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OFFERINGS UNDER REGULATION S

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Regulation S, which was adopted by the Securities and Exchange Commission (the "SEC") in 1990,[1] provides that offers and sales of securities that occur outside of the United States are exempt from the registration requirements of Section 5 of the Securities Act of 1933 (the "Securities Act"). Regulation S is generally intended to facilitate two capital-raising scenarios: (i) a U.S. company that issues securities only to foreigners; and (ii) a U.S. investor who enters a foreign market to buy foreign securities. In essence, Regulation S permits these types of transactions, among others, to occur without SEC registration.

To issuers and other distributors of securities, raising capital without registration means obtaining funding more quickly, more discreetly and less expensively than would be the case if registration were required. Any mechanism that permits such capital raising, however, is capable of being abused, and Regulation S is no exception. Abuse of Regulation S means that securities are being offered or sold without adequate disclosure to the public, the precise result that Section 5 is designed to prevent. In 1998, the SEC identified several regulatory abuses, and amended Regulation S in an attempt to strike a better balance between providing access to international markets and guarding against unwarranted evasion of Section 5 registration requirements.

BACKGROUND

Section 5 Registration. Section 5 of the Securities Act requires that all securities offered or sold by means of interstate commerce be registered unless an exemption is available. The purpose behind Section 5 is to ensure adequate disclosure before a security is offered to the public so that the public may make informed investment decisions. For purposes of Section 5, "interstate commerce" includes, among other things, "trade or commerce in securities or any transportation or communication relating thereto…between a foreign country and any State." Many commentators have remarked that Section 5 could be read to apply to securities offerings occurring outside of the United States, thereby deterring transnational transactions due to the threat of a U.S. registration requirement for such transactions.

Release 4708. At the recommendation of a Presidential Task Force charged with increasing the foreign market for U.S. securities, the SEC adopted Securities Act Release 4708 ("Release 4708"), which limited the scope of the application of Section 5 registration

[1] Offshore Offers and Sales, Securities Act Release No. 33-6863, 17 C.F.R. 230.901-230.904 (1990) ("Release 6863").

requirements.[2] In Release 4708, the SEC stated that it would not take enforcement action with respect to a failure to register when securities were distributed, even though the means of interstate commerce were used, if the distributions were effected in a manner that would result in the securities coming to rest abroad. The SEC reasoned that the purpose of Section 5 of the Securities Act was to protect American investors by preventing offerings of securities without adequate disclosure about such securities. The SEC determined that an offering outside of the United States was properly exempt from registration provided that such unregistered securities would not be distributed or redistributed within the United States or to U.S. nationals without an exemption. Release 4708 did not provide detailed guidance as to what types of offerings were within the purview of Release 4708. As a result, numerous no-action letters were requested to supplement the principles set forth in Release 4708.

Adoption of Regulation S. In response to increasingly global financial markets[3], the SEC adopted Regulations S to clarify and codify its view on the territorial reach[4] of Section 5 of the Securities Act as well as to provide specific guidelines to make compliance more certain. Regulation S exempts offshore offerings from Section 5 registration requirements provided that certain specific conditions are met. Besides the level of detail, another significant difference between Regulation S and Release 4708 is the approach. Release 4708 was intended to protect American investors. Regulation S is intended to protect "U.S. capital markets and those who invest in U.S. capital markets, whether U.S. or foreign nationals."[5] Unlike Release 4708, Regulation S addresses the offshore offerings of the securities of foreign issuers, and under what circumstances such securities would be exempt from Section 5.[6] This clarification may seem superfluous, but has been important in terms of quelling political sensitivities and international comity concerns.[7]

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[2] Registration of Foreign Offerings by Domestic Issuers, Securities Act Release No. 4708, 29 FR 9828 (1964).

[3] From 1980 to 1990, the value of foreign trading in U.S. stocks grew 456%, from $75 billion annually to $417 billion annually. Foreign purchases of U.S. debt securities increased 3073%, from $122.9 billion to $3.9 trillion. In 1992, foreign companies raised $66 billion in capital in U.S. public and private markets, an increase from $48 billion in 1991. See Testy, Kellye Y., *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 Ala. L. Rev 927 (Spring 1994).

[4] See Hamilton, Paul, *The Extraterritorial Reach of the United States Securities Laws Toward Initial Public Offerings Over the Internet*," 13 St. John's J.L. Comm. 343 (Winter 1998) for a discussion of the territorial reach of Section 5 of the Securities Act in light of offerings by foreign issuers over the Internet.

[5] See Release 6863.

[6] See Scott, Hal S., *The Future Content of the U.S. Securities Laws: Internationalization of Primary Public Securities Markets*, 63 Law & Contemp. Prob. 71, 73 (Summer 2000).

[7] See Hamilton, Paul, *The Extraterritorial Reach of the United States Securities Laws Toward Initial Public Offerings Over the Internet*," 13 St. John's J.L. Comm. 343,363 (Winter 1998).

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A few years after the adoption of Regulation S, the SEC identified several regulatory abuses, primarily involving equity securities of domestic issuers. [8] In 1998, the SEC amended Regulation S to curb some of these abuses. (Securities Act Release No. 33-7505 ("Release 7505")).[9]

OPERATION OF REGULATION S

Regulation S consists of five rules: a General Statement (Rule 901); Definitions (Rule 902); an Issuer Safe Harbor (Rule 903); a Resale Safe Harbor (Rule 904); and Resale Limitations (Rule 905). The General Statement broadly restates the SEC's territorial approach to Section 5. The Issuer and Resale Safe Harbors provide specific guidelines for transactions. If these guideline are complied with, such transactions will be deemed to have occurred "outside of the United States" within the meaning of the General Statement. Rule 905 clarifies the consequences of a resale of an equity security of a domestic issuer acquired through a Rule 901, Rule 903 or Rule 904 transaction, linking the "restricted period" of a Rule 144 security with the "distribution compliance period" of a Regulation S security.

General Statement. The General Statement provides that "[f]or purposes of Section 5 of the [Securities] Act, the terms "offer," "offer to sell," "sell," "sale," and "offer to buy" shall…..be deemed not to include offers and sales that occur outside the United States." Transactions that comply with the conditions of either Rule 903 or 904 will be deemed to be outside of the United States within the meaning of the General Statement, and therefore exempt from the registration requirements.[10]

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The author suggests that in the interests of comity, the SEC should provide an exemption from its securities laws in those cases where a United States interest is not involved.

[8] See Problematic Practices Under Regulation S, Securities Act Release No. 33-7190 (1995). The SEC identified a number of practices designed to temporarily place securities offshore to evade registration requirements with a view to permit such securities to flowback to the United States. Such practices include using a shell foreign corporation solely for the purpose of receiving the securities, payments to purchasers to hold the securities and then resell into the United States after the end of a restricted period, and the use of non-recourse promissory notes where repayment derives from resale back into the United States. See also Hanks, Sara, *Direct Regulation S Offerings and the SEC's "Problematic Practices" Release*, 2 Stan J.L. Bus. & Fin. 303 (Summer 1996). See also Levitt, Arthur, *Regulation S and Offshore Capital: Will the New Amendments Rid the Safe Harbor of Pirates*, 19 J. Intl. L. Bus. 58 (Fall 1998).

[9] Offshore Offers and Sales, Securities Act Release No. 33-7505; 17 C.F.R. 230.901-230.905 (1998).

[10] It is possible, however, to have a Regulation S offering that does not meet the conditions of either Safe Harbor yet is within the meaning of the General Statement. See Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, cert. denied, 525 U.S. 1139 (1999). This case involved an offer to purchase foreign securities over the telephone to a

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Safe Harbors. Rules 903 and 904 permit the issuance and resale of unregistered securities under specified conditions. Two general conditions must be met to qualify under both the Issuer Safe Harbor and the Resale Safe Harbor: (i) the offer or sale must be made in an "offshore transaction"; and (ii) no "directed selling efforts" may be made in the United States. An "offshore transaction" takes place when the offer is not made to a person in the United States and either the buyer is outside of the United States (or the offeror reasonably believes that the buyer is outside of the United States) or the transaction is executed on an established foreign securities exchange. "Directed selling efforts" means any activities that condition the U.S. market for such securities (*e.g.*, a roadshow in the U.S., placing an advertisement in a U.S. newspaper, etc.).

In addition to the general conditions, Regulation S also imposes additional conditions depending on the nature of the issuer and the type of security being offered. These additional conditions and restrictions function as safeguards against the flowback of unregistered securities into the United States.[11] The Issuer Safe Harbor (that is, the conditions that, if met, will ensure compliance with Regulation S) is divided into three categories. Category #1 has the least conditions and restrictions, as the likelihood of flowback for these offerings is minimal. By contrast, Category #3 has the most conditions and restrictions, as the likelihood that these securities will flow back to the United States is high. Similarly, in the Resale Safe Harbor, different safeguards are imposed depending on the type of person offering or selling the security.

One additional requirement for Categories #2 and #3 of the Issuer Safe Harbor is that "offering restrictions" be implemented. "Offering restrictions" means:

> (A) that each distributor agrees in writing (i) that all offers or sales prior to the end of a "distribution compliance period" will be made in accordance with Rule 903 or Rule 904 and (ii) if an equity security of a domestic issuer is involved, not to engage in any hedging transaction prior to the end of the applicable "distribution compliance period" and
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> (B) that all offering materials used in connection with offers or sales prior to the end of the applicable "distribution compliance period" shall include a statement that the securities are not registered (and, if equity securities of a domestic

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Canadian citizen temporarily in the State of Florida and the related buy order that originated in Florida. The court determined that although the general conditions of the safe harbors of Regulation S were not clearly met, the transaction was within the General Statement, and therefore exempt from Section 5.

[11] See Scott, Hal S., *The Future Content of the U.S. Securities Laws: Internationalization of Primary Public Securities Markets*, 63 Law & Contemp. Prob. 71, 94 (Summer 2000).

corporation are involved, must also state that hedging transactions involving these securities cannot take place except in compliance with the Securities Act).

Below is a chart that summarizes the additional conditions and restrictions applicable to the Issuer and Resale Safe Harbors. Words or phrases in quotes are defined terms found in Rule 902. Depending on the type of transaction described in Column #1, the conditions and restrictions in Column #2 must be satisfied (in addition to the two general conditions described above) in order to qualify as a Regulation S offering.

ISSUER SAFE HARBORS (may be utilized by issuers or "distributors" (i.e. securities professionals involved in the distribution process pursuant to contract or their affiliates or agents[12])	
TYPE OF SECURITY OFFERED/ TYPE OF PERSON MAKING THE OFFERING	**ADDITIONAL CONDITIONS/RESTRICTIONS**
Category #1- • Any security issued by a "foreign issuer" if such issuer reasonably believes there is no "SUSMI"[13] • Any security in an "overseas directed offering" • Any security backed by the full faith and credit of a foreign government • Any securities sold to an employee of a "foreign issuer" pursuant to an employee benefit plan	• None.

[12] Note that Rule 903 does not affect a broker-dealer not involved in the distribution process. However, Section 4(3) of the Securities Act prevents a U.S. dealer from selling unregistered securities for the 40-day period following commencement of an offer.

[13] "SUSMI" is Substantial United States Market Interest. SUSMI is determined by the level of the trading of a security that takes place in the United States. See 17 C.F.R. 230.902(j).

ISSUER SAFE HARBORS (may be utilized by issuers or "distributors" (i.e. securities professionals involved in the distribution process pursuant to contract or their affiliates or agents[12])	
TYPE OF SECURITY OFFERED/ TYPE OF PERSON MAKING THE OFFERING	**ADDITIONAL CONDITIONS/RESTRICTIONS**
Category #2 – • Equity securities of a reporting[14] "foreign issuer" • Debt securities of a reporting "domestic issuer" • Debt securities of a reporting "foreign issuer" • Debt securities of a non-reporting "foreign issuer"	• "offering restrictions" must be implemented • the offer or sale, if made prior to the end of a 40-day "distribution compliance period" cannot be made to or for the benefit of a "U.S. person," and • each "distributor," selling to a "distributor" or dealer (as defined in §12(a)(12) of the Securities Exchange Act of 1934) prior to the end of a 40-day "distribution compliance period," must send a notice to the purchaser stating that the purchaser is subject to the same restrictions that apply to a "distributor"
• Category #3 – all securities not eligible for Categories #1 and #2 (e.g. debt securities of a non-reporting "domestic issuer" and equity securities of a reporting "domestic issuer")	If debt securities are involved: • "offering restrictions" must be implemented • the offer or sale, if made prior to the end of a 40-day "distribution compliance period" cannot be made to or for the benefit of a "U.S. person" (other than a "distributor") • the securities must be represented upon issuance by a temporary global certificate that is not exchangeable for definitive shares until the end of a 40-day "distribution compliance period" and • each "distributor" selling to a "distributor" or dealer (as defined in §12(a)(12) of the Securities Exchange Act of 1934) prior to the end of a 40-day "distribution compliance period," must send a notice to the purchaser stating that the purchaser is subject to the same restrictions that apply to a "distributor"

[14] A "reporting" issuer is one who files reports with the SEC pursuant to the Exchange Act of 1934. See 17 C.F.R. 230.902(i).

ISSUER SAFE HARBORS (may be utilized by issuers or "distributors" (i.e. securities professionals involved in the distribution process pursuant to contract or their affiliates or agents[12])	
TYPE OF SECURITY OFFERED/ TYPE OF PERSON MAKING THE OFFERING	**ADDITIONAL CONDITIONS/RESTRICTIONS**
Category #3 (cont'd)	If equity securities are involved: • "offering restrictions" must be implemented • the offer or sale, if made prior to the end of a 1-year "distribution compliance period" cannot be made to or for the benefit of a "U.S. person," • if an offer/sale is made prior to the end of a 1-year "distribution compliance period," then the following conditions must be met: (i) the purchaser (other than a "distributor") certifies that it is not a "U.S. person," (ii) the purchaser agrees to resell in accordance with Regulation S and agrees not to engage in any hedging transactions, (iii) any securities of a "domestic issuer" contain a legend about restricted transfer; and (iv) the issuer is required, by contract or bylaws, to refuse to register any security not made in accordance with the Securities Act and • each "distributor" selling to a "distributor" or dealer (as defined in §12(a)(12) of the Securities Exchange Act of 1934) prior to the end of a 1-year "distribution compliance period," must send a notice to the purchaser stating that the purchaser is subject to the same restrictions that apply to a "distributor"
• Dealers or persons receiving selling concessions on transactions occurring prior to the end of the applicable "distribution compliance period"	• the seller cannot know that the offeree or the purchaser is a U.S. person and • the seller must send a notice to the purchaser or offeree stating that the securities may only be offered or sold during the applicable "distribution compliance period" in accordance with Regulation S or another exemption if the seller knows that the offeree or purchaser is a dealer (as defined in §12(a)(12) of the Securities Exchange Act of 1934)
• Certain affiliates (i.e. an officer or director of the issuer or "distributor," if such person is an affiliate of the issuer or "distributor" solely by virtue of holding such position):	• Such affiliate may only receive a customary broker fee

RESALE SAFE HARBORS (may be utilized by persons other than issuers or "distributors")	
TYPE OF SECURITY OFFERED/ TYPE OF PERSON MAKING THE OFFERING	**ADDITIONAL CONDITIONS/RESTRICTIONS**
• Dealers or persons receiving selling concessions on transactions occurring prior to the end of the applicable "distribution compliance period"	• the seller cannot know that the offeree or the purchaser is a U.S. person and • the seller must send a notice to the purchaser or offeree stating that the securities may only be offered or sold during the applicable "distribution compliance period" in accordance with Regulation S or another exemption if the seller knows that the offeree or purchaser is a dealer (as defined in §12(a)(12) of the Securities Exchange Act of 1934)
• Certain affiliates (i.e. an officer or director of the issuer or "distributor," if such person is an affiliate of the issuer or "distributor" solely by virtue of holding such position):	• Such affiliate may only receive a customary broker fee

After a Regulation S "distribution compliance period" ends, resale into the United States still requires an exemption from Section 5.[15]

[15] For example, such an exemption may be found under Rule 144A , Section 4(a)(1) or Section 4(a)(3) of the Securities Act. See Lander, Guy P., *Regulation S – Securities Offerings Outside the United States*, 21 N.C.J. Int'l Law & Com. Reg. 339, 388 (Winter 1996).