to an exemption, it is not clear that Regulation S is an exemption for this purpose. *Cf.* Jerome L. Coben, SEC No-Action Letter (March 12, 1986).

139. *See* §4[a].

140. *See* §5[d].

tions imposed on the investor-purchasers and securities professionals involved in such transactions. The offering restrictions are procedures that the issuer and distributors must follow to assure compliance with the transactional restrictions during the appropriate restricted period. The transactional restrictions vary depending on the safe harbor category and the type of securities. The offering restrictions consist of the following:

> 1. The written agreement of every distributor (underwriters and dealers)[141] participating in the distribution, "pursuant to a contractual arrangement," to offer and sell the security prior to the expiration of the applicable restricted period in compliance with the applicable transaction restrictions and other requirements of the safe harbor, or pursuant to registration or an available exemption from registration.[142]
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> 2. All offering materials and documents (other than press releases) used prior to the expiration of the applicable restricted period must include statements to the effect that the securities have not been registered under the Securities Act, cannot be offered or sold in the United States or to U.S. persons within the applicable restricted period unless the securities are registered or an exemption from registration is available.[143]
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> 3. Such statements must be included (a) on the cover or inside cover page of any prospectus or offering circular, (b) in the underwriting section of any prospectus or offering circular, and (c) in any advertisement made by the issuer or any distributor or any affiliate of or person acting on their behalf.[144] The appropriate statements may appear in summary form on the prospectus cover pages (presumably with a cross-reference to the underwriting section) and in advertisements.[145]

The restricted period during which the offering restrictions must be complied with is a period that commences with the closing of the offering or the date when first offered to persons other than distributors in reliance on Regulation S, whichever is the later, and expires after a specified period of time as provided in the appropriate transactional restriction.[146] In the case of a continuous offering, it does not commence until the lead managing underwriter certifies that the distribution has been completed.[147] In a continuous offering of non-convertible debt securities sold

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141. The term "distributor" encompasses underwriters and dealers who participate in the distribution "pursuant to a contractual arrangement." Rule 902(c). This definition is broad enough to cover the underwriting and selling groups. The term, however, does not necessarily encompass all Section 2(11) statutory underwriters. *See* Proposing Release, *supra* note 3, at 89,133.

142. Rule 902(h)(1).

143. Rule 902(h)(2).

144. Rule 902(h)(3).

145. *Id.*

146. Rule 902(m).

147. *Id.*

in identifiable tranches, the period commences upon completion of the distribution of each tranche as determined and certified by the managing underwriter.[148] In any event, so long as a distributor holds an unsold allotment, it will be deemed in the restricted period at the time of the offer or sale.[149] If the offering restrictions are applicable, and they are not complied with, the safe harbor is not available for the entire offering.[150]

[c] *Category 2 — Reporting Issuers and Debt, Preferred, and Asset-Backed Securities of Non-Reporting Foreign Issuers*

The category 2 safe harbor covers offshore debt or equity distributions by reporting issuers (U.S. and foreign). In addition, it covers debt, non-convertible, non-participating preferred, and certain asset backed issues of non-reporting foreign issuers.[151] Presumably, foreign issuers whether reporting or non-reporting will use category 2 only if they are not making an ODO and SUSMI exists with respect to the securities being offered. If an ODO, or if SUSMI did not exist, the offering is within the category 1 safe harbor.

Offerings within category 2 have the benefit of the safe harbor if: (1) the general conditions are complied with,[152] (2) the offer and sale is not made to a U.S. person for 40 days commencing from the date of closing (or date the offering commences, if sooner) or by a distributor with an unsold allotment, (3) appropriate offering restrictions as described above[153] are adopted, and (4) before the expiration of the 40-day restricted period distributors selling securities to other distributors, dealers, and persons receiving selling concessions or other remuneration deliver a confirmation or other notice advising the purchaser that it is subject to the same restrictions applicable to the selling distributor.[154] The conditions of the safe harbor are the same for debt and equity securities in this category and for debt securities of reporting and non-reporting foreign issuers. Although the offering restrictions require participants in the distribution to disclose to investors through the offering materials and documents that the securities are not registered under the Securities Act and that before the expiration of the restricted period cannot be sold in the United States or to U.S. persons, there is no specified procedure for determining whether purchasers are non-U.S. persons. The stock certificates need include no legend, and the purchasers do not have to specifically agree to comply with the transactional restrictions or certify that they are non-U.S. purchasers. The purchasers, as discussed below,[155] have a safe

148. *Id.*
149. *Id.*
150. *See* Adopting Release, *supra* note 5, at 80,681. *See also* §5[f].
151. Rule 903(1)(a)-(b), (c)(2).
152. Rule 903(1)(a)-(b). *See* §4.
153. *See* §5[b].
154. Rule 903(1)(a)-(b), (c)(2).
155. *See* §6[a].

harbor for their resales.

Although the Category 2 (and 3) transactional restrictions preclude offers or sales to a U.S. person during the restricted period,[156] sales to distributors are excluded from this prohibition. The Adopting Release explains as follows: "Offers and sales to U.S. persons who are distributors are permitted; it is not the Commission's intent to prevent U.S. persons from participating in an offshore offering as distributors."[157] This eliminates any necessity for U.S. investment banking firms to organize a foreign affiliate, although banks will do so in any event because of the Glass-Steagall Act and it is likely to be advisable for securities firms generally to organize an affiliate under local law for purposes of complying with the scheme of the host country relating to engaging in the securities business.

Regulation S includes within category 2, besides debt securities of non-reporting foreign issuers, non-convertible, non-participating preferred stock and certain asset backed securities of non-reporting foreign issuers.[158] The category 2 safe harbor, however, does not refer specifically to such securities and one deduces such securities are included within category 2 because a separate provision states in substance that such securities are debt securities for safe harbor purposes.[159] Since debt securities of a non-reporting foreign issuer are within category 2, it follows that such securities issued by a foreign issuer are within category 2. Since debt securities of a non-reporting domestic issuer are in category 3, such securities, if issued by a non-reporting U.S. issuer, are within category 3 and are debt securities in determining the applicable transactional restrictions.

The preferred stock of the non-reporting foreign issuer that is included within category 2 must be non-convertible; the holders must be entitled to a preference as to the payment of dividends *and* as to the distribution of assets on liquidation or dissolution, but cannot be entitled to participate in residual earnings or assets of the issuer.[160] Asset-backed securities: (1) include securities that represent an ownership interest in a pool of discrete assets if the assets are not generated in transactions between the issuer and its affiliates,[161] or (2) are secured by one or more assets or certificates of interest or participation in such assets and the securities by their terms provide for payments of principal and interest in relationship to payments made on assets meeting the requirements of (1) above.[162] The assets that can back the securities include notes, accounts receivables, installment sales, securities, leases or other contracts, or other assets that by their terms convert into cash over a finite period.[163]

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156. Rule 903(c)(2)(iii), (3)(ii)(A), (3)(iii)(A).
157. Adopting Release, *supra* note 5, at 80,676 n.111.
158. Rule 903(c)(4). *See* Adopting Release, *supra* note 5, at 80,675-76.
159. Rule 903(c)(4).
160. Rule 903(c)(4)(i).
161. Rule 903(c)(4)(ii)(A).
162. Rule 903(c)(4)(ii)(B).
163. Rule 903(c)(4)(ii).

A reporting company is an issuer with a class of securities registered under the Exchange Act or that files reports pursuant to Section 15(d) of the Exchange Act and has filed all required reports during a period of twelve months immediately preceding the offer or sale, or such shorter period during which it was required to file such reports.[164] There is no requirement that a company have been a reporting company for any specified period; hence, even a start-up issuer could voluntarily register a class of equity securities under Section 12(g) of the Exchange Act, become a reporting company, and bring itself within the category 2 safe-harbor. If a subsidiary of a reporting company issues debt securities that are fully and unconditionally guaranteed as to principal and interest by the parent, Regulation S treats the debt securities of the subsidiary and the guarantee as securities of a reporting issuer for purposes of the safe harbor classification and, therefore, into category 2.[165] If the parent and subsidiary are not reporting companies, the debt securities of a U.S. issuer and the guarantee are subject to the more severe restrictions of category 3.[166]

[d] *Category 3 Safe Harbor — Non-Reporting U.S. Issuers and Certain Equity Securities of Non-Reporting Foreign Issuers*

The category 3 safe harbor is available for the distribution outside the United States of all securities not covered by the other categories. By the process of omission, this includes the following offshore distributions:

1. Equity securities and debt securities offered by a U.S. issuer that is not a reporting company.

2. Non-convertible debt, non-convertible and non-participating preferred securities, and asset-backed securities of a U.S. issuer are generally category 3. Under certain prescribed and limited circumstances, however, such securities may be offered in reliance on the category 1 safe harbor in an overseas directed offering made in a single country and conforming with the criteria necessary to be classified as such an offering.[167] In addition, if non-convertible debt securities of a non-reporting U.S. issuer are unconditionally and fully guaranteed as to principal and interest by a parent that is a reporting company, such debt security would be within category 2.[168]

3. Equity securities of a foreign issuer which is not a reporting company and that has a substantial U.S. market interest. In the case of such foreign issuers, the offering would be in category 3 rather than category 1 only if the distribution is multi-jurisdictional and, therefore, not an ODO.[169] In addition, non-convertible, non-participating preferred stock of such an issuer and certain asset-backed securities of such an issuer are in category 2, although the preferred stock at least

164. Rule 902(l).
165. Rule 903(c)(5).
166. *Id.*
167. *See supra* note 129.
168. Rule 903(c)(5).
169. *See supra* note 129.

would usually be considered an equity security.[170]

The restrictions and other conditions of the category 3 safe harbor differ for debt and equity securities. In the case of debt securities, the requirements are identical with those of securities of reporting companies in terms of the 40-day restricted period, the application of the offering restrictions, and the confirmation that must be used in transactions between distributors and dealers.[171] In addition, the securities on issuance must be represented by a temporary global certificate. The global certificate is exchangeable for definitive certificates at the expiration of the 40-day restricted period. The purchaser, to receive a certificate, must certify that the securities are owned beneficially by a non-U.S. person or a U.S. person who purchased the securities in a transaction exempt from registration under the Securities Act (presumably under Rule 144A).[172]

In the case of equity securities, the restricted period during which the securities cannot be sold to U.S. persons is twelve months rather than 40 days.[173] The offering restrictions and the confirmation requirements are applicable.[174] In addition, the investor purchaser of the securities must (1) certify that he (she or it) is not a U.S. person and has not purchased for the account of a U.S. person or is a U.S. person who purchased in an exempt transaction (presumably pursuant to Rule 144A), and (2) agree to resell such securities only in accordance with the provisions of Regulation S, pursuant to registration under the Act, or pursuant to an available exemption from registration.[175] The securities of a U.S. issuer must include a legend to the effect that transfer is prohibited except in accordance with the provisions of Regulation S. The issuer must (by contract, by-laws, articles, or comparable document) refuse to transfer the securities if the sale is not made in compliance with the provisions of Regulation S.[176] If the securities are in bearer form or foreign law prevents the issuer from refusing to transfer the securities, the issuer must adopt other reasonable procedures (such as a legend on the certificate) to prevent any transfer not made in accordance with the provisions of Regulation S.[177]

The Adopting Release describes the category 3 issuer-distributor safe

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170. Rule 903(c)(4).

171. Rule 903(c)(3)(i)-(ii)(A), (iv).

172. The Reproposed Rule required certification of beneficial ownership by a non-U.S. person, "or a qualified institutional buyer as defined in Rule 144A." Reproposed Rule 905(c)(2), Rule 144A Reproposing Release, *supra* note 4, at 80,224. The Rule as adopted substitutes for the quoted language the broader language, "or U.S. person who purchased in a transaction that did not require registration under the Act." Rule 903(c)(3)(ii)(B). This language is broad enough to encompass both Rule 144A transactions and offshore resales to U.S. persons in reliance on the Rule 904 safe harbor. *See* §6[a]

173. Rule 903(c)(3)(i), (iii)-(iv).

174. Rule 903(c)(3)(ii), (iv).

175. Rule 903(c)(3)(iii)(B)(1)-(2).

176. Rule 903(c)(3)(iii)(B)(3)-(4).

177. Rule 903(c)(3)(iii)(b)(4).

harbor as follows:[178]

> As in the case of securities of reporting issuers, offerings of securities in this category are subject to the two general conditions and to offering and transactional restrictions. Offering restrictions that must be adopted for offerings of these securities are the same as for offerings of securities of reporting issuers. In contrast to offerings in the second category, more restrictive transactional restrictions to prevent flowback are applicable.
>
> In essence, the restrictive procedures are similar to those that evolved under the no-action letters involving Release 4708. The procedures adopted are essentially those included in the Reproposing Release. These distinguish between debt and equity securities, recognizing that debt securities are generally sold in institutional markets and that the likelihood of flowback is less than in the case of common equity. The category includes a restricted period of one year for equity securities and forty days for debt securities. Two types of a non-reporting U.S. issuers' securities, which would include non-convertible, non-participating preferred stock and asset-backed securities, will be subject to the same restrictions as debt securities in the third category, including a 40-day restricted period rather than a one-year restricted period. Offerings of securities of a non-reporting foreign issuer of those two types have been added to the second issuer safe harbor category.
>
> Offerings of equity securities in this category are subject to restrictions similar to those afforded no-action treatment in InfraRed Associates, Inc. Prior to the expiration of the one-year restricted period, the securities may not be sold to U.S. persons or for the account or benefit of U.S. persons (other than distributors). Purchasers of the securities (other than distributors) are required to certify that they are not U.S. persons and are not acquiring the securities for the account or benefit of a U.S. person other than persons who purchased securities in transactions exempt from the registration requirements of the Securities Act.[n. 135][179] Such purchasers are also required to agree only to sell the securities in accordance with the registration provisions of the Securities Act or an exemption therefrom, or in accordance with the provisions of the Regulation.
>
> With respect to equity securities of domestic issuers, the safe harbor requires that a legend be placed on the shares stating that transfer is prohibited other than in accordance with the Regulation. The safe harbor further requires that any issuer, by contract or a provision in its bylaws, articles, charter or comparable document, refuse to register any transfer of equity securities not made in accordance with the provisions of the Regulation. Where bearer securities are being sold, or foreign law prevents an issuer from refusing to register securities

178. Adopting Release, *supra* note 5, at 80,679-80 (footnotes from original text included).

179. [n.135] Such a certification could be made, for example, by a qualified institutional buyer who purchased in accordance with Rule 144A.

transfers, use of reasonable procedures, such as a legend, will suffice to satisfy the requirement designed to prevent transfer of equity securities other than in accordance with the Regulation.

Purchasers of debt securities offered under the third issuer safe harbor category (other than distributors) are subject to different restrictions than equity purchasers under this category. Prior to the expiration of the forty-day restricted period, the securities may not be sold to U.S. persons or for the account or benefit of U.S. persons (other than distributors). The debt securities must be represented by temporary global securities not exchangeable for definitive securities until expiration of the restricted period. Upon expiration, persons exchanging their temporary global security for the definitive security are required to certify beneficial ownership by: a non-U.S. person or a U.S. person who purchased securities in a transaction that did not require registration under the Securities Act.[n. 180][180]

Distributors selling equity or debt securities prior to the expiration of the restricted period are required to send a confirmation or other notice to purchasers who are distributors, dealers or persons receiving remuneration in connection with the sale. The notice must state that the purchaser is subject to the same restrictions on offers and sales as the distributor. Non-distributors are not required to send such a confirmation or notice.

In some respects, the restrictions of the third category as to equity securities are more restrictive than they were under Release 4708. The issuer, distributor, and its affiliates are precluded from engaging in directed selling efforts during the entire restricted period.[181] Although the concept of directed selling efforts leaves plenty of room for normal financial public relations, there is a line that cannot be crossed, especially with regard to a non-reporting issuer.[182] Since the restricted period for equity securities of a non-reporting issuer is twelve months, the issuer in effect has a twelve month period in which it must monitor its financial public relations with such restrictions in mind. Specifically, the offering restrictions will preclude the issuer for a period of one year from distributing information about the company in the United States that may be deemed a directed selling effort. Although this does not preclude the distribution of financial reports and the like, it is restrictive, and there was no similar restriction under Release 4708. Similarly, the distributors releasing market letters including recommendations will in effect have to treat the security as if in registration for a period of one year.[183]

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180. [n.136] Certification as to beneficial ownership made by a financial institution or clearing organization through which the beneficial owner holds the securities will suffice for purposes of this safe harbor.

181. *See supra* note 58.

182. *See supra* notes 97-98.

183. *Id.*

[e] *The Restricted Period*

The restricted period during which the Offering and Transactional Restrictions must be complied with is a period which commences with the closing of the offering or the date when first offered to persons other than distributors in reliance on Regulation S, whichever is the later, and expires a specified period of time thereafter as provided in the appropriate transactional restriction.[184] In the case of a continuous offering, it does not commence until the lead managing underwriter certifies that the distribution has been completed.[185] In a continuous offering of non-convertible debt securities sold in identifiable tranches, the period commences upon completion of the distribution of such tranches as determined and certified by the managing underwriter.[186] In any event, so long as a distributor holds an unsold allotment the securities will be non-convertible in the restricted period at the time of the offer or sale.[187] The restricted period relating to warrants and shares underlying warrants is discussed at Section 8 and the restricted period relating to convertible securities is discussed at Section 7. The Adopting Release describes the restricted period relating to securities offered as a Unit as follows:[188]

> Questions also have been raised as to the status of unit securities offerings under the issuer safe harbor. For purposes of determining the applicable issuer safe harbor category within Rule 903, the units offering generally would be analyzed as if it were an offering of each security separately and the most restrictive category applicable will govern the units offering. If, however, the securities comprising the units may be separately traded immediately after issuance, to the extent feasible the restrictions of the issuer safe harbor may be applied as if the securities comprising the units were distributed in separate offerings. Where a unit comprised of both debt and equity securities is offered and sold under the third category of the issuer safe harbor, the restricted period applicable to equity will apply to the debt portion unless the securities comprising the unit may be separately traded immediately after issuance, in which case the debt and equity securities have their separate applicable restricted periods.

The commencement date of the restricted period is of considerable significance since it is obvious that the sooner it commences the sooner it will be over. In an American-style distribution, the lead underwriter puts together a syndicate, engages in pre-sales efforts to test the market, executes an underwriting agreement, and completes the distribution, often within a few hours, based on the prior selling effort, and a closing is held at an agreed upon time. For example, the time might commence five business days after completion of the distribution, at which time the securi-

184. Rule 902(m).
185. *Id.*
186. *Id.*
187. *Id.*
188. Adopting Release, *supra* note 5, at 80,672.

ties are delivered by the issuer and paid for by the underwriter. In a European-style distribution, the underwriters buy the securities and subsequently offer them. The restricted period in the case of the American-style distribution will not commence until closing which may be five to seven days after they are offered. The restricted period in the case of the Euro-style distribution commences on the first day the securities are offered. Regulation S also encompasses a third type distribution, a "continuous offering" which is not defined. Presumably, it refers to an offering expected to be completed over a substantial time frame, for example, three months, and the underwriters take down securities as they sell them. The restricted period in such instance does not commence until the lead underwriter certifies that the distribution has been completed. In both a Euro-style and American-style distribution, although the offering is closed or the underwriters have purchased the entire offering, some members of the syndicate may still hold unsold allotments which they were unable to immediately distribute. As to such securities, the restricted period continues until the securities are sold, but the fact that there are such securities does not turn the offering into a continuous one and defer the commencement of the restricted period. Rather, it defers the expiration of the restricted period as to those particular securities.

The restricted period has special significance to the issuer, distributor, and their affiliates since even though the distribution is complete they are subject to the offering restrictions during the restricted period and also the transactional restrictions. Thus, the issuer during this period must consider whether, for example, a proposed press release in the United States during this period may be deemed a directed selling effort.[189] Similarly, a distributor during the restricted period has to take into account the issuer-distributor safe harbor transactional restrictions rather than the resale safe harbor transactional restrictions even though it is reselling rather than distributing the security. The Adopting Release states in this regard as follows:[190]

> Distributors and their affiliates are not prevented by the Regulation from engaging in secondary transactions in securities of the same class being distributed, provided the securities are not borrowed or replaced with shares from the offering. Once the distribution has ended *and any applicable restricted period specified in Rule 903 has expired*, distributors that have sold their allotments will no longer have distributor status and therefore will be able to use Rule 904's resale safe harbor. So long as a distributor still holds some portion of its allotment, it will continue to be unable to rely on Rule 904 with respect to the offer and sale of the unsold allotment.[n. 32][191]

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189. *See supra* note 97.

190. Adopting Release, *supra* note 5, at 80,666 (footnote from original text included) (emphasis added).

191. [n.32] A distributor holding an unsold allotment of securities in a segregated identifiable account may sell as a non-distributor other securities of the same class, so long as such securities were not borrowed from and will not be replaced by securities that are part

[f] *Failure to Comply With a Safe Harbor Condition or Restriction*

The implications of a failure to comply with a condition or restriction of the safe harbors are not specifically dealt with by Regulation S. The Adopting Release, however, does deal with the consequences of various compliance failures. The Rule 903 issuer-distributor safe harbor is unavailable to anyone if the issuer or distributors or persons acting on their behalf fail to comply with the offering restrictions or engage in directed selling efforts in the United States.[192] Any other failure to comply with the Rule 903 safe harbors makes the safe harbor unavailable for all sales by the non-complying distributor or dealer or its affiliates but does not affect its availability to others.[193] Assuming the adoption of adequate offering restrictions, if a distributor violates the transactional restrictions, offers or sales by other distributors are not affected.[194] An offer or sale made in compliance with the Rule 904 resale safe harbor is within the safe harbor, notwithstanding the fact that unaffiliated persons not acting on behalf of the seller may make a non-complying offer or resale.[195]

The Adopting Release describes the safe harbor protections as follows:[196]

> If an issuer, distributor, any of their respective affiliates (other than officers and directors relying on the resale safe harbor), or any person acting on behalf of any of the foregoing: (1) fails to comply with the offering restrictions; or (2) engages in a directed selling effort in the United States, the Rule 903 safe harbor is unavailable to any person in connection with the offering of securities.[n. 142][197] If the issuer, a distributor, any of such respective affiliates, or any person acting on behalf of any of the foregoing, fails to comply with any other requirement of the issuer safe harbor,[n. 143][198] the safe harbor is not available for any offer or sale in reliance thereon made by the person failing to comply, its affiliates or persons acting on their behalf. The availability of Rule 903 for other persons' offers and sales of securities is unaffected.
>
> Under the reproposal, the failure to comply with the conditions, other than the offering restrictions and the restrictions on directed selling efforts in the United States, would have precluded reliance upon the safe harbor only for non-complying offers and sales. Under

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of the unsold allotment.

192. Adopting Release, *supra* note 5, at 80,681.

193. *Id.*

194. *Id.*

195. *Id.*

196. Adopting Release, *supra* note 5, at 80,681 (footnotes from original text included).

197. [n.142] Resales by officers and directors in compliance with Rule 904 will not affect the availability of Rule 903.

198. [n.143] The confirmation requirement is included in the transactional restrictions, rather than the offering restrictions, in response to commenters' concern that otherwise the failure to provide a simple confirmation would make the issuer safe harbor unavailable for the entire offering.

> Rule 903 as adopted, reliance upon the safe harbor for all offers and sales made by a non-complying person and its affiliates is precluded as an appropriate incentive to comply fully with the conditions of the safe harbor.
>
> The availability of the Rule 904 resale safe harbor generally is unaffected by the actions of the issuer, distributor, their respective affiliates (other than certain officers and directors relying upon Rule 904), or persons acting on behalf of any of the foregoing. An offer or sale of securities made in compliance with the provisions of Rule 904 is within the safe harbor, notwithstanding non-complying offers or resales by other unaffiliated persons not acting on behalf of the seller.[n. 144][199]

Distributors and participants, however, cannot close their eyes to the activities of other participants in the distribution who consistently violate the resale restrictions. The Adopting Release cautions, in this regard, as follows:[200]

> As Preliminary Note 2 states, the Regulation is not available to any transaction or series of transactions that, although in technical compliance with the rules, is part of a plan or scheme to evade the registration provisions of the Securities Act. Thus, for example, a participant in a distribution, regardless of whether it literally takes all steps required for reliance upon the protection of the Regulation, does not have the protection of the Regulation if it knows or is reckless in not knowing that a person to whom it sells securities in reliance upon the Regulation will not comply with the requirements. Clearly, if an underwriter were told by a dealer to whom it intended to sell securities in reliance upon Rule 903 that the dealer had a customer in New York waiting for the securities, that underwriter would not be able to rely upon the protection of the Rule in connection with its sale to that dealer, even if the underwriter complied with all the Regulation's requirements. The same would be true if the underwriter knew or was reckless in not knowing that the dealer to whom it intended to sell had consistently sold to U.S. residents in violation of resale restrictions in other offerings made pursuant to the safe harbor provisions of the Regulation. If, on the other hand, an underwriter sold to a dealer and the dealer sold to a customer in the United States, and the underwriter did not know and was not reckless in failing to know that the non-conforming sale would occur, the underwriter would not lose the protection of the safe harbor.

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199. [n.144] Affiliates of the seller (other than the issuer or a distributor, in the case of an officer or director thereof selling in reliance on the resale safe harbor) will be deemed to be acting on behalf of the seller.

200. Adopting Release, *supra* note 5, at 80,681.

§6 RULE 904 SAFE HARBOR FOR RESALES

[a] *Securities Distributed Pursuant to Regulation S*

There is a separate resale safe harbor for persons other than issuers and distributors.[201] Rule 904, however, deals only with what constitutes a sale outside the United States and does not provide a safe harbor for resales in the United States.[202] It is limited to resales by persons other than the issuer, distributor, or their respective affiliates (except an officer or director who is an affiliate solely because of holding such position).[203] The investor-purchaser who is not a dealer, an officer or director of the issuer, or a distributor, or who is not a person receiving selling concession or other selling remuneration can resell the securities without any restrictions other than the general conditions[204] that require the offer and sale take place offshore.[205] The further general condition that there be no directed selling effort in the United States is applicable only to the seller, an affiliate of, or any person acting for the seller.[206] The Adopting Release describes the resale safe harbor as it relates to the investor-purchaser as follows:[207]

> Persons other than: (1) dealers and persons receiving a selling concession, fee or other remuneration in respect of the securities offered or sold, which may include sub-underwriters (all referred to herein as "securities professionals"), and (2) affiliated officers and directors eligible to rely upon the resale safe harbor, may resell any securities in reliance on this safe harbor, with no restrictions other than the general conditions that the offer and sale be made in an offshore transaction (including offers and sales in a designated offshore securities mar-

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201. Rule 904.

202. Preliminary Note 6 to Regulation S.

203. The Proposing Release contained some inconsistent statements with respect to distributors. The Release stated that once a distributor has distributed its allotment, it is like any other person reselling the securities. Proposing Release, *supra* note 3, at 89,133-34. Elsewhere the Release stated that sales and "resales by issuers, distributors and their affiliates would *always* be subject to Rules 904 and 905 (Rule 903 under Regulation S as adopted)" rather than 906 (Rule 904 under Regulation S as adopted). *Id.* at 89,139 (emphasis added). The Adopting Release states that a distributor cannot rely on Rule 904 until after the distribution is completed and the applicable restricted period has expired. Thereafter, if the distributor has sold its allotment, it can rely on Rule 904 in connection with its activities in the trading market. If it has not sold its allotment, it may place the unsold allotment in a segregated account and sell as a non-distributor other securities of the same class so long as such securities were not borrowed from and will not be replaced by securities that are part of the unsold allotment. Adopting Release, *supra* note 5, at 80,666 n.32. If this means what it says, a distributor having sold its allotment, during the restricted period, which can be as much as a year in the case of equity securities, is subject to a number of requirements in connection with trading transactions not applicable to securities professionals who were not also distributors.

204. Rule 904(a)-(b).

205. *See* §4[a].

206. Rule 904(b).

207. Adopting Release, *supra* note 5, at 80,660.

> ket not prearranged with a buyer in the United States) and without directed selling efforts within the United States.

If the seller, however, is a dealer or other person receiving selling compensation (which would include, for example, a subunderwriter[208]), during the restricted period (which assumes a category 2 or 3 situation) such seller ("securities professional") can resell subject to the same general conditions as the investor-purchaser, but neither the seller nor any person acting on his behalf can be aware of the fact that the offeree or buyer of the securities is a U.S. person.[209] This is not intended, to place a duty of inquiry on the seller.[210] In addition, if the purchaser from such seller is also a dealer or person receiving a selling concession, the seller must deliver to the purchaser a confirmation or other notice stating that during the restricted period the securities can be sold only in compliance with Regulation S or pursuant to registration or an exemption from registration under the Act.[211] The restricted period does not begin anew upon resale of the securities, but applies only to the remainder of the applicable period imposed in connection with the original distribution.[212] The Adopting Release described the resale safe harbor as applicable to securities professionals as follows:[213]

> Resales by securities professionals also are subject to the offshore transaction requirement and the prohibition on directed selling efforts (and the conditions applying to affiliated officers and directors, as applicable). In addition, if the securities being resold are not in the first issuer safe harbor category and the resale is made prior to the expiration of any applicable restricted period, neither the securities professional nor any person acting on its behalf may knowingly offer or sell to a U.S. person.[n. 140][214] Further, if the selling securities professional or a person acting on its behalf knows the purchaser of the securities is a securities professional, the seller is required to send a confirmation or other notice of the applicable restrictions to the purchaser.[n. 141][215]

A securities professional who was also a distributor in connection with the Regulation S distribution cannot rely on Rule 904 during the restricted period, but is subject to the more stringent issuer-distributor restrictions.[216]

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208. *Id.* at 80,680.

209. Rule 904(c).

210. Adopting Release, *supra* note 5, at 80,681 n.140.

211. Rule 904(c)(1)(ii).

212. Proposing Release, *supra* note 3, at 89,137.

213. Adopting Release, *supra* note 5, at 80,680-81 (footnotes from original text included).

214. [n.140] The safe harbor does not place a duty of inquiry on the securities professional.

215. [n.141] Paralleling the issuer safe harbor, the confirmation requirement in the resale safe harbor requires transmission rather than receipt or delivery.

216. *See supra* note 191.

Securities of foreign issuers distributed pursuant to Regulation S are likely in many, if not most, instances to be resold on a Designated Offshore Securities Market.[217] The general condition requiring an offshore transaction will be satisfied only if neither the seller nor any person acting on his behalf knows the transaction has been pre-arranged with a buyer in the United States.[218] Pre-arrangement is different from knowing at the time of the transaction that the buyer is a U.S. person. The Proposing Release had said as to the Rule's initial formulation that the restrictions on pre-arranged U.S. buyers were not intended to impose a duty of inquiry.[219] This comment appears appropriate with respect to the definition of an offshore transaction. The net effect is that an investor-purchaser of a Regulation S security can resell on a DOSM without more provided neither he nor his agent pre-arranges the transaction with a U.S. buyer or knows that it is pre-arranged. On the other hand, a dealer market maker on the DOSM could not locate a U.S. buyer with a view to crossing the transaction on the DOSM with a seller who acquired the securities in a Regulation S transaction.

An investor-purchaser during the restricted period can resell the shares in an offshore transaction not on a DOSM in reliance on Rule 904. Such resale can even be made to a U.S. person if the seller is not a securities professional or other person receiving a selling concession.[220] The transaction would have to be an offshore one and the seller could have engaged in no directed selling efforts in the United States. This would permit, for example, a sale to a U.S. institutional investor that maintains an offshore presence. A securities dealer or other person receiving a selling concession (for example, a sub-underwriter) could not resell securities in reliance on the Rule 904 safe harbor if he knew that the purchaser is a U.S. person. The securities professional could, however, sell offshore under Rule 904 to a foreign affiliate of a U.S. issuer which is not a U.S. person under Rule 902(o)(1)(viii)[221] or to a U.S. investment adviser buying for a discretionary account of a non-U.S. person.[222]

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217. *See supra* note 32 for a list of DOSM's.

218. Rule 902(i)(1)(ii)(B)(2).

219. Proposing Release, *supra* note 3 at 89,140.

220. The offering restrictions preclude offers or sales during the restricted period in the United States or to U.S. persons without registration or an appropriate exemption from registration. Rule 902(h)(2). The transactional restrictions also preclude an offer or sale to a U.S. person during the restricted period. Rule 903(c)(2)-(3). The investor-purchaser, however, enters into a specific agreement only as to category 3 equity securities and as to such securities agrees to resell such securities only in accordance with the provisions of Regulation S, pursuant to registration or an exemption from registration. Rule 903(c)(3)(iii)(B)(2). A resale in accordance with Rule 904 is in compliance with Regulation S and requires only that the transaction be offshore if the seller is not a dealer or person receiving selling concessions. The overall effect is to limit the offering and transactional restrictions on sales to U.S. persons to the issuer, distributors and dealers or other persons receiving a selling concession in connection with the resale.

221. *See supra* note 17.

222. Rule 902(o)(2). Such transaction could take place in the United States and still be

It is not clear whether an investor purchaser could sell to a U.S. person using a securities professional as his agent. The term "dealer" as used in Rule 904 incorporates the Securities Act section 2(12) definition which embraces dealers acting as agents, and the securities professional is defined broadly in Rule 904 to include one in the business of effecting securities transactions for a fee. The issue is whether the restriction on resales by securities professionals to U.S. persons relates to transactions in which the securities professional is the seller in the sense of passing title to the security or also includes transactions in which the securities professional sells for others. If the restriction on sales to U.S. persons is applicable to transactions in which the securities professional acts as agent for the investor-purchaser, the statement in the Adopting Release that the non-securities professional may resell "with no restrictions other than the general conditions" is not wholly accurate since resales generally are likely to be effected through a securities professional.[223]

The safe harbor for resales on a DOSM is particularly significant because as in most offerings made in the United Kingdom or Europe, the securities are likely to be traded on an exchange or in an organized market established by an exchange once the distribution is completed. If, for example, a U.S. issuer that is a non-reporting company makes an offering in the U.K., concurrently listing the security on the Unlisted Securities Market ("USM"), the foreign investors who purchase securities in the offering can resell them through a U.K. broker who would sell them to a market maker on the London (International) Stock Exchange on which USM securities trade. Designation of the Association of International Bond Dealers ("AIBD") as an DOSM assures a ready secondary market for the resale of Eurobonds sold in reliance on Regulation S.[224]

Officers and directors of the issuer as affiliates of the issuer ordinarily are also subject to the issuer-distributor restrictions during the restricted period.[225] If, however, the seller is an officer or director of the issuer or distributor who is an affiliate of the issuer or distributor, respectively, solely because of their position as an officer or director, such persons may

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offshore. *See supra* note 26.

223. Adopting Release, *supra* note 5, at 80,680.

224. The AIBD is recognized by the Securities Investment Board in the United Kingdom as a designated exchange for purposes of the Financial Services Act. The AIBD has its principal offices in Zurich and although only approximately 25% of its members operate in England, such London based members account for about 70% of the secondary market trading in Eurobonds. The members that operate in England also must become members of a self-regulatory organization; in most instances, The Securities Association. The result is that the secondary market operations in England are subject to a regulatory regimen, but those operations conducted outside England are subject to considerably less regulation. But to obtain designation as an exchange under the FSA, the AIBD had to adopt rules permitting expulsion of members and requiring "compliance with just and equitable principles of business or trade, observance of good market practice and application of standards of professional integrity." *See* Fidler, *AIBD Wins UK Legal Exemptions*, Fin. Times, Mar. 10, 1988, at 35.

225. Rule 904.

rely on the Rule 904 safe harbor. In such event, if during the restricted period, in addition to the general conditions, the safe harbor is available only if no more than the usual and customary broker's commissions for an agency transaction are paid.[226] Resales of securities under Rule 904 by officers or directors of the issuer may involve securities acquired onshore that are restricted securities or cannot otherwise be publicly sold by an affiliate without registration under the Securities Act. The Adopting Release stresses that officers and directors cannot use the Rule 904 safe harbor as a conduit to permit the issuer to avoid the offering and transactional restrictions, stating: "Thus, securities being offered in a distribution by the issuer could not be resold under Rule 904 by an officer or director during the distribution or during any applicable restricted period."[227] The Adopting Release explains the Rule 904 safe harbor for officers and directors as follows:[228]

> Under the reproposal, the resale safe harbor was available for offers and sales by all persons other than an issuer, a distributor, their respective affiliates, and any person acting on behalf of any of the foregoing.[n. 137][229] As suggested by several commenters, the Regulation as adopted also specifically allows certain officers and directors of issuers and distributors to rely upon the resale safe harbor. Officers and directors of such persons who are affiliates would otherwise be unable to rely upon the resale safe harbor. As adopted, an officer or director of an issuer or distributor is eligible to rely upon the resale safe harbor if the sole reason such officer or director may be deemed an affiliate is by virtue of position, provided no special selling compensation is paid in connection with the offers and sales by such officer or director and the general conditions (and conditions imposed upon dealers and certain securities professionals, as applicable) are satisfied. Special selling compensation includes any selling concession, fee or other remuneration, other than the usual and customary broker's commissions that would be received by persons executing such sales as agents. Of course, where such officer or director is being used as a conduit to offer and sell securities in reliance on the resale safe harbor by persons ineligible to rely thereon, the resale safe harbor will not be available.[n. 139][230]

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226. Rule 904(c)(2).

227. Adopting Release, *supra* note 5, at 80,680 n.139.

228. *Id.* (footnotes from original text included).

229. [n.137] Rule 904. Several commenters on the reproposed Regulation stated that the resale safe harbor might be interpreted as somehow altering the availability of Sections 4(1) and 4(3) of the Securities Act (15 U.S.C. §§77d(1), 77d(3)) for the resale of securities. The Regulation does not affect the availability of the exemptions contained in those sections.

230. [n.139] Thus, securities being offered in a distribution by the issuer could not be resold under Rule 904 by an officer or director during the distribution or during any applicable restricted period

[b] *Resale of Securities Issued in Reliance on an Exemption*

Rule 904 is not limited to the resale of securities issued in offshore transactions. Rule 904 is available for the offshore resale of securities issued in the U.S. to U.S. persons in reliance on Regulation D or other exemptions from registration. Rule 904 is also available to an officer or director affiliate of the issuer who is such only because of his status as an officer or director.[231] The restricted period for securities offered offshore, under these circumstances, commences on the date upon which the securities were first resold in reliance on Regulation S.[232] If, for example, a U.S. resident purchased securities offered pursuant to Regulation D, prior to the expiration of the Rule 144 two-year holding period, he could sell them offshore complying with the provisions of Rule 904 and the restricted period imposed on his purchaser would commence with the sale to him, assuming it was the first offshore sale. If the securities trade on a DOSM, they could be resold on the exchange in compliance with Rule 904.[233]

This aspect of Regulation S may prove to have considerable practical significance, particularly as to securities privately placed in the United States. If the security trades on a DOSM, purchasers would not have to hold the securities for the two year holding period of Rule 144 (or in the limited Rule 144A market) to resell the security. The illiquidity imposed by the U.S. securities laws could be avoided, but only if the security trades on a DOSM and the sale on such market would not violate the law of the DOSM's domicile. The Adopting Release notes as follows:[234]

> The resale safe harbor is available for the resale offshore of any securities, whether or not acquired in an offshore transaction under Regulation S. Resales pursuant to Rule 904 of securities originally placed privately will not affect the validity of the private placement exemption relied upon by the issuer.

§7 CONVERTIBLE SECURITIES

Regulation S includes several provisions specifically relating to convertible securities, but, nevertheless, one has to go to the Adopting Release to find much of the substantive law and there remain areas that are not dealt with. There are at least three issues relating to convertible debt securities. First, are they debt or equity? Second, in the case of a foreign issuer, how is SUSMI determined? Third, is the restricted period based on the convertible security or the underlying security?

There is no definition in the Regulation of a debt security, raising the issue of whether convertible debt securities are debt or equity. Regulation

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231. Rule 904.

232. Proposing Release, *supra* note 3, at 89,140.

233. Rule 904 could also be used to resell securities offered in the United States in reliance on Rule 147 or any other exemption.

234. Adopting Release, *supra* note 5, at 80,681.

S does provide that for SUSMI to not exist in connection with an offering of a convertible security by a foreign issuer, there must be no SUSMI in either the convertible security or the underlying security.[235] The appropriate approach can be readily determined if both the convertible security and the underlying security are equity securities as SUSMI would be based on the market trading criteria both as to the convertible security and the underlying security.[236] If the convertible debt security is deemed debt, then a determination of SUSMI for the convertible security would be based on aggregate indebtedness[237] and that for the underlying security on the basis of trading criteria. Presumably, convertible debt securities are debt securities for determining whether there is SUSMI in the convertible security.

A similar problem arises in connection with non-convertible preferred stock. Although preferred stock normally is an equity security, Regulation S treats non-convertible, non-participating preferred stock as debt in calculating the aggregate debt outstanding for the purpose of determining whether SUSMI exists with respect to debt securities.[238] This does not specifically determine that such preferred stock is a debt security for determining whether SUSMI exists as to it nor does the fact that Regulation S treats it as debt in determining the applicable safe harbor category,[239] but the logical inference is that if it is debt for these purposes it is also debt for the purpose of determining SUSMI.

Whether a convertible debenture is a debt or equity security is not important with respect to reporting companies since, whether it is considered debt or equity, it will be in category 2 and subject to the same offering and transaction restrictions. In the case of a non-reporting U.S. issuer, whether it is considered debt or equity, it will be a category 3 security. However, as to such issuers, the period and nature of the transactional restrictions depend upon whether the security is a debt or equity security. In the case of a non-reporting foreign issuer with SUSMI, if a convertible debt security is debt it is in category 2; if equity in category 3, and therefore, it is subject to the more rigorous transactional restrictions of that category.

The Adopting Release states that, "[f]or purposes of applying restricted periods under the safe harbor, convertible securities generally are treated as the security into which they are convertible."[240] The restricted

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235. *See* Rule 903(c)(1)(i)(D). The Adopting Release states as follows: "For purposes of the determination of whether substantial U.S. market interest exists, the measurement is made both by reference to the convertible security and the underlying security. If substantial U.S. market interest exists in either, there is substantial U.S. market interest in the convertible securities." Adopting Release, *supra* note 5, at 80,672.

236. *See supra* note 124.

237. *See supra* note 126.

238. Rule 902(n)(2).

239. Rule 903(c)(4).

240. Adopting Release, *supra* note 5, at 80,671. *See also* Proposing Release, *supra* note 3, at 89,139 n.122.

period of convertible securities offered and sold in reliance on Rule 903 that are not convertible until after the applicable restricted relating to the underlying securities, assuming they are offered and sold under Rule 903, however, is determined by the convertible security.[241] The net effect of this is that whether a convertible debenture is debt or equity depends upon when the convertible security can be converted in relation to the restricted period applicable to the underlying security. A convertible debenture, therefore, is an equity security if it is immediately convertible into common stock. If, however, the conversion rights relating to a convertible security of a non-reporting issuer, for example, cannot be exercised for more than twelve months, it will be deemed a debt security.[242] This, as noted above, does not affect the restricted period as to securities of a reporting company. It does, however, affect the restricted period of a non-reporting foreign issuer. If the convertible debenture can be converted within twelve months, the security is an equity security and subject to the category 3 restrictions relating to equity securities. If it is not convertible for twelve months, it is a debt security and subject to the category 2 restrictions.[243] In the same situation, but involving a non-reporting U.S. issuer, it will be a category 3 security in any event, but if the conversion right cannot be exercised for twelve months, it will be deemed a debt security and subject to a forty day restricted period.

If a conversion takes place during the restricted period, the securities issued on conversion will be restricted for the remainder of the restricted period provided the conversion is exempt under section 3(a)(9) of the Securities Act.[244] If, for example, an immediately convertible debenture of a non-reporting U.S. issuer is distributed under Regulation S, upon conversion, the holder could tack the period from the date of acquisition of the convertible debenture to date of conversion in determining when the twelve month restricted period expires.[245] If it is not exempt, typically because compensation is paid on conversion or the security is that of a different issuer, the analysis applicable to a warrant applies to the conversion.[246] But if it is exempt under section 3(a)(9), the holder can tack the period prior to conversion for the purpose of determining the restricted period of the underlying security. This suggests that the underlying security can be resold in the United States immediately upon conversion provided the restricted period measured from the acquisition of the convertible security has expired. The following excerpts from the Adopting Release are pertinent:[247]

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241. Adopting Release, *supra* note 5, at 80,671. *See also* Proposing Release, *supra* note 3, at 89,137 n.113.

242. Adopting Release, *supra* note 5, at 80,671.

243. *Id.*

244. *Id. See also* Proposing Release, *supra* note 3, at 89,137.

245. *Cf.* the holding period of convertible securities under Rule 144. *See* Rule 144(d)(4)(ii), *supra* note 49.

246. Adopting Release, *supra* note 5, at 80,671. *See* §8.

247. Adopting Release, *supra* note 5, at 80,671-72 (footnotes from original text

> For purposes of applying restricted periods[n. 75][248] under the issuer safe harbor, convertible securities generally are treated as the security into which they are convertible.[n. 76][249] However, where the securities are not convertible before any applicable restricted period would have ended if such underlying securities had themselves been offered and sold under Rule 903, the restricted period will be determined by the convertible security. Thus, an offering of convertible debt securities by a foreign issuer with substantial U.S. market interest in its debt and equity securities would fall within the second category of the issuer safe harbor if the debt securities are not convertible for 13 months but would fall within the third issuer safe harbor category if the debt securities were convertible after 11 months.

If the foregoing is a correct analysis, it is a significant departure from the staff's position under Release 4708. The staff's position historically limited the section 3(a)(9) exemption to the conversion and not to the resale of the underlying security which had to be registered or find its own exemption prior to resale. International Telephone and Telegraph (ITT) in September 1972 sold fifty million dollars worth of convertible debentures in the Eurobond market in reliance on Release 4708 adopting a ninety day lock-up as to the debentures. The conversion price was at a premium of approximately forty percent above the current market price of the common stock at the time of distribution.[250] The underlying common stock was listed on the New York Stock Exchange and the issuer was, therefore, a reporting issuer. Counsel for ITT requested a no-action letter asserting that section 3(a)(9) would exempt the conversion and the resale of the underlying shares. The staff replied that based on counsel's opinion it would recommend no action if the convertible debentures were converted into common stock without registration in reliance on section 3(a)(9). The letter, however, went on and stated: "[W]e cannot agree that the exemption provided in said Section 3(a)(9) would cover resales by the holders of the common stock received upon such conversion. Any such resales would require registration under the Act absent some other available exemption." Counsel then came back with the argument that resales would be exempt under section 4(1) as transactions not involving an issuer or underwriter. The staff responded that notwithstanding, "the facts and arguments presented, we are unable to conclude that this Division

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included).

248. [n.75] Where a conversion exempt under Section 3(a)(9) of the Securities Act (15 U.S.C. §77c(a)(9)) takes place during the restricted period, the securities issued on conversion will be restricted for the remainder of the restricted period. A conversion generally would be exempt from registration under Section 3(a)(9) except where compensation is paid on conversion or the security is that of a different issuer. Where the exemption is not available, the same analysis as applies to the exercise of warrants under Regulation S would apply to conversion.

249. [n.76] *See* Sperry Rand Corporation (Mar. 1, 1974); *cf.* Rule 405, 17 C.F.R. §230.405 (1990).

250. *See* Int. Tel. & Tel. Corp., SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,462 (July 27, 1973).

would not recommend appropriate action to the Commission if the subject debentures or the underlying stock were to be distributed in the United States without registration under the Securities Act of 1933." The ITT letter, nonetheless, represented a concession from the position previously asserted that the underlying securities had to be registered prior to conversion.[251]

A sixty million dollar offering by Sperry Rand (Sperry) of convertible debentures in the Eurobond market in February 1973 posed substantially identical issues.[252] The debentures could not be converted until March 1974. Counsel to Sperry expressed the opinion that the conversion would be exempt under section 3(a)(9) and the shares could be resold in reliance on the section 4(1) exemption. The staff gave essentially the same response; no action would be recommended with respect to the conversion, but no views were being expressed as to when the debentures or the shares underlying the debentures could be resold in the United States. In a number of subsequent convertible debenture offerings made in reliance on Release 4708, the debentures were subject to tight lock-up procedures and provision was made for the registration of the common stock prior to conversion apparently to provide the holders with the ability to resell the underlying shares.[253]

The Adopting Release and Proposing Release, however, as discussed above,[254] send a different signal. One confusing aspect of this regulation by release rather than rule is that the no-action letter cited for the proposition that the convertible debenture is an equity security[255] is one of a series of letters taking the position that section 3(a)(9) does not exempt the resale of the underlying security.[256] The approach of the Adopting Release in contrast to the historical position under Release 4708 has the virtue of simplifying the application of Regulation S to convertible debentures, making for a nice tidy package although some nagging doubts remain in certain areas as discussed above. The analysis, if correct, although extremely helpful in determining the transaction restrictions that have to be imposed and providing a blue-print for construction of the conversion terms of the convertible debenture, does not necessarily resolve the issue of whether the securities acquired on conversion can be resold in reliance on section 4(1) or for that matter, whether the convertible securities can be resold in reliance on section 4(1). The problem with respect to resale in the United States of the convertible debentures is the

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251. *See* California Business Communications, Inc., SEC No-Action Letter (Aug. 9, 1972), in which the staff stated: "[I]t is our opinion that the underlying shares must be registered . . . sometime prior to their issuance resulting from the conversion of the debenture."

252. Sperry Rand Corp., SEC No-Action Letter (Mar. 1, 1974).

253. *See, e.g.*, Ni-Cal Finance N.V., SEC No-Action Letter (May 30, 1984); Fairchild Camera and Instrument Corp. Int'l Fin., N.V., SEC No-Action Letter (Dec. 15, 1976).

254. *See supra* notes 240-49 and accompanying text.

255. Sperry Rand Corp., SEC No-Action Letter (Mar. 1, 1974).

256. *See supra* notes 250-53 and accompanying text.

same as that discussed with respect to resales after the restricted period.[257] The problem is somewhat different with respect to the underlying securities. For example, assuming that they are not converted until after the expiration of the restricted period, the seller may attempt to resell on a U.S. stock exchange the day following acquisition from the issuer since there is no separate restricted period.

§8 WARRANTS

It may be helpful in considering the application of Regulation S to warrants (including for this purpose convertible securities that would not have the benefit of the section 3(a)(9) exemption) and the underlying security to describe the dichotomy that exists with respect to convertible securities that are registered under the Securities Act and warrants that are issued with a debt security both of which are registered. Once a registered public offering of convertible securities is completed, that is the end of the matter because the conversion is exempt under section 3(a)(9) and historically section 4(1) has been available for the resale of the underlying shares. In the case of warrants issued as part of a unit consisting of debt and warrants to purchase common stock, if the warrants are presently exercisable, there is a continuing offering of the underlying securities and a registration statement covering the underlying shares has to be kept in effect for the life of the warrants at least if the warrants are "in the money" (that is, a favorable relationship of the exercise price to the market price raises the likelihood the warrants will be exercised).

If the debt security with severable warrants to purchase common stock attached is sold by a foreign issuer in an ODO, the Regulation S category 1 safe harbor requires only compliance with the general conditions even if SUSMI exists as to the common stock. Query, however, whether such an offering satisfies the ODO requirement that the offering be made in a single foreign country? If SUSMI exists as to the common stock, there may be a strong likelihood that the warrants will be resold immediately in the United States and the offering of the underlying security (as distinguished from the unit) may not satisfy the requirement that it be "made in accordance with the local laws and customary practices."[258]

For a unit offering (debt with severable warrants to purchase common stock attached) by a foreign issuer which is not an ODO, SUSMI exists if it exists either in the debt security or in the common stock. Accordingly, assuming no SUSMI in either, the offering will be in category 1 and subject only to the general conditions. In any other offering, there will be a restricted period. The offer of the underlying securities is a continuous one that is not completed until all the warrants are exercised or expire. Absent a special provision taking this into account, the restriction

257. *See* §10.

258. Rule 902(j). *See also* note 129 and accompanying text.

on offers and sales to U.S. persons or in the United States would remain in effect on the underlying security throughout the exercise period and for the specified restricted period that commences with the completion of the offering. Regulation S as adopted attempts to deal with the specific problem relating to warrants by providing that the restricted period rather than commencing on completion of the offering of the underlying securities shall commence upon completion of the distribution of the warrants, as determined and certified by the managing underwriter, if several prescribed conditions are complied with, as follows:[259]

> 1) Each warrant bears a legend stating that the warrants and underlying securities have not been registered under the Securities Act and the warrant cannot be exercised by or on behalf of any U.S. person unless registered or an exemption from registration is available.
>
> 2) On exercise, (a) the person exercising certifies that he is not a U.S. person and is not exercising the warrant for a U.S. person, or (b) a written opinion of counsel is obtained that the warrant and the securities delivered upon exercise have been registered under the Act or are exempt from registration.
>
> 3) Procedures (presumably by the issuer) are adopted that assure that the securities will not be delivered within the United States upon exercise (except in transactions that would nonetheless be offshore transactions)[260] unless registered or exempt from registration.

The restricted period for the common stock underlying the warrants will depend upon whether reliance is placed on the category 2 or 3 safe harbor, but in any event will commence with the completion of the distribution of the warrant. The holder of the warrant, therefore, can tack the period from the completion of the distribution to the exercise date in determining the remaining restricted period. If, for any reason, the conditions are not satisfied, the restricted period would not commence until the expiration of the warrants without regard to when the warrants are exercised. Assuming compliance with the conditions outlined above, if a non-reporting U.S. issuer distributes warrants under Regulation S, the restricted period would be twelve months from the completion of the distribution both as to the warrants and the underlying security.[261] Thus, the Adopting Release states as follows:[262]

> Commenters on the Reproposing Release also expressed concern that warrants offered pursuant to the second or third issuer safe harbor categories could never be offered or sold to U.S. persons absent registration or an available exemption from registration.[n. 125][263] To ad-

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259. Rule 902(m).

260. *See supra* note 26.

261. *See* Adopting Release, *supra* note 5, at 80,675 n.126.

262. *Id.* at 80,678 (footnotes from original text included).

263. [n.125] The Commission noted in the Proposing Release that warrants could be issued in reliance on the Regulation, but so long as the warrants were exercisable, a continuous offering of the underlying securities would be ongoing, and thus the warrants would be

> dress those concerns, the Regulation as adopted provides that the restricted period of the underlying securities will coincide with the restricted period for the warrants if certain procedures are followed to ensure that the underlying securities are not sold to U.S. persons except in a registered or exempt transaction.[n. 126][264] The required procedures are threefold. First, the warrants must contain a legend stating that they and the underlying securities have not been registered under the Securities Act, and that the warrants may not be exercised by or on behalf of U.S. persons unless registered or an exemption from registration is available.[n. 127][265] Second, the person exercising the warrant must be required either to certify that it is not a U.S. person and that the warrants are not being exercised on behalf of a U.S. person, or to provide an opinion of counsel that the securities have been registered or that an exemption from registration is available. Finally, procedures must be adopted to ensure that the warrants may not be exercised in the United States and the underlying securities may not be delivered to the United States,[n. 128][266] absent registration or an available exemption from registration.

The implication is that at the end of that twelve month period the warrants or the underlying security could be resold in the United States. The Adopting Release states that the special definition of restricted period for warrants was adopted in response to the fact that without it, "warrants offered pursuant to the second or third safe harbor categories could never be offered or sold to U.S. persons absent registration or an available exemption from registration."[267] This appears to be saying by implication that providing for a restricted period permits the sale of the warrants (and underlying shares) without registration at the end of the restricted period. The basic issue, however, is somewhat more complicated than the general issue of the resale to U.S. persons after the end of the restricted period in that there must also be an exemption for the exercise of the warrant. So long as held by non-U.S. persons, Regulation S, although not literally an exemption, would "exempt" the exercise since there would be no offer or sale under Regulation S for purposes of Section 5.[268] If the warrants are sold after the restricted period in the U.S., there does not appear to be an exemption available for the exercise of the war-

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subject to the restricted period of the underlying securities, which would not begin to run until the warrants were no longer exercisable because certification that the distribution of the underlying securities had ended could not be given until then.

264. [n.126] The procedures are similar to those described to the Division of Corporation Finance in, Sears Overseas Finance N.V., no-action letter (June 11, 1982).

265. When no physical instrument is delivered to represent the warrants, another procedure, such as delivery of a notice, must be used to inform the recipient of the information that otherwise would be contained in the legend.

266. [n.128] Certain U.S. professional fiduciaries and multinational organizations excluded from the definition of U.S. person (*See* Rule 902(o)(2), (7)) may exercise such warrants and receive such warrants in the United States notwithstanding this requirement. *See* Rule 902(m)(3). *See also* Rule 902(i)(3).

267. Adopting Release, *supra* note 5, at 80,678.

268. Rule 901. *See* §2.

rants since Section 4(1) clearly is not available as the transaction involves an issuer. The Adopting Release[269] describes the procedure as similar to those set forth in the no-action letter relating to *Sears Overseas Finance N.V.*[270] *Sears*, however, imposed a separate restricted period on the underlying securities measured from the date of exercise.[271]

§9 REGULATION S AND AMERICAN DEPOSITARY RECEIPTS

[a] *Overview of American Depositary Receipts*

An overview of the mechanics and general regulatory treatment of American Depositary Receipts ("ADR's") is helpful in analyzing the status of ADR's under Regulation S. An ADR is a negotiable instrument which certifies that a specified number of securities of a foreign issuer have been deposited with a depositary and will be held by it while the ADR is outstanding.[272] An ADR thus is a substitute trading vehicle for foreign securities, enabling a holder to transfer title to the underlying foreign securities by transferring the ADR.[273] A depositary share, or American Depositary Share ("ADS"), is a security, evidenced by an American Depositary Receipt, that represents a foreign security or a multiple or fraction thereof deposited with a depositary.[274] The need for American Depositary Shares arises because of variations in typical trading price levels between countries. If foreign securities trade at different price levels relative to normal trading ranges used in U.S. markets, the unit of trade in the U.S. can be set at a multiple or fraction of a unit of the

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269. Adopting Release, *supra* note 5, at 80,678 n.126.

270. Sears Overseas Finance N.V., SEC No-Action Letter (June 11, 1982) [hereinafter Sears]. In Sears, the company offered offshore units consisting of notes in the principal amount of $100 million and warrants to purchase other notes with a different maturity date in the principal amount of $200 million. The notes originally issued were subject to conventional lock-up provisions for 90 days and the definitive notes and warrants were not delivered to purchasers until the expiration of the 90 days and certification of non-U.S. ownership. The warrants included a legend that they could not be sold to or exercised by any national or resident of the United States. On exercise of the warrants, the holder was required to certify that he was not a U.S. national or resident and undertake not to resell the notes received on exercise of the warrants for 90 days to a U.S. national or resident. No lock-up procedures, however, were adopted as to the notes received on exercise of the warrants. The staff's no-action letter included the usual statement that "no view" was expressed as to when the notes could be reoffered or resold in the U.S. or to citizens or residents of the U.S. without registration under the Securities Act.

271. *Id.*

272. SEC Office of International Corporate Finance, Division of Corporation Finance, *Memorandum on American Depositary Receipts* (Sept. 1983) [hereinafter OICF Memorandum]. Usually at least two banks are involved in an ADR facility. In the typical case, a U.S. bank serves as depositary and a foreign bank serves as custodian. The custodian receives deposits of foreign securities and holds them for safekeeping. The custodian notifies the depositary of a deposit, and the depositary causes ADR's, representing the securities so deposited, to be issued and delivered to the person making the deposit.

273. *Id.*

274. Rule 405, 17 C.F.R. §230.405 (1990).

foreign securities.[275] The U.S. trading unit is also designated as an ADS.[276] The ADS is a receipt, similar to a warehouse receipt for commodities, for the ADR's.[277] The ADR facility may be either a "sponsored" or "unsponsored" arrangement. In a sponsored arrangement, the foreign issuer establishes the facility, pays some or all the depositary's fees, and usually agrees to provide shareholder communications.[278] In a sponsored arrangement, the foreign issuer and the depositary enter into an agreement reflecting the arrangement. In an unsponsored arrangement, the foreign issuer is not involved and the ADR holders pay the fees of the depositary. Depositary banks arrange unsponsored ADR facilities, either upon their initiative or at the urging of large shareholders of or dealers in the foreign securities. Although the ADR mechanism can be established without the participation of the foreign issuer, "the depositary banks will often at least consult with the foreign issuers and refrain from establishing the mechanism if the foreign issuers object."[279]

ADS's are securities separate and distinct from the underlying foreign securities. It is common to have an offering of ADS's requiring registration under the Securities Act without an offering of underlying foreign securities requiring registration.[280] Assume for purposes of illustration that foreign securities are trading abroad in transactions that are either exempt from registration pursuant to section 4(1) or 4(3) of the Securities Act or not subject to the Act because the means of U.S. interstate commerce are not used. The establishment of an ADR facility with respect to such foreign securities ordinarily would involve offers and sales of the related ADS's requiring registration, but not a distribution of the underlying foreign securities as they continue to trade in exempt transactions.[281] On the other hand, it is possible to have a distribution of the underlying foreign securities in connection with a distribution of ADS's. In such event, both the ADS's and the underlying foreign securities must be registered. For example, if a foreign issuer issues new shares in a public offering in the United States and desires to have the shares represented by American Depositary Shares, registration of the depositary shares and the foreign shares would be required. It also would be possible to have a secondary distribution of foreign securities in tandem with a distribution of ADS's. Sponsorship of an ADR facility by a foreign issuer does not, however, necessarily mean that the foreign issuer is distributing its shares. It is possible for an issuer to sponsor an ADR facility with respect to outstanding foreign shares trading in exempt transactions. Whether a distribution of foreign shares is involved when a foreign issuer sponsors an

275. OICF Memorandum, *supra* note 272, at 1.

276. *Id.*

277. *Id.*

278. *Id.* at 3.

279. *Id.* (footnote omitted).

280. ADS's rather than ADR's are registered under the 1933 Securities Act. *See, e.g.*, Form F-6, 17 C.F.R. §239.36 (1990).

281. OICF Memorandum, *supra* note 272, at 4.

ADR facility depends upon all the facts and circumstances, such as the purpose of the transaction and the degree of control over the ADR certificates vested in the foreign issuer.[282] Depositary shares ordinarily are registered under the Securities Act on Form F-6.[283] Form F-6 is available if, *inter alia*, as of the filing date of the registration statement, the issuer of the deposited securities is reporting pursuant to the periodic reporting provisions of the Exchange Act or the deposited securities are exempt pursuant to Rule 12g3-2(b) under the Exchange Act, unless the issuer of the deposited securities concurrently files a registration statement on another form for the deposited foreign securities.[284] Form F-6 is required to be signed by, "the legal entity created by the agreement for the issuance of ADR's."[285] If the issuer of the deposited securities sponsors the ADR arrangement, the issuer and certain of its representatives also must sign the registration statement.

Annual or other reports that would otherwise be required pursuant to section 15(d) of the Exchange Act are not required with respect to depositary shares registered on Form F-6 if the depositary furnishes the information required by Item 4(a) of Form F-6.[286] Depositary shares registered on Form F-6, but not the underlying deposited securities, are also exempt from section 12(g) of the Exchange Act pursuant to Rule 12g3-2(c). If the ADR's are listed on a national securities exchange, they would be required to be registered pursuant to section 12(b). Form 20-F would be available for this purpose.

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282. Royston, *The Regulation of American Depositary Receipts: Americanization of the International Capital Markets*, 10 N.C.J. INT'L & COM. REG. 95 (1985).

283. Prior to the adoption of Form F-6, 17 C.F.R. §239.36 (1990), the Forms available for registration were Form C-3 and Form S-12.

284. Form F-6, 17 C.F.R. §239.36 (1990), General Instruction I.A.3. Form S-12, now rescinded, did not require compliance with the periodic reporting provisions or Rule 12g3-2(b), 17 C.F.R. §240.12(g)3-2(b) (1990), by the foreign issuer. Shortly after Form F-6 replaced Form S-12 in 1983 and this eligibility requirement was adopted, the staff, in recognition of the competitive disadvantages of depositaries who would be unable to create ADR facilities due to the new requirement, stated in a letter dated December 30, 1983, that such eligibility requirement (set forth in General Instruction I.A.3) would be waived under specified conditions. *See Memorandum of Office of International Corporate Finance* (Mar. 28, 1990). This waiver was only applicable to depositaries that were "duplicating" existing Form S-12 facilities that had not been "exhausted." In other words, the staff waived the eligibility requirement when depositaries "duplicated" existing ADR facilities that had been established pursuant to Form S-12 and had not exhausted the number of shares registered on Form S-12. By memorandum dated September 28, 1989, the staff withdrew the waiver instituted in 1983, because in many cases depositaries were allegedly "duplicating" existing S-12 facilities without compliance with the conditions stated in the original waiver letter. However, by memorandum dated March 28, 1990, the staff identified circumstances in which it would be willing to reinstate the waiver of General Instruction I.A.3.

285. Form F-6, 17 C.F.R. §239.36 (1990), Signature Instruction 1. The depositary may sign on behalf of the entity, but the depositary itself is not deemed to be an issuer, a person signing the registration statement, or a person controlling the issuer. *Id.*

286. Rule 15d-3 under the Exchange Act, 17 C.F.R. §240.15(d)-3 (1990).

[b] *Impact of Regulation S*

[i] Sales to U.S. Persons During Restricted Period

As adopted, Regulation S is silent on the question of ADR facilities. The Releases, however, do discuss the applicability of Regulation S to ADR's. Category 2 and category 3 securities may not be sold under Regulation S to U.S. persons during the applicable restricted periods. The question thus arises whether a security distributed offshore in reliance upon Regulation S, and subject to the restrictions on resale to U.S. persons, may be deposited in an ADR facility. Obviously, the Commission would not allow a person to circumvent the Regulation S restricted periods merely by converting a restricted security to ADR form. Questions also arise as to ADR's representing securities of the same class as those distributed offshore pursuant to Regulation S.

As initially proposed, Rule 905(b)(2) and 905(c)(3) prohibited sales in the United States or to U.S. persons during restricted periods, and specifically provided, "that the deposit of any security with a depositary facility in exchange for an American depositary receipt or similar document shall be deemed a sale in the United States."[287] The Proposing Release provided: "Under the proposed safe harbor, the deposit of securities into an American Depositary Receipt ('ADR') or similar facility would be deemed a sale in the United States, and the securities offered or sold in reliance upon the safe harbor could not be placed in such a facility for ninety days."[288] In addition, the Commission stated: "The deposit side of the ADR facility would be required to close down for that period."[289] The Commission solicited comment on whether, if a depositary facility could establish that securities placed with it were not subject to the restrictions on resale imposed by Regulation S, "the facility should be able to continue to accept deposits of securities of the same class as those offered in reliance upon the safe harbor, provided that the depositor represented and could establish that the securities being deposited had not been borrowed, and were not being replaced with new shares acquired in the overseas offering."[290] The depositary institutions were greatly concerned about the Commission's initial Proposal because it required them to close the deposit function during the restricted period, as much as a year in the case of a distribution of equity securities by a non-reporting issuer.[291]

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287. As stated above, during the restricted periods of the safe harbors, sales in the United States in addition to sales to U.S. persons were restricted by the initial proposal. It may have been that the Commission subsequently considered restrictions on sales "in the United States" superfluous in light of the "offshore transaction requirement." In any event, the express restriction on sales in the United States was deleted upon adoption.

288. Proposing Release, *supra* note 3, at 89,137 (referring to category 2 securities).

289. *Id.*

290. *Id.*

291. Maher, *SEC Proposal Throws ADR Community into an Uproar: Regulation S, Designed to Facilitate International Security Sales, Could Destroy ADR Business*, Investment Dealers' Dig., at 5 (Aug. 8, 1988).

As reproposed, Regulation S focused on the sale by a depositary of ADR's representing securities of the class distributed. The Commission cited public comment to the effect that, under then current practice, issuers have assisted depositaries in identification of securities not involved in an offshore distribution, at least for sponsored ADR facilities.[292] The Commission noted that "commenters [sic.] further related that the current practice is to close ADR facilities when securities cannot be so identified."[293]

The Adopting Release continued the position of the Reproposal by focusing on the sale by a depositary of ADR's representing securities of the class distributed offshore. The Release provides that sales by depositaries of ADR's are permitted if, "(1) the ADR's represent securities acquired by the depositary prior to the distribution or (2) the depositary determines by examination of the certificate or other evidence that the security to be deposited is not subject to a restricted period and was neither borrowed nor deposited with the intention that it be replaced with securities subject to the restricted period."[294] The second of the two alternatives focuses on the sale of an ADR by a depositary to a depositor of foreign securities, the apparent reference being to the exchange between the depositary of an ADR for the deposited security. This is somewhat confusing as separately in the same discussion reference is made to the transaction between the depositary and the depositor as an exchange. The Release contemplates that a depositary can issue ADR's to a holder of foreign securities against deposit of the securities without contravening Regulation S if it determined that the security being deposited was not restricted (nor borrowed, etc.). Although the ADR's in almost all cases are securities registered on Form F-6, by the depositary, such procedure is consistent with Form F-6 which is not available if the ADR's represent unregistered securities for which there is no exemption and provides a pragmatic means of policing resales during the restricted period without affecting the operation of the depositary for securities of the same class not subject to the Regulation S restriction. The Regulation could have simply carried over the restrictions applicable to the initial security to the ADR and prohibited resales of the ADR, which is simply a substitute trading security, to U.S. persons during the restricted period. Instead, the Commission's formulation puts the burden of determining compliance on the depositary. Perhaps this approach represented an effort by the Commission to improve compliance by interposing the judgment of a market professional.

The Adopting Release also provides that "issuance of ADR's in exchange for underlying securities and withdrawal of deposited securities by ADR holders is not precluded by the safe harbor provisions."[295] The

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292. Reproposing Release, *supra* note 3, at 80,215 n.42.
293. *Id.*
294. Adopting Release, *supra* note 5, at 80,678.
295. *Id.*

meaning of the first clause of this sentence is unclear since such issuance clearly is precluded in some cases; the reference apparently is to the exchange of securities of the same class that are not subject to the Regulation S restrictions. A single method by which the depositary should identify the securities in question to ensure they are not restricted is not specified in the Adopting Release because, according to the Commission, a particular method may not be consistent with applicable rules in all countries.[296] "Examples of possible methods of identifying newly distributed securities include the underlining of dates, the use of different colors for certificates, the use of legends, the use of identified certificate numbers, and the coding of securities by the transfer agent."[297]

[ii] Substantial U.S. Market Interest

Under the Regulation as initially proposed, an issuer would have been deemed to have a "substantial U.S. market interest" with respect to its equity securities, if, among other things, any of its securities were subject to a sponsored American Depositary Receipt or similar facility.[298] The Commission stated in the Proposing Release in this regard that, "issuers with sponsored ADR facilities may be presumed to have made a conscious decision to enter the U.S. securities markets, and to have an interest in promoting the trading of their securities in such market."[299] The Commission evidently reasoned that the likelihood of flowback was increased and proposed to deem such issuers as having a substantial U.S. market interest. The definition of substantial U.S. market interest for debt securities did not include the same test, presumably because ADR facilities for debt securities are uncommon. The Commission reversed itself without explanation upon Reproposal, stating that "sponsorship of an American Depository Receipt ('ADR') facility would no longer determine U.S. market interest in an issuer's equity securities."[300] The position of the Reproposal was carried over upon adoption so that whether an ADR facility in respect of an issuer's securities exists is irrelevant to whether that issuer has a substantial U.S. market interest in the United States.

§10 RESALES IN THE UNITED STATES OR TO U.S. PERSONS

[a] *The Conceptual Framework*

During the 25 plus years between the pronouncement of Rule 4708 and the adoption of Regulation S, the staff gave repeated no-action letters relating to lock-ups during the distribution and during a period following the completion of the distribution. The Proposing Release states as follows: "The staff traditionally has not expressed any view as to when

296. *Id.*
297. *Id.*
298. Proposed Rule 902(h).
299. Proposing Release, *supra* note 3, at 89,141.
300. Reproposing Release, *supra* note 3, at 80,214.

or under what circumstances securities issued pursuant to Release 4708 could be resold in the United States or to U.S. persons. Rather, the staff has indicated that resales may be made only in compliance with the registration requirements of the Securities Act or an exemption therefrom."[301] The resales in the United States under 4708 had to find a section 4(1) or other exemption; Regulation S, unfortunately, does not wholly dissipate this issue. There is a strong implication that the securities can be resold in the United States or to U.S. persons after the end of the restricted period. The issue, nonetheless, is not free from doubt.

Regulation S takes the form of a Rule defining offer, offer to sell, offer for sale, sale, and offer to buy so that offers and sales made outside the United States are not offers or sales for purposes of section 5 and those made in the United States are offers or sales for purposes of section 5. Regulation S includes a number of safe harbors that, if complied with, result in the offer or sale being deemed made outside the United States and, therefore, not subject to section 5. Regulation S, however, does not deal with resales in the United States except, possibly, by implication. If such resales are to find an exemption, presumably they must find it for the seller under section 4(1) of the Securities Act for transactions not involving an issuer, underwriter, or dealer and for the dealer under the section 4(3) dealer exemption.[302] Rule 144A is available for such resales

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301. Proposing Release, *supra* note 3, at 89,125.

302. Section 5 of the Securities Act provides it is unlawful, absent an exemption, to sell securities that are not registered. § 2(11) defines an underwriter as one acquiring shares from an issuer or an affiliate of an issuer with a view to distribution. In this rather simple fashion the draftsmen of the Act achieved two goals: (1) to require registration whenever an issuer distributes securities, and (2) to require registration whenever affiliates (*i.e.*, controlling persons) distribute securities. In addition, it was necessary to separate out trading transactions so that every time someone trades a security it would not be necessary to file a registration statement. This was done by providing an exemption for transactions not involving an issuer, underwriter, or dealer. A further exemption, now § 4(1), exempts dealer transactions other than for a period of time following the effective date of a registration statement during which dealers must deliver a statutory prospectus in connection with offerings by a non-reporting company and certain transactions in unregistered securities.

Since Regulation S fails to specifically provide that resales in the United States after the expiration of the restricted period is within the § 4(1) exemption, the availability of an exemption for such resales will depend upon the application of the § 4(1) and 4(3) exemptions. Conceptually, Regulation S provides that an offshore offers and sales made in conformity with Regulation S are not deemed an offer or sale for purposes of § 5. Rules 901 and 903. Arguably, if there has not been an offer or sale for purposes of § 5, the investor-purchaser is not an underwriter as it has not "purchased" a security with a view to distribution. There is no assurance, however, that the investor-purchaser may not have purchased for purposes of § 2(11) since Rule 901 defines offer and sale for purposes of § 5 only. In any event, there is the further question of whether a § 4(3) exemption is available for dealers that made a market in the United States in the security distributed offshore pursuant to Regulation S after expiration of the restricted period. Section 4(3)(A) provides that the dealer exemption is not available with respect to unregistered securities until 40 days after the securities are first bona fide offered to the public by the issuer or by or through an underwriter. It has been held that this period does not commence to run until the securities are first publicly offered in the United States and this occurs when they are first quoted in

provided the security is a Rule 144A eligible security.[303] Although securities sold offshore technically are not restricted securities for purposes of Rule 144, historically the staff allowed resales to be made under Rule 144 for offshore distributions made pursuant to Release 4708.[304] Presumably, Rule 144 is available for the resale of securities distributed pursuant to Regulation S, but in view of its two year holding period will be relied upon only if there is no other alternative.

[b] *Regulation S and the Releases*

There are two relevant resale periods: while the Regulation S transaction restrictions are still in effect and after such restricted period. There are, broadly speaking, three relevant transactions — offshore transactions; onshore transactions; and transactions offshore with U.S. persons. Regulation S is relatively specific as to transactions during the distribution and the restricted period. Issuers, distributors, and dealers cannot resell the securities in the United States or to U.S. persons offshore without registration or an available exemption from registration.[305] For this purpose, a distributor is always in the restricted period as to shares part of an unsold allotment.[306] The ordinary investor-purchaser cannot resell the securities in the United States, but can resell them offshore to anyone on a DOSM provided the transaction is not pre-arranged with a person in the United States and in an offshore transaction with anyone including a U.S. person.[307] If the securities are registered, anyone

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an inter-dealer quotation system (as distinguished from the first trade). Kubik v. Goldfield, 479 F.2d 472 (3d Cir. 1973); SEC v. North Am. Research & Dev. Corp., 280 F. Supp. 106 (S.D. N.Y. 1968), *aff'd in part*, 424 F.2d 63, 81 n.14 (2d Cir. 1970); Lustgarten v. Albert Teller & Co., 304 F. Supp. 771, 772 (E.D. Pa. 1969). In all of these cases, however, the securities were sold in the United States in violation of § 5 as the seller was a statutory underwriter and, hence, did not have a § 4(1) exemption. Historically, § 4(3)(A) has been applied only to securities distributed in violation of the registration provisions, although literally it is not so restricted, and not to securities sold pursuant to an exemption. *See* Sec. Act Release No. 646 (Feb. 3, 1936). *See also* Jerome L. Coben, SEC No-Action Letter (Feb. 12, 1986) (LEXIS, Fedsec library, Noact file). The critical question in such event is whether Regulation S is to be viewed as an exempt offering for this purpose. The fact that Rule 144A expressly includes a dealer exemption suggests that it may not, although such inclusion may merely be to avoid any question in the Rule 144A context. The staff has indicated in the context of the category 1 safe harbor, that Regulation S is not an exemption for this purpose but is an unregistered offering for purposes of § 4(3). *See* Adopting Release, *supra* note 5, at 80,672 n.84. *See also* §5[a]. If it is not viewed as an exemption for purposes of § 4(3), the forty day period should be measured from the date of commencement of the public offering outside of the United States as otherwise a dealer could not effect a trade until someone placed a quotation in an inter-dealer quotation system and initiated a forty day period in which all trades would be in violation of § 4(3). This appears to be the conclusion of the staff. *Id.*

303. *See* Rule 144A (b)-(c). *See also* Adopting Release, *supra* note 5, at 80,680 n.135.

304. *See* Int'l. Income Property, Inc., SEC No-Action Letter [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,785 (Dec. 12, 1980).

305. *See* §5.

306. Rule 902(m).

307. *See* §6[a].

can resell them in the United States and anyone may resell them in the United States in reliance on an exemption including the Rule 144A exemption during the restricted period. The offering restrictions explicitly take into account such alternative.[308] The transactional restrictions of Regulation S literally preclude an issuer, distributor or dealer from selling to a U.S. persons during the restricted period although the one instance in which an agreement is obtained under the transactional restrictions from the purchaser provides an exclusion for the resale of securities that are registered or exempt from registration.[309] There is no reason, however, to attach significance to the exclusion of exempt or registered transaction notwithstanding such a provision was included in earlier versions of the then proposed Regulation, since it is self-evident that securities that are registered or exempt from registration can always be offered and sold in the United States. Similarly, the transactional restrictions literally preclude sales to U.S. persons and not sales in the United States; such further restriction is unnecessary, however, as sales in the United States are precluded by the general condition that requires offshore transactions.[310]

Regulation S does not deal with the status of the securities after termination of the restricted period except by implication. The category 1 safe harbor has no specific restricted period after the distribution as there are no offering restrictions or transactional restrictions, merely general conditions one of which is that the securities must be sold only in offshore transactions. The issuer, nonetheless, may chose to voluntarily establish a restricted period to avoid immediate flowback to the United States if that is likely, but presumably such period would not continue beyond the category 2 restricted period. The category 2 safe harbor precludes any sales of securities of a reporting issuer to U.S. persons for 40 days after the closing;[311] and the category 3 safe harbor imposes a 40-day restricted period on debt securities in that category and a 12-month restricted period on equity securities.[312] There is nothing in the restrictions relating to sales in the United States or to U.S. persons of securities of reporting companies and debt securities of non-reporting companies that extends beyond 40 days after the closing nor as to category 3 equity securities beyond one year. The purchaser, however, as to category 3 equity securities, must agree to resell such securities only in accordance with Regulation S, or if the securities are registered or exempt from registration, and these conditions literally continue indefinitely.[313] The offering restrictions specifically refer to limitations on offers and sales "within the restricted period."[314] Similarly, the notice disclosure required of dealers under Rule 904 (which

308. Rule 902(h).
309. Rule 903(c)(2)-(3).
310. *See* §4[a].
311. Rule 903(c)(2).
312. Rule 903(c)(3).
313. Rule 903(c)(3)(iii)(B)(2).
314. Rule 903(h)(2).

is applicable to both categories 2 and 3 securities) also refers to limitations on sales "prior to the expiration of the restricted period."[315] The reasonable construction, therefore, is that all the transactional restrictions in the Regulation are applicable to the restricted period only, subject to the caveat that the sale by a distributor of an unsold allotment is always within the restricted period.[316]

Regulation S, however, purports to deal only with offshore distributions and does not specifically provide when shares may be resold to U.S. persons or in the United States. The implication that one would ordinarily make is that once the restricted period has expired the securities can be freely resold in the United States. It seems downright deceitful to advise purchasers of restrictions applicable during a specified period and not tell them that they may extend beyond that period, if this is the case. There is, however, the troubling fact that under Release 4708 the staff always insisted that after the lock-up period an appropriate exemption had to be found for the sale of the securities in the United States or to U.S. persons.[317] Regulation S includes a Preliminary Note 6 that, although not specifically referring to the period after the restricted period, says something very similar: "Securities acquired overseas, whether or not pursuant to Regulation S, may be resold in the United States only if they are registered under the Act or an exemption from registration is available."[318] It is also interesting that the Rule 904 resale safe harbor is available for resales after the restricted period as well as during the restricted period and is not available to a distributor until after the end of the restricted period.[319] If the securities are no longer restricted after the period, there is no need to rely on Rule 904 after the period has expired.

The Proposing Release included several statements that deal with this issue. The Proposing Release observed that, "if the distribution has been completed and resales into the United States are only made in routine trading transactions," generally the securities, "would be considered to have come to rest abroad."[320] Specifically, the Release stated, referring

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315. Rule 904(c)(1).

316. Rule 902(m).

317. *See supra* note 301. The following is a fairly typical statement of the old staff position. "[W]e express no view as to when or under what circumstances the securities may be reoffered or resold in the U.S. or to its citizens or residents. Any such reoffers and resales must be made in compliance with the registration requirements of the 1933 Act or pursuant to an exemption thereunder. The availability of any such exemption would depend upon the facts and circumstances existing at the time of such reoffers and resales." Sears, *supra* note 270.

318. Adopting Release, *supra* note 5.

319. *See supra* notes 190-91 and accompanying text.

320. Proposing Release, *supra* note 3, at 89,132. The comment was prefaced with the reiteration of a statement in Release 4708 to the effect that trading in the United States shortly after completion of the distribution would be an indication that the distribution was "in fact being made by means of such trading." *Id.* The Release then discusses flowback, noting that equity is more likely to flowback to the issuer's home country or primary market than debt and that the existence of a trading market in the security in the United States

to securities of a reporting issuer, that the purpose of the transactional restrictions is not to prevent flowback, but, "to prevent securities from entering the U.S. capital markets while the market has been preconditioned for such securities . . . ."[321] The Proposing Release further set forth as a basic premise of the safe harbor provisions, "that periodic reporting under the Exchange Act can be relied upon for the protection of investors once the marketing effort has been completed. After the foreign distribution has been completed and the marketing efforts have terminated, routine secondary trading may begin as a matter of course. Where issuers are not subject to the reporting requirements of the Exchange Act, resale restrictions previously developed under Release 4708 to protect against flowback would continue."[322] This suggests that once the restricted period has expired, the securities of a reporting issuer can be traded in the United States, presumably, in reliance on the section 4(1) exemption for transactions not involving an issuer or underwriter and the section 4(3) dealer's exemption. The intention as to securities of a non-reporting issuer is less clear, but the contrast in the flowback danger may merely have been intended to rationalize the more stringent transactional restrictions for securities of non-reporting companies.

The Adopting Release explained the second category safe harbor as follows:[323]

> Securities of all domestic issuers that file reports under the Exchange Act are subject, under the second safe harbor category, both to the general conditions that an offer or sale be an offshore transaction and that no directed selling efforts may be made in the United States, and to specified selling restrictions. Securities of foreign reporting issuers[n. 105][324] with substantial U.S. market interest are subject to the same restrictions. The selling restrictions applicable to the second category are designed to protect against an indirect unregistered public offering in the United States during the period the market is most likely to be affected by selling efforts offshore. In the event flowback of reporting issuers' securities does occur after the restricted period, the information relating to such securities publicly available under the Exchange Act generally should be sufficient to ensure investor protection.

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increases the likelihood of flowback. *Id.* at 89,133. This seems to assume that so long as there is any danger of flowback to the United States that the securities have not come to rest offshore. Perhaps, it means no more than that a longer period must elapse between the completion of the distribution and routine trading transactions in the United States in the case of equity securities that have a trading market in the United States in order for the securities to be deemed to have come to rest offshore.

321. Proposing Release, *supra* note 3, at 89,136.

322. *Id.* at 89,129

323. Adopting Release, *supra* note 5, at 80,675 (footnotes from original text included).

324. [n.105] "Reporting issuer" is defined in Rule 902(1). Issuers furnishing material to the Commission pursuant to Rule 12g3-2(b) of the Exchange Act, 17 C.F.R. §240.12g3-2(b) are not reporting issuers.

The single most important statement relating to the resale of securities after expiration of the restricted period is buried in Note 110 of the Adopting Release and Note 113 of the Proposing Release. After noting the 40 day restricted period applicable to the second category safe harbor, the Releases explain the post-restricted period as follows: "Upon expiration of any restricted period, securities (other than unsold allotments) will be viewed as unrestricted."[325]

The Adopting Release explains the category 3 transactional restrictions as follows:[326]

> All securities not covered by the prior two categories fall into this residual category, which is subject to procedures intended to protect against an unregistered U.S. distribution where there is little (if any) information available to the marketplace about the issuer and its securities and there is a significant likelihood of flowback. This category includes securities of non-reporting U.S. issuers and equity securities of non-reporting foreign issuers with substantial U.S. market interest in their equity securities.
>
> As in the case of securities of reporting issuers, offerings of securities in this category are subject to the two general conditions and to offering and transactional restrictions. Offering restrictions that must be adopted for offerings of these securities are the same as for offerings of securities of reporting issuers. In contrast to offerings in the second category, more restrictive transactional restrictions to prevent flowback are applicable.

The enhanced concern about the flowback of equity securities of non-reporting companies because of the lack of information about them in the marketplace[327] may or may not suggest some ambivalence as to whether such securities after the appropriate restricted period can be resold in the United States without registration in reliance on section 4(1) or may merely explain the need for more stringent transactional restrictions. The Proposing and Adopting Releases suggested that Regulation S imposes substantially the same restrictions as InfraRed on securities of a non-reporting issuer.[328] Those restrictions required that after the restricted period the securities could be resold in the United States only pursuant to registration or if an exemption was available, or they could be resold offshore on a foreign securities exchange. This, however, may only be a safeguard to assure that a delayed U.S. distribution is not in progress. Footnote 110 to the Adopting Release comes close to a categorical statement that securities of any company are no longer restricted after the restricted

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325. Adopting Release, *supra* note 5, at 80,676 n.110; Proposing Release, *supra* note 3, at 89,137 n.113. The language in parenthesis was not in the Proposing Release, but the same note in the Proposing Release observed that securities held by a distributor representing an unsold allotment would remain restricted.

326. Adopting Release, *supra* note 5, at 80,679.

327. Proposing Release, *supra* note 3, at 89,138.

328. *Id.* at 89,139.

period: "Upon expiration of any restricted period, securities (other than unsold allotments) will be viewed as unrestricted."[329] Although made in the context of category 2, it is part of an explanation of the transactional restrictions and may have been intended to be applicable without regard to the safe harbor category.

Regulation S, although cast in terms of offers and sales that occur outside the United States, nonetheless, focuses on the concept of securities coming to rest outside the United States as determinative of whether a distribution is completed outside the United States. The other side of that coin is whether, under section 2(11) of the Securities Act, the purchasers are statutory underwriters. If the securities have come to rest, the distribution in the section 2(11) sense is completed and, absent extraordinary circumstances,[330] persons other than affiliates of the issuer can resell the securities in reliance on the section 4(1) exemption for transactions not involving an issuer or an underwriter.[331] On this basis, once the restricted period of the specific safe harbor provision has expired, the securities should be deemed to have come to rest and the distribution ended so that after that the securities can be resold in the U.S. or to U.S. persons in reliance on the section 4(1) exemption.[332] Unfortunately, Regulation S does not explicitly include a section 4(1) exemption for resales after the end of the restricted period although the Adopting Release comes close to doing so.[333] A reasonable assumption might be that in the staff's view a section 4(1) exemption will ordinarily be available after the expiration of the restricted period for resales in the United States or to U.S. persons, but that in an unusual case, for example, a deferred distribution involving special selling efforts in the United States, section 4(1) would not be available.

The question is somewhat less disconcerting for securities listed or otherwise traded on a DOSM. In that event, the offshore holder can resell the securities on the DOSM during the restricted period as well as after under the provisions of Rule 904.[334] The issuer, however, in the case of

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329. Adopting Release, *supra* note 5, at 80,676 n.110. Although the footnote is included in the section discussing the category 2 safe harbor, the reference is to "any restricted period."

330. The now largely discredited presumptive underwriter doctrine might treat someone purchasing a large part of the offering as a statutory underwriter even after the securities have come to rest.

331. Rule 144A(b)-(c), *supra* note 303. *See also* statement in the Adopting Release that nothing in Regulation S affects "the availability of the exemptions contained in those sections [§§4(1) and 4(3)]." Adopting Release, *supra* note 5, at 80,680 n.137.

332. Compare the coming to rest concept of the Rule 147(e) safe harbor under which an intrastate offering is deemed to come to rest within nine months after the completion of the distribution. A court has held that under the particular circumstances of the case securities sold in reliance on the intrastate offering exemption and resold in the interstate market after seven months had come to rest notwithstanding Rule 147(e). Busch v. Carpenter, *supra* note 10.

333. *See supra* note 326.

334. *See* §6[a].

category 3 equity securities, has an obligation not to transfer the securities unless such transfer is in compliance with Regulation S.[335] This should not preclude a transfer to a U.S. purchaser of securities resold pursuant to Rule 904 on a foreign stock exchange, at least if the issuer receives adequate assurances that the transaction was not pre-arranged.[336] Regulation S precludes a distributor from reselling category 3 equity securities to a U.S. person for one year, but there is no express limitation on the resale by the foreign investor-purchaser under Rule 904 other than the general conditions. To be an offshore transaction under Rule 902(i) neither the seller nor any person acting on the seller's behalf can know that the transaction has been pre-arranged with a buyer in the United States. This does not impose any duty on the seller to inquire about the residence of the buyer provided the transaction is not pre-arranged with a U.S. buyer.[337] The transactional restrictions require the issuer to refuse to transfer the securities to a U.S. person only if not sold in accordance with Regulation S. Assuming appropriate assurances are obtained that the transaction was not pre-arranged, the issuer should be able to transfer the securities. The U.S. purchaser could, in any event, resell the securities during the restricted period in the foreign market and is likely to do so if it is the primary market for the securities.

There is also the opportunity for securities sold offshore to make their way back to the United States through the private market that is likely to develop under Rule 144A. One purpose of Rule 144A is to permit qualified U.S. institutional buyers to acquire securities, particularly securities of foreign issuers, distributed offshore. If a Rule 144A purchaser who is a U.S. person acquires securities of a reporting issuer during the Regulation S restricted period, a number of interesting questions arise since generally securities purchased in reliance on the Rule 144A exemption are restricted securities under Rule 144(a)(3), which would require a holding period of two years from the date initially purchased from the issuer.[338] If, however, a non-securities professional in reliance on Rule 904, sells Regulation S securities through a DOSM and the purchaser is a qualified Rule 144A purchaser, query whether there are any further restrictions on the resale of the securities in view of the fact that although the securities may be Rule 144A eligible securities they were not sold in reliance on that exemption? If the securities were acquired from a securities professional, however, reliance would have to be placed on Rule 144A since the Rule 904 safe harbor is not available to a dealer for sales to a

335. *See* §5[d].

336. If the buyer during the restricted period turns out to be a U.S. person, the buyer will have no notice of the restrictions and understandably would be disappointed if on transfer the issuer refused to transfer the securities in compliance with the category 3 restrictions relating to equity securities.

337. *See* §6[a]. The Adopting Release, *supra* note 5, at 80,681 n.140, in the context of the Rule 904 safe harbor, states: "The safe harbor does not place a duty of inquiry on the securities professional."

338. Rule 144(d)(1), *supra* note 49.

U.S. person during the restricted period. If a qualified Rule 144A purchaser purchases Regulation S securities after the end of the restricted period, reliance could be placed on section 4(1) rather than Rule 144A, the shares would no longer be restricted, and the transaction could take place in the United States. Since securities sold in reliance on Rule 144A are restricted securities as defined by Rule 144(a)(3),[339] qualified Rule 144A purchasers will tend to structure transactions so that they can rely on the shorter Regulation S restricted periods unless there is a liquid Rule 144A market or DOSM for them.[340]

The extent to which trading will be precluded beyond the restricted period depends on resolution of the issues discussed above. Such issues, hopefully, will not give rise to the type of theology prevalent for years relating to "investment intent" before the adoption of Rule 144. For the most part, it will not be a concern of the underwriters who can rely on the safe harbor except to the extent some participants in the underwriting may be concerned about their clients and insist on an opinion regarding the free trading nature of the securities after the restricted period. Qualified Rule 144A institutional purchasers also will have concerns in this regard and may want assurance in an opinion of counsel. It also will be of concern to issuers particularly with respect to category 3 equity securities for which issuers must establish a mechanism for preventing transfers of record to U.S. purchasers. Although in most instances, a resale after the restricted period, if a violation of section 5, should not place the entire "exemption" in jeopardy,[341] it, nonetheless, will be a troublesome transfer agency problem and may place a premium (as was true of pre-Rule 144 opinions) on obtaining an opinion from counsel who tends to see the issue in oversimplified terms. The most concerned party, perhaps, should be the National Association of Securities Dealers. The NASD's PORTAL market must deal with these issues in connection with securities distributed under Regulation S and traded in PORTAL when a seller attempts to exit PORTAL[342] and uncertainties in this regard as to securities distributed under Regulation S could introduce severe inefficiencies.

The interpretive process, hopefully, will make it clear that reliance can be placed on statements in the Proposing and Adopting Releases that after the end of the restricted period the securities can be traded routinely in the United States. This was probably the general position of the securities bar under Release 4708, notwithstanding the staff's admonitions. There is little evidence that enforcement personnel of the Commission attempted to police leakage into the U.S. securities markets of securities distributed under 4708 once the lock-up period expired. It would,

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339. Rule 144(a)(3), *supra* note 49 (as amended in Securities Act Release No. 6862 [1989-90 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶84,523 (Apr. 23, 1990)).

340. *See* §11 for further discussion of the interrelationship of Regulation S and Rule 144A.

341. *See* §5[f].

342. *See* §11.

nonetheless, have been helpful if Regulation S specifically stated that persons acquiring securities issued in compliance with the provisions of Regulation S are not an underwriter for purposes of section 4(1) and that dealers have the section 4(3) exemption with respect to sales in the U.S. or to U.S. persons after the expiration of the restricted period. If Regulation S is used to make a deferred distribution into the United States after the restricted period, reliance could be placed on the fact that "technical compliance" is not sufficient if, "part of a plan or scheme to evade the registration provisions of the Act . . . ."[343]

§11 RULE 144A AND THE PORTAL MARKET

Rule 144A in broad outline is deceptively simple. The rule in subparagraph (a) defines qualified institutional buyers ("QIB's") as any legal entity with a portfolio of securities based on cost (and in limited instances on market value) of $100 million or more either owned or managed with discretionary authority.[344] There are two exceptions, a bank or savings and loan, whether foreign or domestic, in addition must have a net worth of $25 million.[345] A registered broker-dealer need have only a portfolio of $10 million owned or managed under discretionary authority.[346] The purchase must not only be by a QIB, but the QIB must purchase for its own account or the account of another QIB.[347]

The securities that can be the subject of a Rule 144A exemption are any security that is not part of a class of securities traded on a U.S. exchange or on NASDAQ ("fungible securities").[348] Securities traded on an offshore securities exchange or other offshore market, in the pink sheets, and the NASD's Over the Counter Electronic Bulletin Board[349] qualify for Rule 144A transactions provided they are not also traded on a U.S. exchange or NASDAQ.

The seller in connection with all Rule 144A transactions must inform the QIB that the seller may rely on Rule 144A.[350] This does not require any legend or formal document although sellers are not precluded from formalizing this requirement if they choose. There are no further disclosure requirements for reporting companies, foreign governments, and for foreign non-reporting companies which are exempt from registration and reporting under Rule 12g-3(2)(b). Other foreign non-reporting issuers and all U.S. non-reporting issuers must be committed to make available to the holder of the security or a person designated by the holder certain basic information relating to the issuer including a brief statement of the na-

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343. Preliminary Note 2 of Regulation S, Proposing Release, *supra* note 2.
344. Rule 144A(a)(1)(i).
345. Rule 144A(a)(1)(vi).
346. Rule 144A(a)(1)(ii).
347. Rule 144A(a)(1)(i)-(ii),(iv)-(vi).
348. Rule 144A(d)(3).
349. *See* Securities Exchange Act Release No. 27,975 (May 1, 1990).
350. Rule 144A(d)(2).

ture of its business and product or service line, a reasonably current balance sheet and two years of income statements, audited if reasonably available.[351] The exemption is further conditioned upon such information being made available to the buyer if requested.[352]

Subparagraph (b) of the rule provides that if the conditions of Rule 144A are complied with, a seller, other than an issuer or dealer, shall not be deemed an underwriter for purposes of section 4(1) of the Securities Act. Subparagraph (c) of the rule provides that if the conditions of Rule 144A are complied with, a dealer shall not be deemed an underwriter and shall be deemed to have the benefit of the section 4(3) exemption. Preliminary Note 7 provides that the fact that one purchases from an issuer with a view to resale pursuant to Rule 144A does not affect the availability of a section 4(2) or Regulation D exemption. The overall effect is that if the conditions of Rule 144A are complied with, the transaction does not involve a sale by an issuer or underwriter; hence the section 4(1) exemption is available for a seller who is not an issuer or underwriter and the section 4(3) dealer exemption is available for the dealer. None of this provides an exemption for the issuer, but in fact there is a hybrid section 4(2) Rule 144A exemption available if the issuer sells, for example, to a dealer relying on section 4(2) or Regulation D and the dealer resells in reliance on Rule 144A. Preliminary Note 7 specifically provides that such resale does not affect the issuer's exemption. This would require, however, that the dealer actually purchase the shares and not act as the issuer's agent. In the latter event, reliance would have to be placed on Regulation D for the sales to the ultimate investors.

Securities sold pursuant to Rule 144A are restricted securities as that term is defined by Rule 144(a)(3).[353] Such securities, however, can be resold in other Rule 144A transactions without regard to the Rule 144 two-year holding period. Further, the Commission concurrently amended Rule 144(d)(1) so that in a series of Rule 144A or other exempt transactions the holding period does not commence anew, rather the buyer can tack on the holding periods of its predecessors back to the initial transaction with the issuer or an affiliate of the issuer, whichever is the last to occur. This provision should significantly increase the liquidity of securities that are privately placed.

The SEC has approved[354] and the NASD on June 18, 1990 launched the PORTAL Market, a computerized, screen based, quotation, trading, settlement, and clearance system devoted exclusively to Rule 144A qualified securities. PORTAL is a closed market, open only to QIB's, registered SEC securities dealers who are also QIB's, and brokers who are members of the NASD and engaged in the general securities business. All

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351. Rule 144A(d)(4).
352. *Id.*
353. Rule 144A, Preliminary Note 6.
354. *See* Securities Exchange Act Release No. 27,956 (April 27, 1990).

PORTAL participants must apply to the NASD for approved status and engage in a number of undertakings to assure that the securities are sold within PORTAL only to PORTAL QIB's and that the securities exit the PORTAL market in a manner that assures there will be no violation of the registration provisions of the Securities Act. A qualified Rule 144A security becomes a PORTAL security only if a PORTAL participant has applied for its designation as such and the applicant deposits or arranges for the issuer to deposit the securities with the PORTAL depository. The undertakings require the QIB's to purchase only for their own account or the account of another QIB. Only PORTAL dealers can make a market in a PORTAL security. A PORTAL broker cannot purchase a PORTAL security for its own account, but as agent can submit quotations on the PORTAL screens and can purchase PORTAL securities for a QIB. The PORTAL participants cannot sell a PORTAL designated security outside of PORTAL except in limited exit transactions, which include Rule 144 and Rule 145 transactions, which must be effected through a PORTAL dealer or broker.[355]

The PORTAL Market ultimately is to be available for primary placements and secondary trading in Rule 144A securities of both foreign and U.S. issuers. It is presently available only for primary placements of foreign issuers. A primary placement is effected by a PORTAL dealer purchasing a block of securities from the issuer and then placing them through the PORTAL market. The mechanism may involve a letter of intent between the issuer and PORTAL dealer, a testing of the market by soliciting indications of interest through the PORTAL screens and then purchasing the securities from the issuer and selling them on PORTAL on the basis of the pre-offering marketing.

PORTAL satisfies the Rule 144A requirement that the seller notify the buyer that it may rely on Rule 144A by requiring all participants to acknowledge that they understand that any PORTAL transaction may involve a reliance on Rule 144A. In the case, however, of the non-reporting issuers subject to the additional disclosure requirements of Rule 144(d)(4), no provision is made for making this information available through PORTAL. The NASD, however, is expected in connection with an application for the designation of a security as a PORTAL security to "assess" the issuer's commitment to provide such information to a holder or persons designated by the holder of the security.[356]

§12 SUMMING UP THE RESTRICTIONS ON SALES IN THE UNITED STATES AND TO U.S. PERSONS

The interrelationship of the offering restrictions, the general condi-

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355. The description of the PORTAL Market is based on the PORTAL Rules approved by the SEC. *Id. See also* the PORTAL Proposal as summarized in Securities Exchange Act Release Nos. 27,470 (Nov. 24, 1989), and 27,692 (Feb. 8, 1990).

356. Securities Exchange Act Release No. 27,975, *supra* note 233.

tions and transactional restrictions in relationship to each other and to Rule 144A are so complex that to discuss them conceptually tends to obscure the circumstances under which securities distributed offshore can be sold in the United States or to U.S. persons. This section attempts to focus on transactions rather than concepts, and the narrow issue of sales in the United States or to U.S. persons. The persons involved in transactions are classified as distributors, securities professionals (dealers, sub-underwriters,[357] and other persons receiving a selling concession, fee, or other remuneration in connection with the transaction), officers and directors of the issuer, and investors (non-securities professionals but including institutional investors that are not dealers or sub-underwriters).

Before focusing on transactions, however, it may be helpful to outline some of the interrelationships. The offering restrictions are applicable only to the category 2 and 3 issuer-distributor safe harbors, are applicable during the restricted periods of those safe harbors, and are applicable to the issuer, each distributor, their respective affiliates, and all persons acting on their behalf.[358] The general condition relating to offshore transactions is applicable to the issuer and distributor safe harbors (all categories) and to the resale safe harbor.[359] The general condition relating to directed selling efforts is applicable to the issuer and distributor using the safe harbors of Rule 903 for the entire restricted period.[360] As for the resale safe harbor of Rule 904, it is applicable only to the selling shareholder or someone acting on his behalf. The transactional restrictions are applicable during the restricted period to the persons (sellers) involved in the transaction. The Rule 904 safe harbor is unique in that it may be relied upon after the expiration of the restricted period at which point only the general conditions are applicable; that is, the transaction must be offshore and there can be no directed selling efforts in the United States by the seller or a person acting for the seller.

[a] *Distributors*

During the distribution and the restricted period and so long as a distributor is selling any part of an unsold allotment, a distributor, with

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357. Subunderwriters are typically institutional investors who assume part of the underwriting risk by agreeing to purchase a specified number of shares if the offering is not completed and receive a concession from the offering price on shares actually purchased and part of the underwriting concession for assuming the risk. Subunderwriters are common in the United Kingdom, but cannot be part of a U.S. underwriting syndicate because of NASD rules that preclude a member from granting a selling concession to anyone other than a member of the NASD. NASD Rules of Fair Practice, Rule 25, NASD Sec. Dealers Man. (CCH) §2175(b)(1).

358. Rule 144A Adopting Release, *supra* note 5, at 80,679.

359. *See* §4[a].

360. Regulation S does not specifically provide how long after completion of the distribution directed selling efforts are prohibited. However, the Adopting Release specifically states that as to the second and third safe harbor categories they remain in effect during the restricted period. Adopting Release, *supra* note 5, at 80,668.

certain minor exceptions noted below, cannot sell a security distributed pursuant to Regulation S in the United States or to U.S. persons. Securities that are part of the distributor's unsold allotment are always within the restricted period until sold.[361] During the restricted period, distributors are subject to the distributor safe harbor rather than the resale safe harbor even if they have distributed their allotment and must comply with the more onerous conditions including, for example, with respect to equity securities and the category 3 safe harbor obtaining appropriate certifications from purchasers that they are not U.S. persons and are not purchasing for a U.S. person.[362] After completion of the distribution and the end of the restricted period, the distributor can rely on the Rule 904 resale safe harbor, but the question arises as to why it should be necessary to do so since in most instances there would be a section 4(1) exemption for the resale.[363] During the distribution and restricted period, distributors can sell to foreign affiliates of U.S. persons that meet the criteria necessary to avoid being U.S. persons provided the transaction is offshore.[364] The distributors can also sell the securities under Regulation S to U.S. investment advisers with discretion to purchase for accounts of non-U.S. persons and in this narrow area the transaction can take place in the United States.[365] A distributor acting as principal can sell the securities in or out of the United States if the securities are Rule 144A eligible securities to a Rule 144A qualified institutional investor, but in such event the purchaser has acquired restricted securities under Rule 144(a)(3). A distributor could also sell the securities acting as agent for the issuer in the United States to U.S. persons in reliance on the Regulation D exemption. During the entire restricted period, the distributor, even if it has sold its allotment and is not engaged in the offshore secondary market, cannot engage in directed selling effort in the United States. This, among other things, would subject the distributor to the Rule 139 restrictions on publishing information, an opinion or a recommendation

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361. *See supra* note 203. The distributor after the restricted period subject to certain limitations can place the shares representing the unsold allotment in a segregated account and sell other shares of the same class in reliance on Rule 904 and, presumably, §4(1). *Id.*

362. *See* Adopting Release, *supra* note 5, at 80,666. Regulation S is not explicit that a distributor remains a distributor (and, hence, cannot use Rule 904) after it has sold its allotment for the balance of the restricted period. The Adopting Release, however, makes it clear that the distributor remains subject to the conditions of Rule 903 throughout the restricted period and cannot rely on Rule 904 for resales. *Id.* The undertaking required by the offering restrictions specifically precludes a distributor from selling in the U.S. or to a U.S. person during the restricted period. Rule 902(h)(1). It is not clear, however, why any transaction involving a resale by him during the restricted period should be subject to Rule 903 rather than 904. His undertaking under the offering restrictions is to sell the securities during the restricted period "in accordance with the provisions of [Rule] 903 or [Rule] 904 . . . ." *Id.*

363. *See* §10[b].

364. *See* §3.

365. *See id.* Transactions may also take place in the United States if the sale is to certain international organizations, including the United Nations, the International Monetary Fund and the International Bank for Reconstruction and Development. Rule 902(o)(7), 902(i)(3).

relating to the security.[366]

[b] *The Investor*

The investor who is not a securities professional can resell the securities during the restricted period in on or through a DOSM, provided the transaction is not prearranged with a U.S. person. He can sell off a DOSM directly to a U.S. person provided the transaction is offshore. He probably can sell the securities during the restricted period through a securities professional acting as his agent to a U.S. person if the transaction is offshore.[367] The investor could also sell to a foreign affiliate of a U.S. person that for Regulation S purposes is not a U.S. person in an offshore transaction and in any transaction to a professional fiduciary (other than a trust or estate) having discretion to purchase the securities for the account of a non-U.S. person.[368] The investor could also sell the securities if they are Rule 144A eligible securities in reliance on Rule 144A to qualified Rule 144A purchasers who are U.S. persons, including sales that take place in the United States, but the purchaser will have acquired securities restricted under Rule 144(a)(3).[369]

[c] *The Securities Professional*

The securities professional can resell the securities on a DOSM which can include sales to U.S. persons provided that the transaction is not prearranged. The securities professional could not sell the securities during the restricted period off of a DOSM to a U.S. person, but can sell then offshore to any non-U.S. person.[370] The securities professional could sell securities offshore to affiliates of U.S. persons that are not U.S. persons if the transaction is offshore.[371] The securities professional can sell the securities in the United States during the restricted period in reliance on Regulation S to persons having discretion to act for non-U.S. persons and to an international organization.[372] The securities professional can also sell the securities in the United States or to U.S. persons in reliance on Rule 144A, but the purchaser in that event will acquire restricted securities.[373]

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366. *See* §4[b].

367. The qualification is necessary because it is not clear whether the restrictions on sales by securities professional are applicable in any transaction in which the securities professional is acting for the seller or whether they are applicable only when the securities professional is selling securities for its own account. *See supra* note 223.

368. *See supra* notes 22-26 and accompanying text.

369. Rule 144A(b), (c). *See* Adopting Release, *supra* note 5, at 80,680 n.135.

370. *See* §6[a].

371. *See* §3.

372. *See supra* note 26.

373. Rule 144(a)(3), *supra* note 49.

[d] *Officers and Directors of the Issuer*

The initial proposals of Regulation S excluded affiliates of the issuer or distributor from relying on the Rule 904 safe harbor for resales. Presumably, officers and directors of the issuer would have to be non-U.S. persons to have purchased securities sold to them in reliance on Regulation S. This may occur with respect to foreign issuers and in some instances U.S. issuers as well. If the Regulation S securities are sold in reliance on the category 2 or 3 Rule 903 safe harbors, such officers and directors might in any event be precluded from relying on Rule 904 during the restricted period. The Adopting Release cautions that officers and directors cannot use Rule 904 as a conduit for the distribution of the issuer's securities, stating: "Thus, securities being offered in a distribution by the issuer could not be resold under Rule 904 by an officer or director during the distribution or during any applicable restricted period."[374] Presumably, officers and directors can rely on Rule 904 after the restricted period for the resale of securities acquired as part of a Regulation S distribution.

The Rule 904 safe harbor is also available for resales of securities acquired in the United States in exempt transactions.[375] Officers and directors are likely to have acquired significant securities of the issuer in exempt transactions. Further, the section 4(1) exemption generally is not available to affiliates although they can offer securities by complying with the conditions of Rule 144. If a secondary market develops offshore for the securities, Rule 904, if available, provides affiliates with additional liquidity. Rule 904 as adopted permits officers and directors who are affiliates solely because they hold such position to rely on the safe harbor provided they pay only the usual and customary brokerage commission in connection with the execution of the transaction.[376] Although measured by what would be the usual and customary commission in a brokerage transaction executed by an agent, this condition does not literally require an agency transaction. It may, however, be advisable to structure the transaction as an agency transaction since it may otherwise be difficult to determine the amount of the transaction compensation and whether it exceeds the usual and customary brokerage commission.

[e] *Offers and Sales After the Restricted Period*

The foregoing discussion focuses on sales during the restricted period. There is no post restricted period for distributors. So long as they are selling part of their allotment they are in the restricted period. After the restricted period, in inverse order of length of restricted period, investors and securities professionals can resell under Rule 144, Rule 144A, and section 4(1) or Rule 904. Presumably, in most instances the sales will

374. Adopting Release, *supra* note 5, at 80,680 n. 139.
375. *See* §6[b].
376. Rule 904(2). *See* §6[b].

be made in reliance on the section 4(1) exemption which, based on the Commission statements in the Releases relating to Regulation S,[377] would ordinarily be available for routine trading transactions involving sales in the United States. The issue, however, is not free from doubt.[378] For that reason, particularly if there is an offshore market for the security, sellers may elect to rely on Rule 904.

[f] *The Legend*

Since offering restrictions are not applicable to the category 1 safe harbor and since there is no restricted period, Regulation S requires no disclosure of the registration status of the securities if reliance is placed on the category 1 safe harbor.[379] During the restricted period, the offering restrictions applicable to category 2 and 3 safe harbors, require the use of a legend on the Prospectus and in other offering materials and documents.[380] The only legend required on a certificate is in connection with the sale of equity securities of a non-reporting U.S. company in reliance on the category 3 safe harbor.[381] The following literally complies with the offering restriction requirements:

> The securities covered by this Prospectus have not been registered with the United States Securities and Exchange Commission under the Securities Act of 1933 (the "Act"). Prior to [the day after the expiration date of the restricted period] the securities cannot be offered or sold in the United States or to U.S. persons as defined by Rule 902(o) adopted under the Act, other than to distributors, unless the securities are registered under the Act, or an exemption from the registration requirements of the Act is available.[382]

The following legend literally complies with the requirements of Regulation S relating to certificates issued to purchasers of equity securities in reliance on the category 3 safe harbor:

> The securities covered by this Certificate have not been registered with the United States Securities and Exchange Commission under the Securities Act of 1933 ("the Act"). Holders of the securities prior to [the day after the expiration date of the restricted period] can resell the shares only if registered under the Act, pursuant to an exemption from registration under the Act, or in transactions effected in accordance with the provisions of Rule 904 of Regulation S adopted under the Act.[383]

The first legend fails to reflect all of the nuances of Regulation S, and

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377. *See* §10[b].
378. *See* §10.
379. *See* §5[a].
380. *See* §5[b].
381. Rule 903(c)(3)(iii)(B)(3).
382. Rule 902(h)(2).
383. Rule 903(c)(3)(iii)(B)(3).

it may not be possible to do so in a meaningful fashion. There is a limited category of non-U.S. persons to whom offers and sales can be made in the United States.[384] Further, although the issuer-distributor safe harbor may not depend on it, the purchaser-investors are not informed by the foregoing legends of the conditions of their safe harbor or, insofar as the offering restrictions are concerned, that there are any restrictions on their resale. The following legend may be more informative in this respect:

> The securities covered by this Prospectus [Certificate] have not been registered under the Securities Act of 1933 (the "Act") with the United States Securities and Exchange Commission and it is not intended to register them. Prior to [the day after the expiration date of the restricted period] the securities cannot be offered or sold in the United States or to U.S. persons as defined by Rule 902(o) adopted under the Act, other than to distributors, unless the securities are registered under the Act, or an exemption from the registration requirements of the Act is available. Purchasers [Holders] of the securities prior to [the day after the expiration date of the restricted period] can resell the shares only pursuant to an exemption from registration under the Act, or in transactions effected outside of the United States [including transactions executed on the _____ Exchange] and provided they do not (and no one acting on their behalf) solicit purchasers in the United States or otherwise engage in selling efforts in the United States. A holder of the securities who is a distributor, dealer, sub-underwriter or other securities professional, in addition, cannot prior to [the day after the expiration date of the restricted period] resell the securities to a U.S. person as defined by Rule 902(o) of Regulation S unless the securities are registered under the Act or an exemption from registration under the Act is available.

One might add to all of the above legends a paraphrase of Preliminary Note 6 that might read as follows: "Thereafter [after the restricted period] the securities can be sold in the United States only if registered or if an exemption from registration is available."

If a legend is used with the "thereafter" clause attached, the combined statements add up to little more than a statement that the securities cannot be sold in the United States (or during the restricted period to a U.S. person) without registration or an exemption from registration. Such a message is singularly uninformative. The question is to whom is the message to be communicated and whether there can be a right message for all Regulation S purchasers. Thus, although there is no restricted period for securities included in the category 1 safe harbor because the offering is an "overseas directed offering," it may, nonetheless, be advisable to impose a restriction to assure compliance with the conditions of an ODO.[385] The following legend might be considered for this purpose:

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384. *See supra* notes 24-26 and accompanying text. Included in the same category are also certain international organizations. *See* Rule 902(i)(3).

385. *See supra* note 132 and accompanying text.

> The securities covered by this Prospectus have not been registered under the Securities Act of 1933 (the "Act") with the United States Securities and Exchange Commission and it is not intended to register them. The securities are offered only to residents of [name of country in which the offering is made] and cannot be purchased by non-residents of [name of country] or for the benefit of non-residents. Prior to [the day after the fortieth day from commencement of restricted period, if there were a restricted period] the securities cannot be offered, sold, assigned, or transferred to a non-resident of [name of country]. Purchasers of the securities prior to [same date as above] can resell the shares only pursuant to an exemption from registration under the Act, or in transactions effected outside of the United States [including transactions executed on the _____ Exchange] and provided they do not (and no one acting on their behalf) solicit purchasers in the United States or otherwise engage in selling efforts in the United States.

The issuer and distributor safe harbors are based on assumptions as to the securities markets to which trading activity in the security is likely to flow. If in an ODO or other offering within the category 1 safe harbor the assumptions are realistic, probably no legend is needed. The assumptions may not be realistic, however, as to an ODO made in Canada, for example, or an equity offering as to which there is no SUSMI as there can be, for example, a substantial U.S. trading market in a foreign security without such trading constituting a SUSMI.[386]

If the offshore distributions involve bearer bonds of a U.S. issuer, the impact of the tax laws should also be taken into account in framing appropriate restrictions.

§13 INTERRELATIONSHIP OF REGULATION S AND TAX PROVISIONS

Although the Proposing Release did not mention the interaction of Regulation S with federal income tax law, the financial community quickly realized the link between the two regulatory schemes.[387] Section 163 of the Code generally allows a taxpayer to deduct all interest paid or accrued within a taxable year on indebtedness.[388] The Code, however, generally denies a deduction for, *inter alia*, interest on any "registration-required obligation" unless it is in registered as opposed to bearer form.[389] The term "registration-required obligation" does not include an obligation that is issued under arrangements reasonably designed to ensure that it will be sold only to a person who is not a "U.S. person" and meets certain other requirements.[390] Specifically, this provision excludes from

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386. *See* §5[a].

387. *SEC, IRS Headed for Fight on Safe Harbors*, CORP. FIN. WK. 10 (Dec. 12, 1988) [hereinafter *Headed for a Fight*]; Maher, *Reg. S. Creates Tax Loophole for Americans Abroad*, INVESTMENT DEALERS' DIG. 42 (Aug. 22, 1988).

388. I.R.C. §163(a) (1954).

389. I.R.C. §163(f)(1) (1954).

390. I.R.C. §163(f)(2)(A) and (B) (1954). The term "registration required obligation"

the definition of "registration-required obligation" an obligation if there are arrangements reasonably designed to ensure that it will be sold (or resold in connection with the original issue) only to a person who is not a United States person, and (i) interest on the obligation is payable only outside the United States and its possessions, and (ii) on the face of the obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws.[391] If an obligation is a "registration-required obligation," the issuer is not only denied an interest deduction if the security is sold in bearer form, but also is subject to an excise tax.[392] Treasury regulations implement this provision of the Code.[393]

Regulation S impacted the Treasury regulations issued under section 163(f) of the Code because the regulations, in part, were based upon incorporated aspects of federal securities law.[394] One provision of the Treasury regulations under section 163(f)(2)(8) previously stated that the sale of an obligation would meet the "arrangements reasonably designed" test if, *inter alia*, the obligation was not registered under the Securities Act, "because it was intended for distribution to persons who are not United States persons."[395] The regulations previously provided that, for such purposes, "the term 'United States person' has the same meaning as it has for purposes of determining whether an obligation is intended for distribution to persons under the Securities Act."[396]

Regulation S similarly affected another important provision of the Code that, in turn, relied upon section 163(f)(2)(B). Under the Code, a thirty percent withholding tax is generally imposed on interest or dividends derived by foreign persons from sources within the United States.[397] No tax, however, is imposed on a foreign person in the case of, *inter alia*, "portfolio interest."[398] The term "portfolio interest" includes interest which is paid on any obligation described in section 163(f)(2)(B) of the Code, (i.e., obligations sold under arrangements reasonably designed to ensure they are not sold to U.S. persons).[399] This is the same

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also does not include an obligation which (1) is issued by a natural person; (2) is not of a type offered to the public; or (3) has a maturity of not more than one year. I.R.C. §163(f)(2)(A) (1954). Query, whether the typical Eurobond issue would be deemed offered to the public. Such bonds often escape regulation in Europe on the theory that they are not offered to the public.

391. I.R.C. §163(f)(2)(B) (1954). *See* Treas. Reg. §1.163-5(c)(2)(v) (1954) (interest payable outside the United States).

392. I.R.C. §4701(a) (1954).

393. Treas. Reg. §1.163-5 (1990).

394. *See* Treas. Reg. §1.163-5(c)(2)(i)(A) (1990).

395. *Id. See* Haseltine, *United States Tax and Securities Laws: Working "Together" Toward Different Goals in Eurobond Financing*, 11 MD. J. INT'L L. & TRADE 228, n.25 (Summ. 1987) [hereinafter *Working Together*].

396. Treas. Reg. §1.163-5(c)(2)(i)(A) (1990).

397. I.R.C. §§871(a), 881(a).

398. *Id.* at §§871(h)(1); 881(c)(1).

399. *Id* at §§871(h)(2)(A); 881(c)(2)(A).

section discussed above that provides the exception to the rule denying the interest deduction for bearer securities that was linked to Release 4708 by the prior Treasury regulations.[400]

The Service was disinclined to incorporate into its regulations Regulation S as proposed by the Commission,[401] and, therefore, proposed amendments of its own on August 24, 1989.[402] The regulations were adopted on May 7, 1990.[403] Although the new tax regulations follow Regulation S in many respects, the Service diverged from the SEC in a number of important areas, including the definition of "U.S. person," the ability to sell to U.S. persons during a restricted period following a distribution and certification requirements. As the Service stated, "[t]hese final regulations are separate and independent from the rules and interpretations that the SEC chooses to adopt in its administration of the securities laws."[404] Noting that it would consider the SEC's interpretation of its regulations "where appropriate," the Service pointed out that it "must ultimately base its interpretations on the tax policies underlying section 163(f)(2)(B)."[405] To a significant extent, the new IRS regulations nullify the benefits of Regulation S for U.S. companies desiring to issue debt securities in a market that requires bearer securities, such as the Eurobond market.[406]

The new Treasury regulations contain three basic requirements. First, the issuer must not offer or sell the obligation during the "restricted period"[407] to a person who is "within the United States"[408] or its possessions or to a "U.S. person."[409] The same general requirement ap-

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400. Treas. Reg. §1.163-5(c)(2)(i)(A) (1990).

401. *See Headed for a Fight*, *supra* note 387.

402. 54 Fed. Reg. 35,200 (1989).

403. T.D. 8300, 55 Fed. Reg. 19,622 (1990); *see* 47 TAX NOTES 804 (May 14, 1990). With respect to obligations originally issued after May 10, 1990 and on or before September 7, 1990, the issuer may choose to apply the new rules or the rules set forth in other provisions of the regulations. T. D. 8300, 55 Fed. Reg. 19,623 (1990).

404. T.D. 8300, 55 Fed. Reg. 19,623 (1990).

405. *Id.* at 19,623.

406. Regarding the necessity for bearer securities in the Euromarket, *see Working Together*, *supra* note 393, at 223, 229. In the case of an obligation issued only outside the United States by an issuer that does not significantly engage in interstate commerce with respect to the issuance of such obligation, different rules may apply. Treas. Reg. §1.163-5(c)(2)(i)(C) (1990). Under limited circumstances, a U.S. issuer may rely upon these rules. *Id.*

407. *See infra* note 414.

408. An offer or sale will be considered to be made to a person who is "within the United States" or its possessions if the offeror or seller of the obligation has an address within the United States or its possessions for the offeree or buyer of the obligation with respect to the offer or sale. There are certain exceptions to this provision. Treas. Reg. §1.163-5(c)(2)(i)(D)(1)(iii)(A) (1990).

409. Treas. Reg. §1.163-5(c)(2)(i)(D)(1)(i) (1990). The term "United States person" is defined in I.R.C. §7701(a)(30) (1954) in a manner different from the definition in Regulation S. *See supra* note 403. The obligation may, however, be sold to a U.S. person in certain circumstances. T.D. 8300, *supra* note 403, at 19,623. There are other exceptions to the gen-

plies to "distributors,"[410] and the failure of a distributor to meet the standard would appear to result in adverse tax consequences to the issuer. A distributor, however, will be deemed to satisfy the requirement if it covenants that it will not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a U.S. person, and the distributor has in effect procedures reasonably designed to ensure that its agents who are engaged in selling the obligation are aware that the obligation may not be offered or sold during the restricted period to a person who is within the United States or is a U.S. person.[411]

The second general requirement is that in connection with the sale of the obligation during the restricted period, neither the issuer nor any distributor deliver the obligation in definitive form within the United States or its possessions.[412] Third, on the earlier of the date of the first payment of interest by the issuer on the obligation or the date of delivery by the issuer of the obligation in definitive form, a certificate must be provided to the issuer stating that on such date, the obligation is owned by a person that is not a U.S. person. There are certain exceptions to the certification requirement.[413]

A "distributor" means a person who offers or sells the obligation during the restricted period pursuant to a written contract with the issuer or pursuant to a written contract with such a person, or in some cases an affiliate that acquires the obligation from another member of its affiliated group for the purpose of offering or selling the obligation during the restricted period.[414] The "restricted period" begins on the earlier of the closing date (or the date on which the issuer receives the loan proceeds, if there is no closing) or the date on which the obligation is offered to persons other than a distributor, and ends on the expiration of the forty day period beginning on the closing date (or the date on which the issuer receives the loan proceeds, if there is no closing with respect to the obligation).[415] However, any offer or sale of an obligation by the issuer or a distributor shall be deemed to be during the restricted period if the issuer or distributor holds the obligation as part of an unsold allotment or subscription.[416]

"U.S. Person" is not defined in the new regulations, so the general

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eral rule. *See* Treas. Reg. §1.163-5(c)(2)(i)(D)(1)(iii)(B), (C) (1990).

410. *See infra* note 414.

411. Treas. Reg. §1.163-5(c)(2)(i)(D)(1)(ii)(B) (1990).

412. Treas. Reg. §1.163-5(c)(2)(i)(D)(2) (1990).

413. *E.g.*, Treas. Reg. §1.163-5(c)(2)(i)(D)(3)(iii) (1990) (targeted offshore offerings).

414. Treas. Reg. §1.163-5(c)(2)(i)(D)(4). Treas. Reg. §1.163-5(c)(2)(D)(5) (1990) sets forth the concept of "exempt distributor." An offer or sale will not be treated as made to a person in the United States or to a U.S. person if the person to whom the offer or sale is made is an exempt distributor. *Id.* at §1.163-5(c)(2)(i)(D)(1)(iii)(B).

415. Treas. Reg. §1.163-5(c)(2)(D)(7) (1990).

416. *Id.*

definition of the Code would apply.[417] The Code defines "U.S. person" to mean (i) a citizen or resident of the United States; (ii) a domestic partnership; (iii) a domestic corporation; and (iv) any estate or trust (other than a foreign estate or foreign trust, within the meaning of section 7701(a)(31) of the code).[418]

The new Treasury regulations will nullify in a number of areas the benefits of Regulation S to U.S. issuers of debt securities in Eurobond markets and other bearer debt markets. To qualify for the exception that is the basis for both the interest deduction and the exclusion from the thirty percent withholding tax, in essence the securities must not be sold to a "U.S. person" for forty days, whereas sales can be made under Regulation S to U.S. persons in category 1 transactions and there is no restricted period.[419] A U.S. issuer, however, can utilize the category 1 safe harbor only for a limited type of overseas directed offering which has to be made to residents of the single country in which made and, hence, will be primarily affected in this regard by the forty day restricted period. The tax requirement that U.S. citizens are U.S. persons may not have a great impact on natural persons, but could adversely affect the classification under Regulation S of certain U.S. entities as non-U.S. persons under limited circumstances.[420] The principal impact, however, will be to limit the ability to resell Regulation S bearer debt instruments of U.S. issuers to U.S. persons during a forty day restricted period (for all categories of securities) pursuant to Rule 144A , another exemption, or Rule 904 to the extent permitted by Regulation S during the restricted period.[421] The new tax regulations also reinstate certification requirements that the Commission had abandoned for debt securities and, hence, reintroduce one of the inefficiencies of Rule 4708.[422] The forty day restricted period under the new tax regulations, nonetheless, is shorter than the ninety day restricted period under Release 4708 that the previous tax regulations incorporated by reference.

§14 SOME SCENARIOS

[a] *Offering in Canada by a Foreign Issuer*

[i] The Issuer

The issuer is incorporated under the laws of a Canadian province, all

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417. 54 Fed. Reg. 35,201 (1989). The Service stated that the SEC's definition of "U.S. person" on the basis of residence was not "consistent with the general purpose of section 163(f) to prevent avoidance of U.S. tax by U.S. persons." *Id.*

418. I.R.C. §7701(a)(30) (1954).

419. *See* §5[a].

420. *See supra* note 17.

421. *See* §6[a].

422. Certification was required in transactions under Release 4708 but is not required by Rule 903(c)(1) or 903(c)(2) of Regulation S. *Cf.* Rule 903(c)(3)(ii)(B) and 903(c)(3)(iii)(B)(1).

of its properties are located in Canada, the members of its board of directors and its executive officers are exclusively citizens and residents of Canada, and its shareholders are predominately Canadian. The issuer is a reporting company under the United States Securities Exchange Act of 1934.

[ii] The Distributors

The lead underwriter is a Canadian investment banking firm as are most of the members of the underwriting and selling groups. Some of the distributors, however, are Canadian affiliates of international investment banking firms.

[iii] The Security

The security is common stock and part of the same class of common stock as is traded on the Toronto Stock Exchange and in the United States on NASDAQ.

[iv] The Offering

The securities are registered in several Canadian provinces and are being sold only in those provinces by securities dealers registered under the laws of the province in which they expect to make sales. The offering is not specifically limited to residents of Canada, but no special effort is being made to sell to non-residents.

[v] Issuer-Distributor Safe Harbor Category

The category 1 safe harbor for an overseas directed offering appears to be available. The only issue in this regard is the fact that the offering is not specifically restricted to residents of Canada and an ODO must be "directed" to the residents of the country in which the offering is being made.[423] Query, what directed means in this context and who are residents for this purpose? The category 1 safe harbor would also be available if NASDAQ is not the largest single market and if less than twenty percent of the trading in the common stock occurred on NASDAQ and, in any event, if fifty-five percent of all trading occurs on the Toronto stock exchange.[424] If the offering is not an ODO and if there is SUSMI in the common stock, the category 2 safe harbor would be available as the issuer is a reporting company.[425]

[vi] Who Can Purchase the Security?

If reliance is placed on the ODO, the securities should be sold only to residents of Canada. If, however, reliance is placed on the absence of

423. *See* §5[a].
424. Rule 902(n)(1). *See supra* note 125.
425. *See* §5[c].

SUSMI, the securities can be sold to anyone, including U.S. persons, provided the transaction is an offshore one.[426] If SUSMI exists and the offering is not an ODO, reliance would have to be placed on the category 2 safe harbor and the offering could be made in offshore transactions only to non-U.S. persons. This would, however, permit offshore transactions with the same persons described under this subheading at section 14[b] below.

[vii] Restricted Period

There is none, assuming that the category 1 safe harbor is available.

[viii] Offering Restrictions

There are none, assuming that the category 1 safe harbor is available.

[ix] Transactional Restrictions

None are required by Regulation S, assuming that the category 1 safe harbor is available. The issuer and distributor may, however, want to restrict resales so that they can take place only on the Toronto Stock Exchange or in Canada for a specified period of time. This may be important for two reasons: First, to avoid any contention that the Canadian purchasers are conduits for sales to non-residents if reliance is placed on the ODO safe harbor.[427] Second, to prevent resales in the United States for at least forty days in order to assure that the section 4(3) dealer exemption will be available for resales in the United States.[428]

[x] Directed Selling Effort

The issuer and distributor are precluded from engaging in directed selling efforts in the United States while the distribution is in process which would continue so long as any distributor is holding an unsold allotment.[429] However, once the distribution is completed, there are no further restrictions on directed selling efforts in the United States. In any event, restrictions on directed selling efforts do not preclude the issuer from distributing its periodic reports and other customary communications to its shareholders, making normal press releases relating to earnings and corporate developments.[430] While the distribution is in progress, there could not be any direct solicitation in the United States or any advertising in the United States relating to the offering except within narrow limitations relating to tombstones and advertisements required by law.[431]

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426. *See* §5[a].
427. *See supra* note 132.
428. *See supra* note 138.
429. *See* §4[b].
430. Adopting Release. *supra* note 5, at 80,670.
431. Rule 902(b)(4).

[xi] Offshore Transactions

All transactions that are part of the distribution have to be offshore.[432] This does not, however, preclude sales to U.S. professional fiduciaries purchasing for the accounts of non-U.S. persons even if the solicitation and other aspects of the transaction take place in the United States.[433] Similarly, with respect to purchases by the International Monetary Fund, the International Bank for Reconstruction and Development, and certain other international institutions, the sales can take place in the United States.[434] Sales to these two categories of purchasers do not have to take place offshore and contacts with them solely in such capacities do not constitute directed selling efforts.

[xii] Concurrent Offering in the United States

A concurrent offering of a tranche of the same securities can be made in the United States in reliance on Regulation D. The purchasers in the United States would acquire Rule 144 restricted securities and ordinarily would have to hold the securities for two years, if not registered, prior to resale in the public securities markets. Rule 144A would not be available for either the initial placement or for resales since the securities are quoted on NASDAQ and, hence, are not Rule 144A eligible securities.[435] The securities could, however, during the Rule 144 restricted period, be resold on the Toronto Stock Exchange in reliance on Rule 904.[436]

[xiii] Resales

The offshore purchaser can always resell the securities in reliance on Rule 904 which, among other things, would permit the immediate resale of the securities on the Toronto Stock Exchange. Conceptually, since there is no restricted period or transactional restrictions, the Regulation S purchaser could resell the securities to a U.S. person or in the United States in reliance on the section 4(1) exemption. The securities, however, could not be sold on NASDAQ or through a dealer in the United States for forty days from the date of distribution since there will be no dealer exemption under section 4(3) until forty days has elapsed.[437] Rule 144A is not available for such resales because the security is not an eligible Rule 144A security as it is quoted on NASDAQ.

[xiv] Variation in the Facts

If the assumptions are the same as to the issuer except fifty-one percent of its voting securities are held of record by persons with a U.S. ad-

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432. *See* §4[a].
433. Rule 902(b)(3), 902(o)(2).
434. Rule 902(b)(3), 902(o)(7).
435. *See* §11.
436. *See* §6[b].
437. *See supra* note 138.

dress and its assets are primarily located in the United States, the issuer is a domestic rather than foreign corporation.[438] This would also be true, assuming more than fifty percent of the voting securities are held of record by U.S. persons even if the assets were primarily Canadian, if the business were administered principally in the United States or the majority of the executive officers or directors were U.S. citizens or residents.[439] If the issuer is a domestic issuer, the category 2 safe harbor rather than the category 1 safe harbor would be available. The only category 1 safe harbor available to a domestic issuer is for an offering of non-convertible debt, non-convertible, non-participating preferred stock, or certain asset backed securities provided the principal and interest of the securities (or par value, as applicable) are not denominated in U.S. dollars.[440]

[b] *Offering in the Eurobond Market by a U.S. Issuer*

[i] The Issuer

The issuer is incorporated offshore and is a non-reporting company which is the wholly owned subsidiary of a corporation organized under the laws of Delaware that is a reporting company.

[ii] The Distributor

The lead underwriter is an international affiliate of a U.S. underwriter; most of the members of the underwriting group are international investment banking firms. All are members of the AIBD.[441]

[iii] The Security

Non-convertible debt security with principal and interest denominated in dollars. The security is guaranteed as to principal and interest by the parent of the issuer. The security will be listed on the Luxembourg Stock Exchange.

[iv] The Offering

The securities are to be offered in the Eurobond market through AIBD dealers in London, Brussels, Zurich, and Frankfurt.

[v] Issuer-Distributor Safe Harbor

Although the issuer is a non-reporting company, the securities will be eligible for the category 2 safe harbor as the securities are guaranteed as to principal and interest by the parent which is a reporting company.[442]

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438. Rule 902(f)(2). *See* §5[a].
439. *See* §5[a].
440. Rule 902(j)(2). *See* §5[a].
441. For a description of the AIBD, *see supra* note 224.
442. Rule 903(c). *See* §5[c].

[vi] Who Can Purchase the Security?

The securities can be purchased in an *offshore transaction* by the following:[443]

1. Any non-resident of the United States, including a non-resident citizen of the United States.[444]

2. Any non-national of the United States provided he is not a resident of the United States.[445]

3. A non-U.S. corporation or partnership including one organized and controlled by U.S. persons provided it is not organized "principally" for the purpose of buying securities offshore.[446]

4. A non-U.S. corporation organized by U.S. persons for the purpose of buying securities offshore, provided all of the stockholders are accredited investors as defined by Rule 501(a).[447]

5. An agency or branch of a U.S. entity engaged in operating offshore, provided it is not operated for the purpose of investing in unregistered securities and provided it is engaged in the banking or insurance business and is subject to regulation by the relevant banking or insurance authority in the country in which it operates.[448]

6. A U.S. professional fiduciary acting on a discretionary basis purchasing the security for the account(s) of non-U.S. person(s).[449]

[vii] Restricted Period

The restricted period is forty days.

[viii] Offering Restrictions

The offering restrictions require the following:[450]

1. The written agreement of every distributor (underwriters and dealers) participating in the distribution "pursuant to a contractual arrangement" to offer and sell the security prior to the expiration of the applicable restricted period in compliance with the applicable transaction restrictions and other requirements of the safe harbor, or pursuant to registration or an available exemption from registration.[451]

2. All offering materials and documents (other than press releases) used prior to the expiration of the applicable restricted period must in-

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443. *See generally* §3.
444. Rule 902(o)(1)(i).
445. *Id.*
446. Rule 902(o)(1)(viii).
447. *Id.*
448. Rule 902(o)(6).
449. Rule 902(o)(1)(vii)(2).
450. *See generally* §5[b].
451. Rule 902(h)(1).

clude statements to the effect that the securities have not been registered under the Securities Act, cannot be offered or sold in the United States or to U.S. persons within the applicable restricted period unless the securities are registered or an exemption from registration is available.[452] For suggested legends to accomplish this see section 12[f].

3. Such statements must be included: (a) on the cover or inside cover page of any prospectus or offering circular; (b) in the underwriting section of any prospectus or offering circular; and (c) in any advertisement made by the issuer or any distributor or any affiliate of or person acting on their behalf.[453]

If the offering restrictions are not complied with, the safe harbor is not available for the entire offering.[454]

[ix] Transactional Restrictions

The following restrictions are applicable during the restricted period:[455]

1. No offer or sale can be made to a U.S. person or for the benefit of a U.S. person.[456]

2. Each distributor selling securities to a dealer during the restricted period must send a confirmation or other notice to the purchaser stating that the purchaser cannot for the balance of the restricted period offer or sell the security to a U.S. person or for the benefit of a U.S. person.[457]

3. No legend has to be included on the certificate and the issuer need issue no stop transfer or other instructions to implement the foregoing.

[x] Directed Selling Effort

The issuer and distributor are precluded during the distribution, *the entire restricted period*, and so long as any distributor is holding an unsold allotment, from engaging in any directed selling efforts in the United States.[458] The restrictions on directed selling efforts do not preclude the issuer from distributing its periodic reports and other customary communications to its shareholders or making normal press releases relating to earnings and corporate developments.[459] There could not, however, be any direct solicitation in the United States or any advertising in the United States relating to the offering except within narrow limitations relating to tombstones and advertisements required by foreign or U.S.

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452. Rule 902(h)(2). For suggested legends to accomplish this, see §12[f].
453. Rule 902(h)(2)(i), (ii), (iii).
454. *See* Adopting Release, *supra* note 5, at 80,681. *See also* discussion at §5[f].
455. *See generally* §5[c].
456. Rule 903(c)(3)(iii)(A).
457. Rule 903(c)(3)(iv).
458. *See generally* §4[b].
459. Adopting Release, *supra* note 5, at 80,670.

law.[460] The distributors are restricted as to the extent to which they can recommend the security in the United States in a market letter during the restricted period.[461]

[xi] Offshore Transactions

All transactions that are part of the distribution have to be offshore,[462] but this does not preclude sales to U.S. professional fiduciaries purchasing for the accounts of non-U.S. persons even if the solicitation and other aspects of the transaction take place in the United States.[463] Similarly, with respect to purchases by the International Monetary Fund, the International Bank for Reconstruction and Development, and certain other international institutions, the sales can take place in the United States.[464] Sales to these two categories of purchasers do not have to take place offshore and contacts with them solely in such capacities do not constitute directed selling efforts.

[xii] Concurrent Offering in the United States

A concurrent offering of a tranche of the same securities can be made in the United States in reliance on Regulation D or Rule 144A. The purchasers in the United States would acquire Rule 144 restricted securities in either event which ordinarily would have to be held for two years or registered prior to resale in the public securities markets. The securities could be resold in reliance on Rule 904 on the Luxembourg Stock Exchange or the AIBD over the counter market prior to the expiration of the Rule 144 restricted period. Rule 144A would be available for both the initial placement or for resales since the securities are Rule 144A eligible securities, as they are not part of a class of securities listed on a U.S. stock exchange or quoted on NASDAQ.[465] The U.S. placement could consist of a tranche of the offering purchased, for example, by the lead underwriter who then uses the facilities of the PORTAL market to place the tranche in the United States to Rule 144A qualified institutional buyers who have elected to participate in the PORTAL market.[466] The restrictions on directed selling efforts would not preclude the solicitation of U.S. persons in connection with the offering of the U.S. tranche.[467]

[xiii] Resales

The offshore purchaser can always resell the securities in reliance on

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460. Rule 903(b)(4).

461. Adopting Release, *supra* note 5, at 80,669.

462. *See* §4[a].

463. Rule 902(b)(3), 902(o)(2).

464. Rule 902(b)(3), 902(o)(7).

465. *See* §11.

466. *See* §11. The PORTAL Market may not be available, however, for some time as the NASD is initially limiting it to securities of foreign issuers.

467. Adopting Release, *supra* note 5, at 80,668.

Rule 904 which, among other things, would permit the immediate resale of the securities on the Luxembourg Stock Exchange and the AIBD over the counter market. The securities could not be sold in the U.S. until after the expiration of the forty day restricted period. The securities could also be resold in the United States or to U.S persons during the restricted period in reliance on Rule 144A. The purchaser, however, would have acquired Rule 144 restricted securities under Rule 144(a)(3) with the two year holding period commencing on the date the predecessor(s) in interest acquired the securities in the Regulation S distribution.[468] Such Rule 144A purchaser could resell the securities in Rule 144A transactions, or could resell them on the Luxembourg Stock Exchange or the AIBD market pursuant to Rule 904.

[xiv] Variations

If the debt securities of the issuer are not guaranteed by the parent, the category 3 safe harbor rather than category 2 will be available. The only significant difference will be that receipts rather than certificates will have to be issued to purchasers prior to the expiration of the forty day restricted period, the securities during this period being represented by a temporary global certificate. On expiration of the restricted period, the purchasers can receive a certificate provided they certify that the securities are owned beneficially by a non-U.S. person or a U.S. person who purchased the securities in a transaction exempt from registration under the Securities Act (presumably, in most instances, Rule 144A).[469]

[c] *Offering in the United Kingdom by a Non-Reporting U.S. Issuer*

[i] The Issuer

The issuer is incorporated under the laws of Delaware and is a non-reporting company.

[ii] The Distributor

The lead underwriter is an international affiliate of a U.S. underwriter; most of the members of the underwriting group are international investment banking firms. All are members of The Securities Association, a self regulating organization established pursuant to the British Financial Services Act of 1986 ("FSA"), and authorized persons under that Act.[470]

[iii] The Security

The security is common stock and part of the same class of common stock as is presently traded on the pink sheet market in the United

468. Rule 144(d)(1), *supra* note 49.
469. Rule 903(c)(3)(ii)(B). *See generally* §5[d].
470. *See* the British Financial Services Act at §3.

States. Application has been made to the International Stock Exchange in London for admission of the security for dealings on the Unlisted Securities Market upon completion of the offering and such admission is a condition to the offering.

[iv] The Offering

The securities are being offered as a placing in accordance with the rules of the International Stock Exchange and the lead underwriter has formed a small underwriting group to place the securities with their customers. Some members of the underwriting group have passed off part of their risk to several sub-underwriters (insurance companies and institutional investors). The placing agreement provides that the underwriters will purchase the securities at a closing to be held seven business days after commencement of the offering. A prospectus meeting the requirements of the Stock Exchange and applicable U.K. law has been filed with the Stock Exchange and the Registrar.[471]

[v] Issuer-Distributor Safe Harbor Category

The category 3 safe harbor for equity securities of a non-reporting issuer is available.

[vi] Who Can Purchase the Security?

The securities can be purchased in offshore transactions by the same persons noted at section 14[b][vi].

[vii] Restricted Period

The restricted period is twelve months from the date of closing.

[viii] Offering Restrictions

The offering restrictions, except for the longer restricted period, are the same as those described at section 14[b][viii].

[ix] Transactional Restrictions

The following restrictions are applicable during the restricted period:[472]

1. No offer or sale can be made to a U.S. person or for the benefit of a U.S. person.[473]

2. The investor purchaser of the securities must: (1) certify that it is not a U.S. person and has not purchased for the account of a U.S. person or is a U.S. person who purchased in an exempt transaction (presumably,

471. *See Id.* at §162.
472. *See generally* §5[d].
473. Rule 903(c)(3)(iii)(A).

pursuant to Rule 144A), and (2) agree to resell such securities only in accordance with the provisions of Regulation S, pursuant to registration under the Act, or pursuant to an available exemption from registration.[474]

3. The securities must include a legend to the effect that transfer is prohibited except in accordance with the provisions of Regulation S.[475]

4. The issuer must (by contract, by-laws, articles, or comparable document) refuse to transfer the securities if the sale was not made in compliance with the provisions of Regulation S.[476]

5. Each distributor selling securities to a dealer during the restricted period must send a confirmation or other notice to the purchaser stating that the purchaser cannot, for the balance of the restricted period, offer or sell the security to a U.S. person or for the benefit of a U.S. person.[477]

[x] Directed Selling Effort

The issuer and distributor are precluded during the distribution, *the entire restricted period*, and so long as any distributor is holding an unsold allotment, from engaging in any directed selling efforts in the United States.[478] The restrictions on directed selling efforts, however, do not preclude the issuer from distributing its periodic reports and other customary communications to its shareholders, making normal press releases relating to earnings and corporate developments.[479] There could not, however, be any direct solicitation in the United States or any advertising in the United States relating to the offering except within narrow limitations relating to tombstones and advertisements required by foreign or U.S. law.[480] The distributors are restricted as to the extent to which they can recommend the security in the United States in a market letter during the restricted period.[481] The issuer, since it is a non-reporting company, must avoid press releases or unusual product advertising that might be construed as an attempt to condition the U.S. market for the security. These restrictions continue for the one year restricted period.[482]

[xi] Offshore Transactions

The offshore transaction requirements are the same as those described at section 14[b][xi].

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474. Rule 903(c)(3)(iii)(B)(1), (2).
475. *Id.*
476. Rule 903(c)(3)(iii)(B)(3), (4).
477. Rule 903(c)(3)(iv).
478. *See generally* §4[b].
479. Adopting Release, *supra* note 5, at 80,670.
480. Rule 903(b)(4).
481. Adopting Release, *supra* note 5, at 80,669.
482. *See* Adopting Release, *supra* note 5, at 80,668.

[xii] Concurrent Offering in the United States

A concurrent offering of a tranche of the same securities can be made in the United States in reliance on Regulation D or Rule 144A. The purchasers in the United States would acquire Rule 144 restricted securities in either event which ordinarily would have to be held for two years or registered prior to resale in the public securities markets. The securities, however, could be resold in reliance on Rule 904 on the Unlisted Securities Market prior to the expiration of the Rule 144 restricted period. Rule 144A would be available for both the initial placement or for resales since the securities are Rule 144A eligible securities as they are not part of a class of securities listed on a U.S. stock exchange or quoted on NASDAQ.[483] The U.S. placement could consist of a tranche of the offering purchased, for example, by the lead underwriter who then uses the facilities of the PORTAL market to place the tranche in the United States to Rule 144A qualified institutional buyers who have elected to participate in the PORTAL market.[484] The restrictions on directed selling efforts would not preclude the solicitation of U.S. persons in connection with the offering of the U.S. tranche.[485]

[xiii] Resales

The offshore purchaser can always resell the securities in reliance on Rule 904 which, among other things, would permit the immediate resale of the securities on the Unlisted Securities Market.[486] The securities could not be sold in the U.S. pink sheet market until after the expiration of the one year restricted period. The securities could also be resold in the United States or to U.S persons during the restricted period in reliance on Rule 144A. The purchaser, however, would have acquired Rule 144 restricted securities under Rule 144(a)(3) with the two year holding period commencing on the date the predecessor(s) in interest acquired the securities in the Regulation S distribution.[487] Such Rule 144A purchaser could resell the securities in Rule 144A transactions or could resell them on the Unlisted Securities Market in London pursuant to Rule 904.

[d] *Private Offering in U.K. by Reporting U.S. Issuer*

[i] The Issuer

The issuer is a corporation organized under the laws of Delaware and is a reporting company.

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483. *See* §11. It may, however, be unrealistic to assume that the mega institutional investors that satisfy the Rule 144A requirements as qualified institutional buyers would be interested in purchasing securities of such an issuer.

484. *See* §11. The PORTAL Market may not be available, however, for some time as the NASD is initially limiting it to securities of foreign issuers.

485. Adopting Release, *supra* note 5, at 80,668.

486. *See generally* §6[a].

487. Rule 144(d)(1), *supra* note 49.

[ii] The Distributor

There is to be no underwriter. The issuer expects to place the securities directly.

[iii] The Security

The security is common stock and part of the same class of common stock as is presently traded on NASDAQ in the United States.

[iv] The Offering

The securities are being offered initially directly by the issuer to insurance companies and institutional investors all of whom qualify as exempted persons under the FSA. The placement is so limited to avoid the necessity of the issuer being deemed "engaged in the investment business" and subject to the FSA requirement that any person engaged in the investment business must be a member of an approved self-regulatory organization.[488] If the issuer is unable to place the securities itself, it may engage a member of one of the self-regulatory organizations to act as its agent in connection with the placement. No prospectus is to be used in connection with the offering.

[v] Issuer-Distributor Safe Harbor Category

The category 2 safe harbor for securities of a reporting issuer appears to be available. Although Regulation S in many respects contemplates an offshore distribution that would be a public offering under the U.S. securities laws (*e.g.*, offering restrictions applicable to distributors, and restricted periods that commence with a closing of the distribution), its conceptual basis is that offers and sales that take place outside the United States are not subject to section 5[489] and this would be applicable to a private offering as well as a public offering.

[vi] Who Can Purchase the Security?

For reasons noted above the placement is being made only to U.K. investment companies and institutional investors in the United Kingdom.

[vii] Restricted Period

The restricted period is forty days from the date of closing.

[viii] Offering Restrictions

The offering restrictions are applicable, but since no distributors are being engaged and no offering materials are being used they may not be triggered. As a matter of precaution, the issuer should assure that the

488. *See* Financial Services Act, *supra* note 470, §3, Schedule 1, §§12, 17.
489. *See* §2.

required statements are included in any written material that it delivers to the prospective purchasers.[490] If a distributor is engaged and offering materials are used, then the offering restrictions described at section 14[b][viii] are applicable.

[ix] Transactional Restrictions

The applicable restrictions are the same as those described at section 14[b][ix].

[x] Directed Selling Effort

The issuer and distributor (if one is engaged) are precluded during the distribution and during the entire restricted period from engaging in directed selling efforts in the United States. The restrictions on directed selling efforts, are generally the same as described at section 14[b][x].

[xi] Offshore Transactions

All transactions that are part of the placement must be offshore.

[xii] Concurrent Offering in the United States

A concurrent offering of the same securities could be made in the United States in reliance on Regulation D. The purchasers in the United States would acquire Rule 144 restricted securities which ordinarily would have to be held for two years or registered prior to resale in the public securities markets.[491] The securities could not be initially placed in the United States or resold in reliance on Rule 144A as the securities are not Rule 144A eligible securities since securities of the same class are quoted on NASDAQ.[492] The U.S. purchasers could resell the securities offshore during the Rule 144 restricted period in reliance on Rule 904 provided they were able to find an offshore purchaser.[493]

[xiii] Resales

The offshore purchaser could resell the securities offshore in reliance on Rule 904, but this presumably would be a limited market. During the forty day restricted period the securities could not be sold on NASDAQ and in no event could they be resold in reliance on Rule 144A. After expiration of the forty day restricted period, can the securities be resold in the United States on NASDAQ in reliance on the section 4(1) exemption for transactions not involving an issuer, underwriter, or dealer and in reliance on the section 4(3) exemption for dealers? If the Adopting Release can be relied upon, securities can be resold in routine trading transactions

490. Rule 902(h)(2).
491. Rule 144(d)(3), *supra* note 49.
492. *See* §11.
493. *See generally* §6[b].

in the United States after expiration of the restricted period.[494] In such event an issuer can make a private placement offshore with only a forty day restricted period, whereas the same securities concurrently offered in the United States pursuant to Regulation D are subject to a two year restricted period and the resale would be subject to the other limitations imposed by Rule 144. The resale in the United States after expiration of the restricted period may not free from doubt, with respect to securities privately placed outside of the United States as to which a Regulation D exemption would otherwise be available.

[xiv] Variation in the Facts

Same assumptions except the issuer is a non-reporting company and its securities are traded in the pink sheets rather than on NASDAQ. The appropriate safe harbor is now category 3 and the securities are subject to a one year restricted period and the more severe category 3 transactional restrictions.[495] The securities are also Rule 144A eligible securities; hence, among other things, during the restricted period they could be resold in the U.S. subject to the Rule 144A conditions. The resale would change the status of the securities to Rule 144(a)(3) restricted securities subject to a two year restricted period which would have commenced with the date the predecessor(s) acquired the securities from the issuer.[496] The Rule 144A purchasers, however, could resell the securities during the restricted period to other Rule 144A purchasers.[497]

[e] *Eurobond Offering by Japanese Issuer of Equity Related Security*

[i] The Issuer

The issuer is a Japanese corporation. It is not a reporting company but complies with the requirements of the section 12g3-2(b) exemption.[498]

[ii] The Distributors

The lead underwriter is an affiliate of a Japanese investment banking firm and the members of the underwriting group are primarily other Japanese securities affiliates. Some of the distributors, however, are affiliates of other international investing banking firms and all are members of the AIBD.

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494. *See generally* §10[b].

495. *See* §14[c][ix].

496. Rule 144(d)(1), *supra* note 49.

497. *See* §11.

498. Rule 12g3-2(b), 17 C.F.R. §240.12g3-2(b) (1990), provides an exemption for foreign issuers for securities not listed in the United States on an exchange or quoted on NASDAQ if the issuer files with the SEC the reports it is required to file with the foreign stock exchange on which it is listed or foreign regulatory authorities.

[iii] The Security

The security is a unit consisting of a debt security with principal and interest denominated in Swiss Francs and warrants to purchase common stock that is part of the same class of common stock as is traded on the Tokyo Stock Exchange and in the United States on the NASD's Electronic Bulletin Board. The U.S trading of the issuer's common stock is an insignificant part of the overall trading in the common stock and there is no significant U.S. market for the issuer's debt securities. The warrants are exercisable ninety days after the date of issuance and are for a term of three years. The exercise price is the equivalent of ten dollars per share based on the exchange rate at date of issuance and the market price based on exchange rates at date of issuance is ten dollars per share. The issuer's bonds do not presently trade in the United States.

[iv] The Offering

The securities are being offered in the Euro-bond market concurrently in Switzerland, the United Kingdom, France, and Belgium. The bonds are expected to trade through the AIBD market and the warrants will be listed on the Tokyo Stock Exchange.

[v] Issuer-Distributor Safe Harbor Category

The category 1 safe harbor appears to be available for the bonds, the warrants, and the common stock underlying the warrants as SUSMI does not exist as to any of the securities.

[vi] Who Can Purchase the Security?

If the transactions are offshore, any person can purchase the unit offered in the distribution insofar as Regulation S is concerned.[499] Since, however, the warrants during the three year term involve a continuous offering of the underlying security, if the units are offered to U.S. persons outside of the United States, the offering at some point will be made to persons in the United States unless it is framed as an offer only to the employee-representative of the U.S. persons who permanently maintains an offshore presence. This may be extremely difficult to accomplish; therefore, consideration should be given to limiting the offering to persons described section 14[b][vi] and a mechanism adopted to assure that the warrants are held and exercised only outside of the United States.

[vii] Restricted Period

There is no restrictive period for this category.

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499. *See* §5[a].

[viii] Offering Restrictions

There are no offering restrictions for this category.

[ix] Transactional Restrictions

There are no transactional restrictions for this category.

[x] Directed Selling Effort

The issuer and distributor are precluded from engaging in directed selling efforts in the United States while the distribution is in process which would continue so long as any distributor is holding an unsold allotment.[500] Once the distribution is completed, there are no further restrictions. But query, when is the distribution completed as to the shares underlying the warrants? Rule 902(m) deals with the related problem of when does a restricted period commence in this context and provides that it commences on completion of the distribution of the warrants if certain restrictions and procedures are followed that essentially preclude a U.S. person from holding the warrants during the restricted period. But there is no restricted period since the securities are in category 1 and in any event Rule 902(m) does not deal with the issue of directed selling effort. There could not while the distribution is in process, presumably for the life of the warrants, be any direct solicitation in the United States or any advertising in the United States relating to the offering except within narrow limitations relating to tombstones and advertisements required by law.[501] The restrictions on directed selling efforts, however, do not preclude the issuer from distributing its periodic reports and other customary communications to its shareholders, making normal press releases relating to earnings and corporate developments.[502]

[xi] Offshore Transactions

All transactions that are part of the distribution have to be offshore. See discussion at section 14[e][vi] for special problems presented with respect to the warrants and the securities underlying the warrants. In any event, sales can be made to U.S. professional fiduciaries purchasing for the accounts of non-U.S. persons even if the solicitation and other aspects of the transaction take place in the United States.[503] Similarly, with respect to purchases by the International Monetary Fund, the International Bank for Reconstruction and Development, and certain other international institutions, the sales can take place in the United States.[504] Sales to these two categories of purchasers do not have to take place offshore

500. *See generally* §4[b].
501. Rule 902(b)(4).
502. Adopting Release, *supra* note 5, at 80,670.
503. Rule 902(b)(3), 902(o)(2).
504. Rules 902(b)(3), 902(o)(7).

and contacts with them solely in such capacities do not constitute directed selling efforts.

[xii] Concurrent Offering in the United States

A concurrent offering of a tranche of the same securities can be made in the United States in reliance on Regulation D and or Rule 144A.[505] The purchasers in the United States would acquire Rule 144 restricted securities in either event which ordinarily would have to be held for two years or registered prior to resale in the public securities markets.[506] The bonds, however, could be resold in reliance on Rule 904 on the AIBD market and the warrants and underlying shares on the Tokyo Stock Exchange prior to the expiration of the Rule 144 restricted period. Rule 144A would be available for both the initial placement or for resales since the securities are Rule 144A eligible securities as the OTC Bulletin Board is not an inter-dealer quotation system. The U.S. placement could consist of a tranche of the offering purchased, for example, by the lead underwriter who then uses the facilities of the PORTAL market to place the tranche in the United States to Rule 144A qualified institutional buyers who have elected to participate in the PORTAL market.[507] The restrictions on directed selling efforts would not preclude the solicitation of U.S. persons in connection with the offering of the U.S. tranche.[508]

[xiii] Resales

The offshore purchaser can always resell the securities in reliance on Rule 904 which, among other things, would permit the immediate resale of the bonds through the AIBD market and the warrants and common stock on the Tokyo Stock Exchange. Conceptually, since there is no restricted period or transactional restrictions, the Regulation S purchaser could resell the securities to a U.S. person or in the United States in reliance on the section 4(1) exemption. The securities, however, could not be sold on the OTC Electronic Bulletin Board or through a dealer in the United States for forty days from the date of distribution since there will be no dealer exemption under section 4(3) until forty days has elapsed.[509] Rule 144A, however, would be available immediately for such resales because the securities are eligible Rule 144A securities. Although the issuer is not a reporting company, its exemption under section 12g3-2(b) does reduce the amount of disclosure required in connection with a Rule 144A transaction.[510] There may be some reluctance to purchase the securities in a Rule 144A transaction since it will result in a two year holding period which can be avoided by deferring the purchase until expiration of the

505. *See generally* §11.
506. Rule 144(a)(3), *supra* note 49.
507. *See* §11.
508. Adopting Release, *supra* note 5, at 80,668.
509. *See supra* note 138.
510. Rule 144A(d)(4), *supra* note 49; *See* §11.

forty day period after which the section 4(3) dealer exemption will become available and the securities can be freely traded in the United States.

Some special problems arise, however, in any event, in connection with the resale of the warrants in the United States. The warrants during their term constitute a continuing offering by the issuer which must find an exemption. Rule 144A is not available since it is not an exemption for an issuer. Regulation S is no longer available on the assumption that the warrants have been purchased by a U.S. person in the United States. The most likely exemption is Regulation D which would ordinarily under these circumstances require resales in the United States to be limited to persons who are Regulation D accredited investors.[511] Such steps would have to be taken at the time of the offshore distribution to elicit the cooperation of the issuer. Given the foregoing and the availability of a market in Japan, it is unlikely that the issuer and distributors would be prepared to take these steps and are more likely to restrict the warrants so that they cannot be held or exercised by a U.S. person.

[xiv] Variation in the Facts

The assumptions are the same as to the issuer, except it is engaged in the oil and gas exploration and production business exclusively in the United States and although it is a Japanese corporation, fifty-one percent of its common stock is owned of record by the U.S. promoters who several years earlier persuaded a Japanese investment banking firm to take the company public in Japan. The company is therefore a domestic rather than foreign issuer.[512] Assume also that the company is a reporting company. The category 2 safe harbor is available, which requires compliance with the offering restrictions and the transactional restrictions during a forty day waiting period. The restricted period and restrictions are the same as to the debt securities, the warrants, and the underlying stock. The restricted period as to the underlying stock, however, will commence to run from the date of issuance only if the warrants contain the required legend and other steps and procedures are initiated to assure that the warrants are held and exercised only by non-U.S. persons.[513] Otherwise, the restricted period will not commence until the expiration of the exercise period of the warrants. Although the legend and related procedures are not specifically limited to the restricted period, since the purpose of the requirement is to permit resales to U.S. persons or in the U.S. under certain circumstances absent an exemption or registration, the special limitations imposed are necessarily limited to the restricted period. Since the warrants in any event cannot be exercised for a period of ninety days, the restricted period will have expired before the warrants can be exer-

511. *See* Rules 501(a), 506, 17 C.F.R. §230.506 (1990).
512. Rule 902(f)(2).
513. Rule 902(m). *See* §8.

cised. At the end of forty days, however, it would appear that they could be resold in the United States and to U.S. persons in reliance on section 4(1).[514] Alternatively, the offshore holder of the warrants could exercise them after ninety days and immediately resell the underlying shares on the pink sheet market in the United States in reliance on section 4(1) as the restricted period would have run on the underlying shares even if they are held by the holder for only one day.[515] If, however, the holder after forty days resells the warrants in the United States in reliance on section 4(1), the U.S. purchaser is in a somewhat different position as the issuer is now making an offering onshore to U.S. persons so long as the warrants remain exercisable. It appears under these circumstances that the issuer would have to rely on an exemption under either section 4(2) or Regulation D for such offers and it would be difficult to control the situation so as to assure the availability of such exemption. Under these circumstances, the issuer in connection with the initial distribution should probably take appropriate steps to assure that the warrants are not resold to U.S. persons or are sold to U.S. persons who are accredited investors for purposes of Regulation D. In any event, if a U.S. person were to acquire such warrants, upon exercise of the warrants he would acquire Rule 144 restricted securities subject to a two year holding period before they could be resold in the public U.S. markets.[516] Further, such person would not have the benefit of any prior holding period since the predecessor owned the warrants and not the underlying security. The U.S. purchaser during the Rule 144 restricted period could resell the shares to a Rule 144A qualified institutional buyer, since the OTC Electronic Bulletin Board is not an inter-dealer quotation system and the security is a Rule 144A eligible security.[517] The U.S. purchaser could also resell the security on the Tokyo Stock Exchange in reliance on Rule 904 and under these circumstances would probably purchase the warrants and the underlying shares in reliance on the availability of that market.

If the underlying shares are admitted to quotation on NASDAQ prior to the expiration of the exercise period of the warrants, an interesting situation would develop as to the Rule 144A status of the securities. The determination of whether securities are Rule 144A eligible securities is made when the securities were issued.[518] Accordingly, those that exercise the warrants before the underlying shares are quoted on NASDAQ would continue to hold Rule 144A securities (as would any Rule 144A purchaser from them) whereas those exercising the warrants after quotation on NASDAQ would not have Rule 144A eligible securities.

For reasons noted at section 14[e][xiii], the issuer and distributor may find it advisable to restrict the warrants so that they cannot be held

514. *See* §10[b].
515. Adopting Release, *supra* note 5, at 80,678. *See* §8.
516. Rule 144(a)(3), *supra* note 49.
517. *See* §11.
518. Rule 144A(d)(3)(i).

or exercised at any time by a U.S. person.

[f] *Offshore Offering of Convertible Debentures By a U.S. Issuer*

[i] The Issuer

The issuer is a corporation organized under the laws of Delaware and is a reporting company.

[ii] The Distributor

The lead underwriter is an international affiliate of a U.S. underwriter; most of the members of the underwriting group are international investment banking firms. All are members of the AIBD.[519]

[iii] The Security

Convertible debentures with principal and interest denominated in dollars. The debentures are convertible at any time within three years into common stock at a price representing a conversion premium of twenty percent based on the conversion ratio relative to the market price of the common stock at the time the convertible securities are distributed. The common stock is traded in the United States on NASDAQ. The convertible debenture will be listed on the Luxembourg Stock Exchange.

[iv] The Offering

The securities are to be offered in the Eurobond market through AIBD dealers in London, Brussels, Zurich, and Frankfurt.

[v] Issuer-Distributor Safe Harbor

Both the convertible debenture and the underlying common shares are eligible for the category 2 safe harbor as the issuer is a reporting company.[520]

[vi] Who Can Purchase the Security?

The securities can be purchased in *offshore transactions* by the same persons as those described at section 14[b][vi].

[vii] Restricted Period

The restricted period is forty days both with respect to the convertible debentures and the shares underlying the convertible debentures. The important issue, however, is when does the restricted period commence to run as to the shares underlying the conversion rights? If the section 3(a)(9) exemption is available (which it will be since the conversion will

519. For a description of the AIBD, *see supra* note 224.
520. *See generally* §5[c].

involve an exchange of securities of the same issuer and no commissions or remuneration will be paid to anyone in connection with such conversion) the restricted period on the underlying shares will commence at the same time as it commences as to the convertible debentures (generally on closing).[521]

[viii] Offering Restrictions

The offering restrictions are the same as those described at section 14[b][viii].

[ix] Transactional Restrictions

The transactional restrictions are the same as those described at section 14[b][ix].

[x] Directed Selling Efforts

The restrictions on directed selling efforts in the United States are the same as those described at section 14[b][x].

[xi] Offshore Transactions

See section 14[b][xi].

[xii] Concurrent Offering in the United States

A concurrent offering of a tranche of the convertible debentures securities can be made in the United States in reliance on Regulation D or Rule 144A. Although the underlying shares are not Rule 144A eligible securities, the convertible debentures are since they are not listed on a U.S. stock exchange or quoted on NASDAQ and the conversion premium is at least ten percent.[522] The purchasers in the United States would acquire Rule 144 restricted securities, in either event, which ordinarily would have to be held for two years or registered prior to resale in the public securities markets. If the debentures are converted into common stock, the Rule 144 holding period would commence to run from the date the convertible debentures were acquired from the issuer.[523] The common stock received on conversion, however, would not be Rule 144A eligible and could not be resold in reliance on Rule 144A. The holder of the convertible debenture, accordingly, is unlikely to convert the security unless forced to because the securities are called and can be redeemed unless converted. The convertible debentures could also be resold during the Rule 144 restricted period in reliance on Rule 904 on the Luxembourg Stock Exchange or the AIBD over the counter market. The U.S. placement could consist of a tranche of the offering purchased, for example, by

521. *See generally* §7.
522. Rule 144A(d)(3)(i).
523. Rule 144(d)(3)(ii), *supra* note 49.

the lead underwriter who then uses the facilities of the PORTAL market to place the tranche in the United States to Rule 144A qualified institutional buyers who have elected to participate in the PORTAL market.[524] The restrictions on directed selling efforts would not preclude the solicitation of U.S. persons in connection with the offering of the U.S. tranche.[525]

[xiii] Resales

The offshore purchaser can always resell the securities in reliance on Rule 904 which, among other things, would permit the immediate resale of the convertible debentures on the Luxembourg Stock Exchange and the AIBD over the counter market. The offshore purchaser could resell the convertible debentures or the underlying shares in the U.S. after the expiration of the forty day restricted period. Since the debentures are immediately convertible into common stock which is traded on NASDAQ, this would appear (assuming expiration of the forty day restricted period) to permit the offshore holder to convert and immediately resell the common stock on NASDAQ notwithstanding the fact that it is contrary to the position of the staff prior to the adoption of Regulation S.[526] The convertible debentures could also be resold in the United States or to U.S persons during the restricted period in reliance on Rule 144A. The purchaser, however, would have acquired restricted securities under Rule 144(a)(3) with the two year holding period commencing on the date the predecessor(s) in interest acquired the securities in the Regulation S distribution.[527] Such Rule 144A purchaser could resell the debentures (but not the shares received on conversion) in Rule 144A transactions or could resell the debentures on the Luxembourg Stock Exchange or the AIBD market and the underlying shares offshore, if there is a market for them, in reliance on Rule 904.

[xiv] Variation

If the conversion premium was not at least ten percent, then neither the debentures nor the underlying shares would be Rule 144A eligible securities. In that event, the status of the convertible security as a Rule 144A security is determined by the security underlying the conversion rights.[528] If the conversion would not be exempt pursuant to section 3(a)(9) (e.g., if remuneration is paid to dealers who solicit the conversion) the conversion rights will be treated as warrants.[529]

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524. *See* §11. The PORTAL Market may not be available, however, for some time as the NASD is initially limiting it to securities of foreign issuers.

525. Adopting Release, *supra* note 5, at 80,668.

526. *See* §7.

527. Rule 144(d)(1), *supra* note 49.

528. Rule 144A(d)(3).

529. *See* §14[e] for a warrant scenario.

§15 CRITIQUE OF REGULATION S

The adoption of Regulation S will stimulate offshore distributions and will enhance the access of U.S. institutional investors to issues of securities by foreign companies. The impact, however, is likely to be, by U.S. institutional investors that organize a separate subsidiary based offshore since such subsidiaries will not be U.S. persons. Those that do not have a subsidiary can purchase securities distributed offshore by foreign issuers relying on the category 1 safe harbor, but only if the transaction (including the offer) takes place offshore. This will be no easy matter for an institutional investor that has neither an offshore subsidiary nor an offshore presence. It is further complicated by the fact that there can be no directed selling effort in the United States; hence, there is a problem regarding how such institutional investors will become aware of the offering. Qualified U.S. institutional buyers, however, can effect Rule 144A transactions with the original purchasers in a Regulation S distribution. The primary way most such U.S. institutional investors are likely to participate is by purchasing the securities distributed offshore in the organized offshore securities market in which they trade and by purchasing securities of foreign issuers placed privately in the United States through PORTAL in reliance on Rule 144A.[530]

There was a tendency during the proposal period to overlook the significance of the General Statement to the effect that offshore offers and sales of securities are not subject to the registration provisions of section 5.[531] One obviously prefers to rely on a safe harbor, and much of the value of the General Statement was gutted by the deletion of the relevant criteria. The General Statement, nonetheless, may still be useful in situations in which there is an inadvertent failure to comply with Regulation S and in the process some deleted general criteria included in the proposals may be resurrected.

A frustrating aspect of Regulation S is the tendency to regulate by the legislative history reflected in the proposing, reproposing, and adopting releases rather than in the regulation. A consequence is that one must scour the releases (including the footnotes) for important nuances not covered by the rules, including whether resales can be made in the United States after the restricted period, the effect of a failure to comply with a safe harbor restriction or condition, and a number of other areas. The SEC's interpretive process can be expected to flush out, over time, other areas of uncertainty that need clarification. The variety of scenarios that can develop involving offshore distributions and the interrelationship of Regulation S, Rule 144A, and the PORTAL Market are limitless.

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530. Rule 144A and PORTAL are discussed at §11 .

531. *See* §2.