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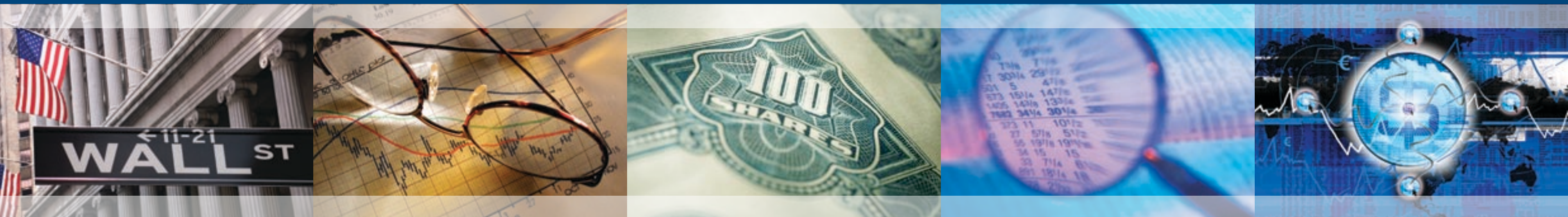

ACCESSING THE U.S. CAPITAL MARKETS

NON-U.S. ISSUERS

An Introduction to United States Securities Laws

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INTRODUCTION

Accessing the U.S. Capital Markets is a basic primer for financial institutions, corporations and governmental entities interested in accessing the U.S. capital markets through conducting a securities offering, listing on a U.S. securities exchange or acquiring a U.S. company. This is one of three *Accessing the U.S. Capital Markets* volumes that we are publishing. This volume has been prepared for non-U.S. issuers. A second volume, which is expected to be published shortly, will focus on securities products that are commonly offered in the U.S. capital markets (*Accessing the U.S. Capital Markets – Securities Products*). The third volume will focus on U.S. issuers (*Accessing the U.S. Capital Markets – U.S. Issuers*).

For the definitions of certain terms used in this volume, please refer to the Glossary beginning on page 366.

Each volume of this edition of *Accessing the U.S. Capital Markets* will appear on our web site at www.accessingsidley.com. Our web site also contains client alerts, memoranda and a wealth of other information that are helpful to issuers, investment banks and other participants in the U.S. capital markets.

This is the twelfth edition of *Accessing the U.S. Capital Markets*. We would like to thank our partners, associates and staff who contributed their time and effort in preparing this edition.

Sidley Austin has over 1,800 lawyers practicing in 16 offices located on four continents. Please contact us at any of our offices if we can be of any assistance.

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January 2009

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GENERAL

The U.S. federal securities laws and regulations distinguish between non-U.S. issuers[1] that are "foreign private issuers," "Canadian issuers" and "foreign governmental issuers."

A "foreign private issuer"[2] is any non-U.S. issuer (other than a foreign governmental issuer) unless, as of the last business day of its most recently completed second fiscal quarter, (i) more than 50% of its outstanding voting securities are directly or indirectly held of record by residents of the United States and (ii) any one of the following exists: (A) the majority of its executive officers or directors are U.S. citizens or residents; (B) more than 50% of its assets are located in the United States; or (C) its business is administered principally in the United States.[3]

"Canadian issuer" means any non-U.S. issuer (other than an investment company) incorporated or organized under the laws of Canada or any Canadian province or territory.

"Foreign governmental issuer" means any government of any country other than the United States or any of its political subdivisions, and any other entity that the SEC determines is eligible for similar treatment in connection with U.S. public offerings.

The U.S. federal securities laws expressly preserve the power of the states and certain territories of the United States to regulate securities activities within each state and territory, although the states' and territories' authority is limited by federal legislation. Every state and certain territories have adopted securities laws, commonly known as "blue sky" laws, which are administered by state or territory securities regulators.

Thus, in addition to complying with U.S. federal securities laws, issuers desiring to sell securities in a particular state or territory may have to register the securities with that state or territory unless an exemption from such registration applies. However, the National Securities

1 A "non-U.S. issuer," or a "foreign issuer" in the SEC's rules, is any issuer that is a government (other than the government of the United States or any of its political subdivisions), a national of any country (other than the United States) or a corporation or other organization incorporated or organized under the laws of any such country or any of its political subdivisions.

2 "Foreign private issuer" is defined in Rule 3(b)-4 under the 1934 Act and Rule 405 under the 1933 Act.

3 An issuer conducting an initial public offering (an "IPO") or a first-time listing in the United States may determine its status as of any date within 30 days of filing a registration statement with the SEC.

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Markets Improvement Act of 1996 ("NSMIA") deprives the states and territories of any authority to require registration or exemption for many types of offerings. For example, issuers that have any securities listed on a U.S. securities exchange generally do not have to register offerings with the states and territories. Blue sky laws and NSMIA are discussed at greater length in this chapter below under the heading "—'Blue Sky' or State Securities Laws."

U.S. SECURITIES INDUSTRY REGULATORS

The U.S. Securities and Exchange Commission

The U.S. Securities and Exchange Commission (the "SEC") is the primary U.S. federal government agency responsible for administering the U.S. federal securities laws. Five principle statutes comprise the U.S. federal securities laws: (i) the Securities Act of 1933 (the "1933 Act"); (ii) the Securities Exchange Act of 1934 (the "1934 Act"); (iii) the Trust Indenture Act of 1939 (the "1939 Act"); (iv) the Investment Company Act of 1940 (the "1940 Act"); and (v) the Investment Advisers Act of 1940. The SEC's responsibilities include:

- interpreting the U.S. federal securities laws and regulations;
- issuing new rules and amending existing rules;
- overseeing the inspection of securities firms, investment advisers, securities exchanges and ratings agencies;
- overseeing private regulatory organizations in the securities, accounting and auditing fields; and
- coordinating U.S. securities regulation with federal, state and foreign authorities.

The SEC's web site is http://www.sec.gov. It contains the U.S. federal securities laws, the securities registration and issuer reporting forms, current and proposed rules and regulations and SEC staff interpretations and speeches, registrations and reporting obligations and information concerning the SEC's enforcement and regulatory proceedings. The SEC also administers and maintains the Interactive Data Electronic Applications ("IDEA") web site at http://idea.sec.gov, which contains issuer filings in connection with securities offerings, correspondence relating to the SEC staff's comments on issuer filings and key financial information about public companies and mutual funds.[4]

Chapter 3 (*The Securities Registration and Reporting Process*) and Chapter 4 (*Disclosure Requirements*) of this volume discuss these matters at greater length.

The Financial Industry Regulatory Authority

The Financial Industry Regulatory Authority ("FINRA") is a private, not-for-profit organization established in June 2007 through the consolidation of the National Association of

[4] As of the time of publication of this volume, issuer filings and certain other information available on the SEC's IDEA web site continues to be available at http://www.sec.gov.

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Securities Dealers, Inc. (the "NASD") and the member regulation, enforcement and arbitration functions of the New York Stock Exchange (the "NYSE"). FINRA's activities include registering and educating securities industry participants, examining securities firms, writing rules, enforcing those rules and the U.S. federal securities laws, informing and educating the investing public, providing trade reporting and other industry utilities, and administering a dispute resolution forum for investors and registered firms. FINRA also performs market regulation under contract for the NYSE, the NYSE Alternext US,[5] NASDAQ, the International Securities Exchange and the Chicago Climate Exchange.

FINRA's web site is http://www.finra.org. It contains FINRA's rules for broker-dealer reporting and other requirements for securities offerings and trading, a list of broker-dealers that are registered with FINRA and information concerning FINRA's enforcement and regulatory proceedings.

The Public Company Accounting Oversight Board

The PCAOB is a private, not-for-profit corporation created by the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") to oversee the auditors of public issuers to protect investors and further the public interest in the preparation of informative, fair and independent audit reports, through registration and inspection, standards-setting, enforcement and support functions.

The PCAOB's web site is http://www.pcaob.com. It contains the PCAOB's standards and rules and its interpretations of those standards and rules, proposed standards and rules, a list of registered accounting firms and information concerning the PCAOB's examinations and enforcement and regulatory proceedings.

U.S. Securities Exchanges

The NYSE, the NYSE Alternext US, NASDAQ and the other securities exchanges in the United States administer rules approved by the SEC that apply to securities and issuers of securities listed on the exchanges, other than those rules and regulations administered by FINRA. Although each securities exchange's rules are similar, each exchange has a unique set of rules. The securities exchanges, which are private, for-profit corporations, are themselves regulated as "national securities exchanges" subject to registration under the 1934 Act and to the SEC's supervision.

The NYSE's web site is http://www.nyse.com, the NYSE Alternext US's web site is http://www.amex.com[6] and NASDAQ's web site is http://www.nasdaq.com. Each contains the exchange's rules for listing and trading securities on the exchange, and the exchange's current interpretations of its rules, a list of issuers that are listed and dealers eligible to trade on the exchange and information concerning the exchange's disciplinary and enforcement actions. In

[5] Formerly known as the American Stock Exchange or the AMEX. Following the acquisition of the AMEX by NYSE Euronext on October 1, 2008, the AMEX was renamed NYSE Alternext US LLC. The NYSE Alternext US will continue to operate a marketplace for equities, options, bonds and, for a limited period of time, Exchange Traded Funds and certain structured products. Its web site continues to be available at www.amex.com.

[6] Id.

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addition to its physical exchange, the NYSE operates an electronic platform known as NYSE Arca.

U.S. securities exchanges, including the listing requirements of the NYSE, the NYSE Alternext US and NASDAQ, are discussed in Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

U.S. State and Territorial Securities Regulators

U.S. state and territorial securities regulators administer rules and regulations that apply to securities offered or sold and broker-dealers and investment advisers that operate in their respective jurisdictions. The North American Securities Administrators Association ("NASAA") is an association of U.S. state and territorial securities regulators and Canadian and Mexican securities regulators. NASAA facilitates coordination of its members' securities, broker-dealer and investment adviser regulation.

NASAA's web site is http://www.nasaa.org. It contains links to securities, broker-dealer and investment adviser laws and regulations of its members, uniform forms and information on the current legislative, regulatory and enforcement activities.

U.S. Federal and State Bank and Thrift Regulators

The Board of Governors of the U.S. Federal Reserve System (the "Federal Reserve Board"), the U.S. Office of the Comptroller of the Currency of the U.S. Department of the Treasury (the "OCC"), the U.S. Office of Thrift Supervision of the U.S. Department of the Treasury (the "OTS") and various state bank regulatory agencies have the power to regulate certain securities offerings in the United States by U.S. banking and other financial institutions and U.S. branches and agencies of non-U.S. banks.

The Federal Reserve Board's web site is http://www.federalreserve.gov, the OCC's web site is http://www.occ.treas.gov and the OTS's web site is http://www.ots.treas.gov. The Federal Reserve Board has not adopted regulations that apply to securities offerings by state banks that are members of the Federal Reserve System. Each of the OCC's and OTS's web sites contains the agency's securities laws and regulations, the securities and other forms, proposed rules and regulations and interpretations, filings with the regulator in connection with securities offerings and information concerning the regulator's enforcement and regulatory proceedings.

Securities regulation applicable to U.S. banking and other financial institutions and U.S. branches and agencies of non-U.S. banks is discussed in Chapter 12 (*Bank Issuers*) of this volume.

The Commodity Futures Trading Commission

The Commodity Futures Trading Commission (the "CFTC") was created in 1974 as an independent U.S. federal agency with the mandate to regulate commodity futures and options markets in the United States.

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The CFTC's web site is http://www.cftc.gov and contains, among other things, the Commodity Exchange Act and the rules adopted by the CFTC thereunder, the CFTC's current and proposed rules and current staff interpretations and information concerning enforcement and regulatory proceedings.

SECURITIES ACT OF 1933

Purpose

The two basic objectives of the 1933 Act are to require that investors receive financial and other significant information concerning securities being offered for public sale and to prohibit deceit, misrepresentations and other fraud in the sale of securities.

Registration

An issuer that wishes to sell its securities in the United States must register the sale of those securities under the 1933 Act unless an explicit exemption is available for either the transaction or the securities sold. Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume discusses the exempt transactions and exempt securities that are often regarded as the most significant for non-U.S. issuers.

To register securities under the 1933 Act, an issuer must file with the SEC a disclosure document, known as a registration statement, which contains a prospectus that must provide a description of the issuer's business, financial condition, results of operations and management, as well as a description of the securities offered. The form of registration statement available to most larger companies permits much of the required disclosure to be incorporated by reference from 1934 Act periodic reports. The "Plain English" rule requires the use of clear and simple writing principles in parts of the prospectus.

Chapter 3 (*The Securities Registration and Reporting Process*) of this volume discusses the registration process in more detail, including the forms of registration statements and the mechanics of the registration process.

Chapter 5 (*Shelf Registration*) of this volume discusses Rule 415 under the 1933 Act, which permits delayed or continuous offerings of securities. This rule allows issuers to register securities in advance of their offering; in effect, to register and place them "on the shelf" for later offering without any further SEC action.

Chapter 13 (*Canadian Issuers*) of this volume discusses the Multi-jurisdictional Disclosure System ("MJDS"), which is available to a Canadian issuer that can satisfy certain transaction or market capitalization tests, has at least a one-year reporting history with Canadian securities authorities and is in compliance with its Canadian reporting obligations.

Chapter 14 (*Foreign Governmental Issuers*) of this volume discusses the 1933 Act registration requirements for foreign governmental issuers, including eligibility requirements and shelf registration requirements.

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Prospectuses

The prospectus filed with the SEC by an issuer in a registered securities offering must be delivered or made available to purchasers of the securities. In most exempt securities offerings it is still customary to deliver a disclosure document. The amount of information in a disclosure document used for an offering that is not registered under the 1933 Act (typically called an "offering memorandum" or an "offering circular") depends primarily on the nature of the issuer, the type of securities being offered and the nature of the investors being solicited.

Trading Restrictions

Securities that have been registered under the 1933 Act (other than securities owned by affiliates) and securities that are themselves exempt from 1933 Act registration (*e.g.*, Section 3(a)(3) commercial paper and securities issued or guaranteed by banks or the U.S. government or its agencies) generally are freely tradable after their initial sale. Securities that are sold pursuant to transaction exemptions under the 1933 Act (*e.g.*, a private placement or a non-U.S. offering) may be subject to transfer restrictions. These transfer restrictions are discussed generally in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume, and specifically as to particular securities in *Accessing the U.S. Capital Markets – Securities Products*. Issuers and securities firms involved in the distribution of securities are also subject to trading restrictions until the completion of the distribution, as discussed in Chapter 1 (*The U.S. Offering Process*) of this volume.

American Depositary Receipts

When equity securities of a non-U.S. issuer are sold in the United States in the form of American Depositary Receipts ("ADRs"), the ADRs must be registered by the depositary with the SEC on Form F-6 whether or not the sale of the underlying securities is exempt from registration under the 1933 Act, unless the ADRs themselves are distributed in an exempt transaction. A 1933 Act registration statement on Form F-6 contains the deposit agreement (pursuant to which ADRs are issued) and the form of ADR, but virtually no information about the non-U.S. issuer. Sponsored and unsponsored ADRs, procedures for listing ADRs on a U.S. national securities exchange and procedures for offering ADRs and other securities in the U.S. capital markets are discussed in *Accessing the U.S. Capital Markets – Securities Products*.

SECURITIES EXCHANGE ACT OF 1934

Purpose

The 1934 Act is the most comprehensive of the federal securities laws. It includes provisions applicable to public companies, U.S. securities exchanges, securities dealers, transfer agents and clearing agencies. In general, the 1934 Act is intended to ensure fair and orderly securities markets in the United States. The continuous reporting requirements of the 1934 Act applicable to public companies require reliable financial and other disclosures considered necessary for informed investment decisions concerning the securities of publicly-traded companies.

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Registration and Reporting

An issuer that lists its securities on a U.S. national securities exchange (such as the NYSE, the NYSE Alternext US or NASDAQ) must register the class of securities pursuant to the 1934 Act and SEC regulations. Registration under the 1934 Act results in a duty to file with the SEC annual reports on Form 10-K or 20-F, quarterly reports on Form 10-Q (in the case of registrants that file reports on Form 10-K) and current reports on Form 8-K or 6-K. An issuer that registers securities for sale under the 1933 Act must also file reports under the 1934 Act for the fiscal year in which the securities were registered and for each subsequent fiscal year at the beginning of which such securities are held of record by 300 or more persons which, in the case of a foreign private issuer, are persons that reside in the United States. A foreign private issuer may otherwise be eligible to terminate 1934 Act registration and reporting, a subject treated in Chapter 18 (*De-registering under the 1934 Act*) of this volume. The information concerning issuers and their publicly-offered securities required by the 1934 Act is virtually the same as that required by the 1933 Act, which is a consequence of the SEC's integrated disclosure system.

A foreign private issuer that has total assets of more than U.S.$10 million and a class of equity security (other than an exempt security) held of record by 500 or more persons on a worldwide basis, at least 300 of whom reside in the United States (including U.S. investors in ADRs representing an equity security), is also required to file periodic reports under the 1934 Act unless exempt pursuant to Rule 12g3-2(b) under the 1934 Act. Rule 12g3-2(b) is available to foreign private issuers generally, including those whose ADRs or other equity securities trade in the United States in the over-the-counter market. Foreign private issuers eligible for the Rule 12g3-2(b) exemption need not file 1934 Act reports. As revised in 2008, a foreign private issuer is generally only required to publish electronically in English on its web site the information it provides to its shareholders in its home country, files with the stock exchanges on which its securities are traded or is otherwise required to make public.[7]

An issuer may choose to voluntarily register a class of its securities under the 1934 Act and commence filing reports on Form 10-K or 20-F and Form 8-K or 6-K under the 1934 Act, even though it is not legally required to do so. Due to the SEC's integrated disclosure system, these filings may prepare the issuer for future public offerings in the United States. Furthermore, issuers that are required to and timely file reports on Form 10-K or 20-F and Form 8-K or 6-K for one year may be eligible to use the abbreviated 1933 Act registration statement on Form S-3 or F-3. Eligibility for Form S-3 or F-3 is a practical necessity for those issuers interested in public offerings involving shelf registrations, such as off-the-shelf debt and equity offerings and at-the-market equity offerings, and is very convenient for continuous offerings such as medium-term note programs. Voluntary registration under the 1934 Act would subject issuers to the requirements of Sarbanes-Oxley.

Foreign private issuers and governmental issuers are exempt from the proxy rules under Section 14 of the 1934 Act and the rules under Section 16 of the 1934 Act governing reporting of beneficial ownership, short-swing profit recapture and short sales. Foreign governmental issuers repurchasing their own securities are also exempt from the tender offer rules under Sections

[7] Rule 12g3-2(b) is discussed further in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

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14(d) and (e) of the 1934 Act. Pursuant to Rules 3a12-3(b) and 3b-4 under the 1934 Act, these exemptions apply so long as the non-U.S. issuer is principally owned and managed by non-U.S. persons and its assets are principally located and its business managed outside the United States.

SARBANES-OXLEY ACT OF 2002

Purpose

Sarbanes-Oxley was designed largely to enhance investor protection through improving the accuracy and reliability of corporate disclosure made pursuant to the securities laws. The enactment of Sarbanes-Oxley and the promulgation of regulations thereunder by the SEC resulted in significant changes in disclosure requirements for issuers.

Disclosure and Related Requirements

Sarbanes-Oxley requires an issuer that files annual reports with the SEC on Forms 10-K, 20-F or 40-F to:

- file certifications of the chief executive officer (the "CEO") and chief financial officer (the "CFO") of an issuer regarding the accuracy of disclosure and the fair presentation of financial information in the annual report;
- file certifications of the CEO and the CFO regarding management's assessment of internal controls over financial reporting and the effectiveness of the issuer's internal control over financial reporting, together with the opinion of the issuer's external auditors on the effectiveness of the issuer's internal control;
- disclose whether at least one audit committee member is an "audit committee financial expert," as defined by SEC rules adopted pursuant to Sarbanes-Oxley, or if not, why not;
- disclose whether it has adopted a code of ethics for certain of its executive officers or, if not, why not;
- disclose critical accounting estimates used in applying the issuer's accounting policies;
- disclose any off-balance sheet arrangements and contractual obligations; and
- reconcile to generally accepted accounting principles ("GAAP") any non-GAAP financial measures in an issuer's oral or written public statements (including press releases and reports filed with the SEC).

Audit, Auditor and Audit Committee Requirements

Pursuant to Sarbanes-Oxley, the SEC has adopted standards for an issuer listed on the NYSE, the NYSE Alternext US and NASDAQ (but not for non-listed 1934 Act reporting issuers) relating to:

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- the composition and role of audit committees;
- audit committee pre-approvals of auditor services;
- prohibitions and limitations on independent accountants performing specified non-audit services;
- rotation of audit partners;
- records retention by the accounting firm;
- limitations on the issuer's employment of a former member of the audit engagement team; and
- prohibitions on an issuer's improper influence on the conduct of audits.

Under these rules, the NYSE, the NYSE Alternext US and NASDAQ must prohibit the listing of an issuer's securities if the issuer is not in compliance with the audit, auditor and audit committee requirements.

Other Requirements

Other Sarbanes-Oxley provisions relate to:

- requirements for attorneys "appearing and practicing" (as defined by SEC rules adopted pursuant to Sarbanes-Oxley) before the SEC to report a material violation of U.S. law by the issuer to the issuer's chief executive or chief legal officer, or other specified persons or groups, and to determine whether an appropriate response has been made;
- prohibitions on issuer loans to directors and executive officers;
- forfeiture of bonuses by CEOs and CFOs following a restatement of the issuer's financial statements due to material non-compliance by the issuer, as a result of misconduct, with any financial reporting requirement of the U.S. securities laws;
- whistleblower protections for employees; and
- prohibitions on insider trading during blackout periods under sponsored individual account plans.

Application

Sarbanes-Oxley applies to "issuers," which are generally companies that are required to file periodic reports with the SEC under Section 13(a) or 15(d) of the 1934 Act. A company that has filed a registration statement under the 1933 Act for an IPO is also an "issuer," although most operative provisions of Sarbanes-Oxley will not apply to such a company until it has become subject to SEC reporting requirements. By its terms, Sarbanes-Oxley makes no allowances for non-U.S. issuers.

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Sarbanes-Oxley does not apply to foreign private issuers that claim exemption from 1934 Act registration under Rule 12g3-2(b). Sarbanes-Oxley also does not apply to non-U.S. issuers that only issue securities in the United States under Rule 144A. Counsel should be retained to determine whether a particular rule under Sarbanes-Oxley applies to an issuer.

TRUST INDENTURE ACT OF 1939

Purpose

The purpose of the 1939 Act is to protect investors in debt securities registered under the 1933 Act by mandating certain qualifications of indenture trustees and certain terms and conditions in qualified indentures relating to those debt securities. These indenture terms protect the rights of indenture securityholders by imposing certain duties and rights on the indenture trustee and the obligor and by prohibiting provisions inconsistent with the statutory standards. Issuers of certain other obligations, such as guarantees and trust preferred securities, must also qualify those instruments under the 1939 Act.

Qualification

Any issuer that proposes to sell its debt securities in the United States must issue those debt securities pursuant to a trust indenture qualified under the 1939 Act unless an exemption from qualification is available. Generally, if an offering or a debt security is exempt from the registration requirements of the 1933 Act, such as Rule 144A offerings and private placements, the issuer is not required to qualify a trust indenture pursuant to the 1939 Act. Foreign governmental issuers are exempt from the 1939 Act.

Trust indentures that are qualified under the 1939 Act are largely standardized except for covenants and events of default, which vary depending upon the nature of the issuer and the type of security to be issued. Where qualification of a trust indenture is not required, issuers may issue debt securities pursuant to an agreement that does not impose on the issuing agent fiduciary duties to the securityholders equivalent to those imposed on a trustee under a trust indenture. These agreements, known as “issuing and paying agent agreements” and “fiscal agency agreements,” are also largely standardized. An issuing and paying agent agreement or a fiscal agency agreement may result in lower administrative costs for the issuer because, due to the absence of fiduciary responsibilities, the issuing and paying agent charges less for its services. Certain issuers of privately-placed longer-term debt (such as medium-term notes and Yankee bonds), however, may use a trust indenture because they expect to issue 1933 Act-registered debt securities in the future or because they have been advised by securities firms that the fiduciary role of the trustee improves the marketability of debt securities issued under a trust indenture.[8]

[8] Under a trust indenture, the trustee owes certain fiduciary obligations to and in certain cases is permitted or required to take actions on behalf of securityholders, whereas a fiscal agent or issuing and paying agent generally acts only as the agent of the issuer and owes no fiduciary duties to securityholders.

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INVESTMENT COMPANY ACT OF 1940

Purpose

The 1940 Act is designed to regulate investment vehicles offered to U.S. investors that fall within the definition of "investment company" under the 1940 Act. "Investment company" is broadly defined in Section 3(a) of the 1940 Act to include any issuer that is (i) engaged primarily in the business of investing, reinvesting or trading in securities, (ii) engaged in that business (whether or not primarily so) or the holding or owning of securities and owns or proposes to acquire investment securities[9] (exclusive of securities issued or guaranteed by the U.S. federal government and cash items) having a value exceeding 40% of the value of the issuer's total assets on an unconsolidated basis or (iii) engaged in the business of issuing face-amount certificates of the installment type.

Registration

Because the 1940 Act embodies a broad regulatory scheme intended primarily for mutual funds, unit investment trusts and closed-end investment companies, it contains requirements that are not consistent with conducting normal business operations in other industries. Accordingly, it is important that issuers avoid having to register under the 1940 Act. Most issuers that are operating companies, banks or insurance companies will not be subject to the 1940 Act either because they do not fall within the definition of an investment company or because they qualify for an exemption. In addition, foreign governments and their political subdivisions generally are not subject to the 1940 Act because of the nature of their activities.[10] However, because the definition of security under the 1940 Act is extremely broad, certain issuers (such as leasing companies and companies with significant interests in less than majority-owned affiliates) may have more difficulty in qualifying for an exemption under the 1940 Act. Chapter 9 (*1940 Act-Exempt Issuers*) of this volume discusses exemptions from the 1940 Act that we believe are most applicable to non-U.S. issuers. Appendix A (*Determining whether an Issuer is a Prima Facie Investment Company or Exempt Pursuant to Rule 3a-1 under the Investment Company Act of 1940*) of this volume contains a discussion of how to determine whether an issuer is a *prima facie* investment company or exempt pursuant to Rule 3a-1 under the 1940 Act.

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[9] The term "investment securities" is defined in Section 3(a)(2) of the 1940 Act to include all securities except (1) U.S. government securities, (2) securities issued by employees' securities companies and (3) securities issued by majority-owned subsidiaries of the owner (a) which are not investment companies and (b) which are not relying on the exception from the definition of "investment company" found in paragraph (1) or (7) of Section 3(c) of the 1940 Act.

[10] It is not always clear whether a particular entity, such as a government development bank, would be considered part of a foreign government or its political subdivisions. For example, circumstances may exist where a non-U.S. issuer serving a governmental purpose determines that it nonetheless needs to seek an exemptive order under the 1940 Act.

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"BLUE SKY" OR STATE SECURITIES LAWS

Purpose

Each state has "blue sky" or securities laws, which frequently regulate both offerings of securities and the activities of broker-dealers. Unlike U.S. federal laws and regulation, which tend to focus on disclosure requirements, blue sky laws often focus on protecting investors through an examination of the merits of an offering.

Federal Preemption

By enacting NSMIA, Congress intended to promote efficiency in the regulation of the U.S. capital markets. NSMIA preempts certain aspects of state securities laws, eliminates much state regulation of national securities offerings and streamlines state regulation of broker-dealers. The states retain authority to regulate small, regional or intra-state securities offerings, and to bring actions to enforce state laws and regulations prohibiting fraud and deceit, including broker-dealer sales practice abuses.

NSMIA preempts state authority to require registration of offerings by registered investment companies, companies with securities listed on a principal securities exchange and issuers selling securities privately pursuant to Rule 506 under the 1933 Act. NSMIA preserves, however, the states' ability to require notice filings and assess fees in connection with certain of such offerings. NSMIA also preempts state regulation of broker-dealers with respect to capital, custody, margin, financial responsibility, record keeping, bonding and financial or operational reporting that differs from federal requirements.

Registration

Subject to the limitations imposed by NSMIA, securities offerings must be registered in any state where the securities will be offered or sold unless there is an applicable exemption. The most useful securities exemption applies to companies listed on the NYSE, the NYSE Alternext US or NASDAQ. The exemption covers not only the listed security itself, but also extends to securities of the same issuer that are of senior, or substantially equal, rank to securities which are so listed. This means, for example, that if an issuer has listed its common stock on the NYSE, all offerings of its common stock, preferred stock and debt would be eligible for the exemption. Therefore, qualifying issues of securities by issuers under the blue sky laws can be relatively simple, and involve relatively little expense in state filing fees, if the issuer enjoys such a listing exemption. The blue sky process is typically handled by counsel for the underwriters or the selling agents.

Generally, an offer and sale of securities made in violation of a state's securities registration requirement under its blue sky law results in rescission liability or damages against the "seller" of the securities, as well as any "controlling" person thereof, and may also result in the imposition of civil and criminal fines and penalties. Most states' blue sky laws are modeled

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upon some version of a Uniform Securities Act promulgated by the NASAA, although there are notable exceptions.[11]

All states provide some kind of transaction exemption for offers and sales to broker-dealers and institutional investors, although in certain states the classes of investors are limited. Such investors typically are banks, savings institutions, trust companies, insurance companies, investment companies, pension or profit-sharing trusts and "other financial institutions or institutional buyers." This blue sky exemption is commonly available for offerings that are marketed exclusively to institutional investors, such as commercial paper, certain medium-term note programs and Rule 144A offerings.

In addition, special state laws may be applicable if the issuer is funding certain types of businesses, such as real estate or gambling.

Certain states, in addition to their blue sky laws, have separate insurance securities laws that regulate the offer and sale of securities by insurance companies, insurance holding companies and other issuers, domestic or foreign, which will use the proceeds from the offering to finance the operations of an insurance company (for example, an offering by a non-insurer/sister affiliate or a special-purpose vehicle set up offshore for tax or off-balance sheet financing purposes). Under certain states' insurance securities laws, an offeror is required to secure a "solicitation permit" from the applicable states' insurance commissioner prior to the commencement of "offers" therein (such as, the solicitation of indications of interest and/or the circulation of offering materials).[12]

[11] For example, the blue sky laws of Florida, Illinois, New York and Ohio do not follow the Uniform Securities Act.

[12] In addition, the New York state blue sky law generally requires the registration of public offerings involving participation interests or investments in real estate, including mortgages or leases, subject to certain exemptions. The New York Attorney General's Office, which oversees the New York state blue sky law, generally takes the position, for example, that the securities issued by hotel operators are "real estate" because the hotel operator generates revenues from the "renting" of hotel rooms – a "real estate" activity. A separate filing could be required in New York for this type of offering, although filings should not be required for Section 4(2) or Rule 506 offerings or Rule 144A offerings.

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SECTION I: PRELIMINARY MATTERS

The process of offering and selling securities in the U.S. capital markets, and the preparation required to do so, varies according to the structure of the transaction, the type of security being offered and the requirements of investors to whom the securities are to be offered and sold. For instance, the offering process for privately-placed securities will differ from that for publicly-offered securities; negotiated private placements will proceed differently from so-called "take it or leave it" private placements or Rule 144A offerings; 1933 Act-registered public offerings will proceed differently from 1933 Act-exempt offerings; whether the securities are being offered through an existing securities facility, such as a medium-term note program or shelf registration, will also affect the offering process. Equity offerings differ from debt offerings in certain respects. The approach for securities that are to be sold only in the U.S. capital markets may differ from that employed for securities that are to be sold internationally as well.

The purpose of Section I of this volume is to address some key aspects of offering and selling securities in the U.S. capital markets.

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CHAPTER 1

THE U.S. OFFERING PROCESS

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GENERAL

An issuer considering accessing the U.S. capital markets typically engages one or more securities firms with a significant presence in the U.S. capital markets to "lead" or "arrange" the transaction. We sometimes refer to these firms as "underwriters" or "agents," depending upon the nature of their commitment. Both the issuer and the securities firms engage experienced U.S. law firms such as Sidley to assist in documenting the transaction and ensuring it complies with applicable U.S. laws, regulations, customs and practices. The offering process itself differs significantly depending on the type of security, the manner of offering and the markets into which the securities are being offered and sold. For example, the time and expense involved in offerings of commercial paper, U.S. bank certificates of deposit or extendible notes is typically significantly less than the time and expense involved in a 1933 Act-registered and NYSE-listed initial public offering of common stock, ordinary shares or ADRs.

After discussing some initial considerations an issuer needs to consider prior to a securities offering, this chapter provides an overview of the mechanics of the U.S. offering process and SEC issuer categories, and then focuses on the preparation and use of the offering documents, the purposes and mechanics of due diligence, the limitations on publicity during the U.S. offering process, the permissibility of certain types of securities analyst research reports during the offering process, certain considerations relating to roadshows and the rules for stabilizing the price of offered securities during the offering. In addition, chapters of this volume and the other *Accessing the U.S. Capital Markets* volumes address the U.S. offering process in particular circumstances, including those that focus on the following:

- the manner in which a U.S. offering is conducted;[1]
- the U.S. offering process for particular types of securities;[2] and

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[1] See Chapter 3 (*The Securities Registration and Reporting Process*), Chapter 5 (*Shelf Registration*) and Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

[2] See *Accessing the U.S. Capital Markets – Securities Products.*

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- the U.S. offering process for particular types of issuers.[3]

INITIAL CONSIDERATIONS

In addition to the issues discussed below, which apply generally to all issuers, in Chapter 2 (*Pre-Offering Matters*) of this volume we address certain pre-offering matters that we have found to be particularly relevant to issuers that are accessing the U.S. capital markets for the first time.

Stand-Alone Offering or Program

An important decision that an issuer has to make is whether to offer securities in a stand-alone transaction or establish a program or a shelf through which it can continuously or from time to time sell securities. A program or shelf provides an issuer with the ability to access the U.S. capital markets opportunistically and potentially reduces the overall cost of multiple offerings, but comes with the cost of maintaining and updating the disclosure and other documentation relating to the program or shelf.

In certain cases, a stand-alone offering is the only option. For example, an issuer offering its equity securities for the first time in a 1933 Act-registered public offering must do a stand-alone offering as it is not permitted by the SEC's rules to file a shelf registration statement. In the case of some securities, such as high-yield debt securities, it may be possible to establish a program but, for various reasons, those securities are generally offered on a stand-alone basis.[4] Also, an issuer may intend to access the U.S. capital markets so infrequently or irregularly that the maintenance costs of a program or shelf are not commercially justifiable.

Some types of securities, such as medium-term notes and commercial paper,[5] are only offered in the U.S. capital markets pursuant to programs. Also, 1933 Act-registered programs are more convenient for some issuers than others. As discussed in Chapter 5 (*Shelf Registration*) of this volume, an issuer that is a well-known seasoned issuer ("WKSI") has the ability to establish a shelf that covers a broad range of securities with a 1933 Act registration statement that becomes effective automatically upon filing with the SEC, and enjoys other benefits that are not available to other types of issuers. As a result, many more WKSIs than non-WKSIs, particularly WKSIs domiciled in the United States, have established a 1933 Act-registered shelf program.

1933 Act-Registered or Not

Another decision that faces an issuer seeking to offer securities in the U.S. capital markets is whether to register the offering under the 1933 Act[6] or to offer the securities pursuant

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[3] See Chapter 10 (*Finance Subsidiaries*), Chapter 11 (*REITs*), Chapter 12 (*Bank Issuers*), Chapter 13 (*Canadian Issuers*) and Chapter 14 (*Foreign Governmental Issuers*) of this volume.

[4] See *Accessing the U.S. Capital Markets – Securities Products*.

[5] See *Accessing the U.S. Capital Markets – Securities Products*.

[6] See Chapter 3 (*The Securities Registration and Reporting Process*) and Chapter 5 (*Shelf Registration*) of this volume.

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to a transactional exemption from the 1933 Act.[7] This is not an issue for securities that are themselves exempt from the registration requirements of the 1933 Act, regardless of the transaction by which they are offered. These types of securities include those issued by U.S. banks, and U.S. branches and agencies of foreign banks that are exempted pursuant to Section 3(a)(2) of the 1933 Act, commercial paper that is exempted by Section 3(a)(3) of the 1933 Act and the other 1933 Act-exempt securities.[8]

The decision to register non-exempt securities under the 1933 Act depends on many factors, including whether the benefits to the issuer of the broader distribution available in a 1933 Act-registered offering outweigh the related costs to the issuer. Following the adoption of Sarbanes-Oxley, many foreign private issuers have avoided 1933 Act-registered offerings and offered securities in 1933 Act-exempt offerings in order to avoid the cost of having to comply with Sarbanes-Oxley and the SEC's rules thereunder. In response, the SEC has taken a number of steps that reduce the burden on foreign private issuers that are subject to the 1934 Act's reporting and other obligations (including those under Sarbanes-Oxley)[9] and make it easier to terminate their 1934 Act reporting and other obligations.[10]

The provisions of Sarbanes-Oxley generally apply to issuers that have securities listed on a U.S. securities exchange under Section 12 of the 1934 Act or are required to file reports under Section 15(d) of the 1934 Act, or that file or have filed a 1933 Act registration statement that has not yet become effective and has not been withdrawn. Certain provisions of Sarbanes-Oxley apply to voluntary filers under Section 15(d) of the 1934 Act. The provisions do not apply to an issuer that has only issued securities under Rule 144A, unless followed by a registered exchange offer. The provisions also do not apply to foreign private issuers that only provide "home country" information to the SEC pursuant to Rule 12g3-2(b) under the 1934 Act.[11]

It should be noted that many of the ongoing and other reporting requirements of the 1934 Act and other applicable laws need to be satisfied at the time of the offering and sale of securities in the U.S. capital markets or at the time of listing on a U.S. securities exchange, as well as on an ongoing basis. Also, some of these requirements, such as those under the Foreign Corrupt Practices Act of 1976, as amended (the "FCPA"), the rules administered by the Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury and margin rules, are applicable to exempt offerings and offerings of exempt securities.

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[7] See Chapter 8 (*1933 Act-Exempt Offerings and Securities)* of this volume.

[8] Id.

[9] See Chapter 4 (*Disclosure Requirements*) of this volume, which describes an issuer's disclosure obligations under the 1933 Act and the 1934 Act (including the SEC's accommodation for foreign private issuers that prepare financial statements in accordance with IFRS as issued by the IASB) and Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume, which describes an issuer's 1934 Act reporting obligations.

[10] See Chapter 18 (*De-Registering under the 1934 Act*) of this volume, which describes the ability of a foreign private issuer to terminate its 1934 Act reporting (including Sarbanes-Oxley requirements) and other obligations.

[11] See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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U.S. Only or International Offering

Whether the securities are offered solely in the United States or in other jurisdictions as well will have an impact on the U.S. offering process. Some securities that are offered and sold in the U.S. capital markets, such as commercial paper and extendible notes, are directed primarily toward the U.S. capital markets and rarely include an international or Regulation S tranche. Others, such as offerings of longer-term fixed-income securities and equity securities, have varying degrees of international components; in certain of these types of offerings, the U.S. capital markets are not the sole or primary market for the securities being offered.

Where the U.S. capital markets are in fact the sole or primary market for a securities offering (*e.g.*, an IPO of NYSE-listed common stock with limited sales to investors outside the United States), the mechanics of the U.S. offering process will generally prevail. However, where the U.S. capital markets are the secondary market for a securities offering (*e.g.*, an IPO of Hong Kong Stock Exchange-listed common stock with a Rule 144A offering to "qualified institutional buyers," as defined in Rule 144A ("QIBs"), in the United States) or one of several primary markets in a global offering (*e.g.*, an IPO of common stock that is listed on the NYSE, the Hong Kong Stock Exchange, the Tokyo Stock Exchange and the London Stock Exchange), the mechanics of the U.S. offering process are more likely to be modified to follow or accommodate the mechanics of the offering process in each other applicable jurisdiction. In any such case, however, it is important to ensure that the requirements for a U.S. offering are still satisfied.

In a global offering, a portion of the securities may be designated for sale in a public offering in the United States and registered under the 1933 Act. In this situation, the principal consideration for the issuer is to what extent the offering outside the United States should be registered under the 1933 Act. The three options are:

(1) register only those securities allotted to the U.S. underwriters for sale in the United States and rely on Regulation S for the securities sold in offshore transactions outside the United States to non-U.S. persons;

(2) register a certain amount of additional securities to provide for the possibility of additional securities flowing back into the United States; or

(3) register the entire offering.

The most conservative approach is to register the entire offering. If this is done, there is no risk of unregistered securities being sold into the U.S. capital markets as part of the distribution in violation of the registration requirements of the 1933 Act. The main disadvantage to this approach is the SEC filing fee, which is calculated on the amount of securities being registered.[12] If one of the other two options is selected then, in order to restrict the flow of

[12] As of the date of publication of this volume, the SEC is operating under a continuing resolution that maintains the 2008 fiscal year fee rate of U.S.$39.30 for each U.S.$1 million of securities sold until five days after the enactment of the SEC's regular appropriation for the 2009 fiscal year, at which time the rate will increase to U.S.$55.80 for each U.S.$1 million of securities sold

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unregistered securities back into the United States, procedures such as limitations on sales by the international underwriters to the U.S. underwriters should be implemented.

OVERVIEW OF THE U.S. OFFERING PROCESS

Set forth below is an overview of the process for offering and selling securities in the U.S. capital markets:

- as discussed in this chapter below under the heading "—Offering Documents," the issuer and its counsel, with input from the underwriters or agents and their counsel, prepare the initial offering document, which is normally a prospectus, offering memorandum or similar document that contains or incorporates by reference descriptions of the issuer, the securities offered and the relevant transaction documents, and any supplemental offering materials delivered to investors;

- if the offering of the securities is 1933 Act-registered, the issuer and its counsel, with input from the underwriters or agents and their counsel, prepare the applicable 1933 Act registration statement (including the form of prospectus and required exhibits such as legal opinions, certain transaction documents and material contracts), file it with the SEC and, if the issuer is not a WKSI, resolve any SEC staff comments; [13]

- the underwriters or agents and, where U.S. counsel is required to deliver a 10b-5 statement regarding the information contained or incorporated by reference in the offering documents, U.S. counsel to the issuer and the underwriters, perform due diligence on the issuer as discussed in this chapter below under heading "—Due Diligence," primarily to ensure that there are no material misstatements or omissions in the offering documents, the registration statement (if the offering is 1933 Act-registered) or any information incorporated by reference therein;

- where a comfort letter is required to be provided with respect to financial information contained or incorporated by reference in the disclosure package, the issuer's auditors perform procedures on such financial information in order to enable them to provide comfort to the underwriters or agents regarding that information;

- if the securities are to be listed on a U.S. securities exchange, the issuer and its counsel, with input from the underwriters or agents and their counsel, prepare the listing documentation and file it with the applicable exchange;[14]

(http://www.sec.gov/news/press/2008/2008-232.htm). The SEC periodically issues Fee Rate Advisories, which are published as press releases on the SEC's web site at http://www.sec.gov/news/press.shtml.

[13] See Chapter 3 (*The Securities Registration and Reporting Process*) and Chapter 5 (*Shelf Registration*) of this volume.

[14] See Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

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- unless the offering is specifically exempt from such requirements,[15] U.S. counsel to the underwriters, with input from the issuer and its counsel, prepare and file with FINRA documentation to show that the underwriting arrangements are fair and reasonable;[16]

- unless the offering is specifically exempt from such requirements,[17] U.S. counsel to the underwriters, with input from the issuer, prepare and file with various states filings to qualify the offering for sale in those states and territories and prepares a "blue sky" survey for the underwriters or agents explaining the investors to whom and the states in which the securities may be offered and sold; [18]

- the issuer, the underwriters or agents and their respective counsel agree upon the terms of the securities to be offered (other than the terms to be determined at pricing);

- the other transaction documents are prepared, which normally include:

  - interview question lists about the issuer for management and, in some cases, a directors' and officers' questionnaire for management due diligence, an interview list for due diligence with the issuer's accountants and a document request list for documentary or "legal" due diligence, as discussed in this chapter below under the heading "—Due Diligence;"

  - the agreement between the issuer and the securities firm or firms that the issuer engages to underwrite or place its securities (the scope, content and name of which varies by product and offering and may be referred to as, among other things, an "underwriting agreement," a "purchase agreement," a "distribution agreement," a "dealer agreement," a "selling agreement" or an "agency agreement");

  - if the offering is a traditional private placement,[19] a note purchase agreement between the issuer and the investors that would also include the purchase terms, as well as the terms and the form of the securities;

  - in the case of equity securities, the issuer's organizational documents, if necessary;

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[15] 1933 Act-exempt offerings, including Rule 144A offerings, and offerings of 1933 Act-exempt securities are normally also exempted from FINRA filings.

[16] See Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

[17] 1933 Act-exempt offerings, including Rule 144A offerings, of securities that rank junior to securities of the issuer that are listed on a U.S. securities exchange and offerings of 1933 Act-exempt securities are normally also exempted from blue sky laws.

[18] For further detail, see the discussion under the heading "'Blue Sky' or State Securities Laws" in *An Overview of U.S. Securities Regulators and Laws* of this volume.

[19] See *Accessing the U.S. Capital Markets – Securities Products*.

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- the agreement or indenture with the entity (normally a commercial bank or trustee), if any, that acts as issuing and paying agent for the securities and, in the case of 1933 Act-registered and sometimes privately-placed debt securities, as trustee for the securityholders;

- the form or forms of the security being offered; [20]

- if the securities require a calculation agent, such as floating rate, structured and extendible notes, the calculation agency agreement between the issuer and the calculation agent;

- in the case of book-entry securities, the agreement between the issuer, the issuing agent and DTC;

- a comfort letter from the issuer's auditor regarding the financial information in the offering documents; and

- opinions, officers' closing certificates and other closing documents, including, as the case may be, 10b-5 statements from U.S. counsel to the issuer and the underwriters to the effect that they do not believe the offering documents contain any material misstatements or omit any material information.

• in the case of a U.S. traditional private placement, the selling agent introduces the investors to the issuer and the issuer negotiates the terms of the securities and the sale price directly with the investors;

• if the offering is 1933 Act-registered, the registration statement is either automatically declared effective in the case of a WKSI or, if not (*e.g.*, in the case of an IPO), any SEC staff comments on the registration statement (and any 1934 Act reports incorporated by reference) are addressed and responded to in one or more amendments to the registration statement and the registration statement, including the preliminary prospectus or "red herring" it contains, is finalized and FINRA approval is obtained;

• if the issuer is only setting up a program or shelf with no immediate take down, the offering document or documents are finalized and a closing occurs at which various transaction documents are signed and delivered as discussed below, but no securities are issued at such time;

• if the issuer is involved in a stand-alone offering or a take down from a program or shelf, the underwriters or agents, with the assistance of the issuer and within applicable guidelines discussed in this chapter below under the heading "—

[20] The terms of the securities may be set forth in the security itself or may be set forth in the document (*e.g.*, indenture or organizational document) under which the security is being issued.

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Limitations on Publicity," market the securities[21] to potential investors and gather indications of interest in the securities, thereby "building a book" for possible pricing;

- based on the indications of interest obtained by the underwriters or agents, "pricing" occurs whereby the issuer and the underwriters or agents agree to the terms of the securities and the price at which the issuer sells them, the underwriting agreement or similar agreement is signed by the parties, the issuer's auditors deliver their comfort letter (if any) and, if the securities are listed on a U.S. securities exchange, trading in the securities is approved on a when-issued basis;

- the underwriters or agents contact investors that have indicated interest in purchasing the securities, inform them of the pricing terms (normally by delivering a terms sheet or, in the case of a 1933 Act-registered offering, a free writing prospectus agreed upon with the issuer) and confirm the investor's orders and, if the underwriters or agents stabilize the trading price of the securities to ensure an orderly offering, they do so in accordance with the applicable guidelines discussed in this chapter below under the heading "—Stabilization and Regulation M;" and

- normally three business days after the pricing[22] of a U.S. securities offering, the closing occurs at which the remaining transaction documents, including the closing documents, are signed and delivered and the securities are delivered by the issuer in exchange for receiving the purchase price from the underwriters or agents or, in the case of a U.S. traditional private placement, the investors.

ISSUER CLASSES

Securities Offering Reform, a comprehensive set of rule and Form changes adopted by the SEC in 2005[23] ("Securities Offering Reform") that established the following classes of issuers: (i) WKSIs; (ii) "seasoned issuers;" (iii) "unseasoned issuers;" (iv) "non-reporting issuers;" and (v) "ineligible issuers."

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[21] Marketing normally occurs through the use of a preliminary offering document. In the case of an offering under a program or a shelf, the base offering document is frequently accompanied by a preliminary supplement relating to the terms of the securities. See also the discussion in this chapter below under the heading "Offering Documents."

[22] Rule 15c6-1 under the 1934 Act establishes three business days ("T+3") as the standard settlement cycle for securities transactions (T+4 is the standard settlement cycle for the sale of securities priced after 4:30 p.m., Eastern time, pursuant to a registered firm commitment underwritten offering). Rule 15c6-1 also permits the parties to establish a longer settlement cycle in exceptional circumstances when T+3 or T+4, as the case may be, is not feasible or when otherwise expressly agreed to by all parties to the transaction (including purchasers of the securities). The SEC is currently working with the securities industry to determine the feasibility of shortening the settlement cycle to one business day ("T+1").

[23] See SEC Release No. 33-8591 (July 19, 2005) (http://www.sec.gov/rules/final/33-8591.pdf).

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WKSIs

Securities Offering Reform is of the most benefit to WKSIs. As defined in Rule 405 under the 1933 Act, an issuer is a WKSI if:

- it is current in its 1934 Act reports and has filed these reports timely in the twelve months preceding the filing of a registration statement;
- it is eligible to use Form S-3 or F-3[24] to register a cash offering for its own account;
- as of a date within 60 days of the determination, either:
  - the value of its common equity securities (whether or not voting) held worldwide by unaffiliated persons is at least U.S.$700 million; or
  - it has issued in registered primary offerings at least U.S.$1 billion of non-convertible debt or preferred securities in the preceding three years; and
- it is not an ineligible issuer.

Majority-owned subsidiaries of WKSIs may qualify as WKSIs themselves based on the parent's status if:

- the parent fully and unconditionally guarantees the subsidiary's non-convertible debt or preferred securities;
- the subsidiary securities being registered are guarantees of the debt securities of its parent or the non-convertible securities of another majority-owned subsidiary where such securities are supported by the parent's full and unconditional guarantee; or
- the subsidiary is registering non-convertible investment grade securities.

Issuers of asset-backed securities, foreign governmental issuers, investment company issuers and business development company issuers registered under the 1940 Act are not eligible for WKSI status.

Seasoned Issuers

"Seasoned issuers" are those issuers that do not qualify as WKSIs but that are eligible to make primary offerings of securities on Form S-3 or Form F-3.

[24] The criteria for use of Form F-3 are described in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

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Unseasoned Issuers

"Unseasoned issuers" are those issuers that are required to file reports under the 1934 Act but are ineligible to make primary offerings on Form S-3 or F-3. Unseasoned issuers include issuers that voluntarily file reports under the 1934 Act even though they are not obligated to do so. Such unseasoned issuers are neither eligible for WKSI status nor seasoned issuer status.

Voluntary Filer Status

The facing sheets for Forms 10-K and 20-F require the issuer to state whether it is required to file reports pursuant to the 1934 Act. Issuers who file reports as technical volunteers must identify themselves as such. Most voluntary filers are obligors on debt securities. Because many issues of debt securities are held of record by less than 300 persons, the obligor's reporting obligation under Section 15(d) automatically falls into suspense after the fiscal year in which the associated registration statement became effective. Voluntary filers of this type generally report to comply with indenture covenants to continue reporting, notwithstanding the suspension of the statutory duty. The SEC believes that investors should be aware that voluntary filers may, at least under the 1934 Act, stop reporting at any time.

Non-Reporting Issuers

"Non-reporting issuers" are issuers that do not file 1934 Act reports with the SEC voluntarily or otherwise. Generally, this category covers issuers filing their first registration statement with the SEC. Such an issuer becomes subject to 1934 Act reporting obligations upon effectiveness of its 1933 Act registration statement.

Ineligible Issuers

"Ineligible issuers" may not be WKSIs and are subject to certain other disabilities. As defined in Rule 405 under the 1933 Act, ineligible issuers include:

- issuers that are subject to the reporting requirements of the 1934 Act but are delinquent in filing those reports in the prior 12 months, except for certain current reports on Form 8-K or 6-K;[25]

[25] In the case of an asset-backed issuer, this would also include a delinquency by the depositor of another asset-backed issuer of a class of securities involving the same asset class established by the same depositor.

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- issuers that are or have been in the past three years a blank check issuer,[26] shell company[27] or penny stock company;[28]

- limited partnerships when offering securities other than in firm-commitment underwritings;

- issuers that have filed for bankruptcy or insolvency in the preceding three years;

- issuers, including subsidiaries, that in the past three years have been convicted of specified offenses under the 1934 Act or that are subject to a decree or order of a U.S. or non-U.S. court prohibiting conduct specified in the anti-fraud provisions of the federal securities laws; and

- issuers that are or have been in the past three years subject to certain administrative proceedings under the 1933 Act.

The disqualification for decrees and orders related to the anti-fraud provisions of the federal securities laws will include decrees and orders entered as part of settlements with the government, such as consent decrees, but do not apply to any settlement entered into before December 1, 2005. Disqualifications stemming from a subsidiary's misconduct will only result if the issuer owned the subsidiary at the time of the actions in question, which will prevent an issuer acquiring a new subsidiary from becoming an ineligible issuer as the result of actions taken at a time before the subsidiary was acquired.

The SEC may determine, "upon a showing of good cause," that an issuer otherwise covered by the definition should not be considered an ineligible issuer. The staff has authority under this provision to make the determination that an issuer need not be considered ineligible.

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[26] Rule 419(a)(2) under the 1933 Act defines a blank check company as a "development stage company that (i) has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or other entity or person and (ii) is issuing 'penny stock' as defined in Rule 3a51-1 of 1934 Act."

[27] Rule 405 under the 1933 Act defines a shell company as a registrant, other than an asset-backed issuer as defined in Item 1101(b) of Regulation AB, that has:

(1) no or nominal operations; and

(2) either:

(i) No or nominal assets;

(ii) Assets consisting only of cash or cash equivalents; or

(iii) Assets consisting of any amount of cash and cash equivalents and nominal other assets.

[28] Rule 3a51-1 under the 1934 Act defines "penny stock" generally as an equity security with a price of less than U.S.$5.00 which is not listed on a national securities exchange. "Penny stock" typically comprises very low-priced, high-risk, speculative shares in unproven companies.

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OFFERING DOCUMENTS

The preparation of the offering documents for a U.S. securities offering is a very important task, as these documents are the basis on which the securities are offered and sold. These documents, together with the other information conveyed to investors at the time they decide to purchase offered securities (which we collectively call the "disclosure package"), are also the primary source of liability for issuers, their directors and controlling persons, underwriters and accounting firms.[29] The issuer and its counsel (with input from the underwriters or agents and their counsel, the issuer's auditors and others) normally prepare the offering documents and typically review and comment on all other parts of the disclosure package. The issuer, the underwriters and their respective counsel perform the due diligence discussed in this chapter below under the heading "—Due Diligence" with a view to ensuring that the offering documents and other information contained in the disclosure package, including information incorporated therein by reference, contain no material misstatements and omit no material information.

Most offerings in the U.S. capital markets use at least two offering documents. The offering document initially distributed to the investors to solicit their interest is discussed in this chapter below under the heading "—Offering Documents—Primary Offering Document." The other offering document contains the pricing terms and is sent to investors by the underwriters or agents, normally via a Bloomberg message or other electronic means. In the context of a 1933 Act-registered offering, this is a "free writing prospectus." Most offering documents also incorporate information by reference from other documents filed by the issuer with the SEC that are electronically available to investors.

Free Writing Prospectus

A "free writing prospectus" is any written communication offering for sale securities registered under the 1933 Act, but does not include the prospectus forming part of the registration statement, limited announcements pursuant to Rules 134 and 135 under the 1933 Act, certain materials permitted by the rules for issuers of asset-backed securities or sales literature used after the effective date of a registration statement that is accompanied or preceded by a prospectus satisfying Section 10(a) of the 1933 Act.

Because a free writing prospectus is not a part of the registration statement, the Section 11 liability provisions of the 1933 Act do not apply to it. However, material misstatements and omissions in a free writing prospectus are actionable under Section 12(a)(2) of the 1933 Act. Misleading disclosure in a free writing prospectus may also lead to liability under Section 17(a) of the 1933 Act, which is enforceable by the SEC, but not by private litigants, and liability under Rule 10b-5 under the 1934 Act.

[29] See Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume.

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Pre-Filing Free Writing Prospectuses by WKSIs

Rule 163 under the 1933 Act provides that it is not gun jumping[30] for WKSIs to make oral and written communications about an offering of securities prior to filing a 1933 Act registration statement. The written offers are considered free writing prospectuses, must contain a prescribed legend and, with some exceptions, must be filed with the SEC "promptly" upon the filing of the registration statement. There are cure provisions for "immaterial or unintentional" failures to include the required legend or make the required filing. Rule 163 may not be used by prospective underwriters or other offering participants on behalf of a WKSI issuer. Rule 163 is not available to investment companies, business development companies or acquisitions being registered under the 1933 Act.

Post-filing Free Writing Prospectuses

Pursuant to Rule 164 under the 1933 Act, a free writing prospectus may be used by the issuer or any offering participant after the filing of a registration statement. The rule prescribes eligibility conditions and makes provisions for the cure of certain compliance failures, which are similar to the cure provisions in Rule 163. Rule 433 under the 1933 Act sets out the filing, delivery, notice and recordkeeping conditions to the use of a free writing prospectus.

Certain issuers are not eligible to use free writing prospectuses, including investment companies and business development companies and issuers that are, or have been in the past three years, blank check companies, certain shell issuers and penny stock issuers. The ability of ineligible issuers to use of a free writing prospectus is limited to providing descriptions of the offerings, the terms of the securities being offered and, for issuers of asset-backed securities, certain specified information from Regulation AB.

The following conditions apply to the use of the free writing prospectus under Rule 433:

- issuers other than WKSIs must have filed with the SEC a 1933 Act registration statement that includes a prospectus satisfying Section 10 of the 1933 Act;
- unseasoned and non-reporting issuers must make prior or contemporaneous delivery (which might be satisfied by hyperlink access) of the prospectus satisfying Section 10;
- information in the free writing prospectus, "the substance of which is not included in the registration statement," may not "conflict" with information that is part of the registration statement, including 1934 Act reports incorporated by reference;
- the free writing prospectus must include a prescribed legend directing investors to the prospectus in the registration statement;

[30] For a further discussion of gun jumping, see the discussion in this chapter below under the heading "—Limitations on Publicity—Rules That Apply to a 1933 Act-Registered Offering."

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- subject to certain exceptions, the free writing prospectus must be filed with the SEC, but not as part of the registration statement, by "means reasonably calculated to result in filing no later than the date of first use;" and
- issuers and offering participants must retain copies of any free writing prospectus not required to be filed with the SEC for a period of three years from the first *bona fide* public offering of the securities.

A base prospectus for a shelf offering and a preliminary prospectus are types of prospectuses that satisfy Section 10. In the case of an IPO, the SEC requires an estimated range of the public offering price for satisfaction of Section 10. The delivery requirement applicable to unseasoned and non-reporting issuers generally calls for the use of the most recent prospectus satisfying Section 10. Once available, the final prospectus for such an issuer must accompany or precede any free writing prospectus delivered after effectiveness. If a free writing prospectus is delivered electronically, an active hyperlink to a prospectus satisfying Section 10 will satisfy the delivery requirement.

The requirement that the information in the free writing prospectus may not "conflict" with statements in SEC filings at times may be difficult to apply in practice. The limit of the SEC's guidance in the adopting release is that the prohibition will not prevent disclosure that is "different from or additional or supplemental to" the disclosures included in the registration statement.[31] In the SEC's view, the inclusion of disclaimers, such as a statement that the free writing prospectus is not a prospectus, would remove the protection of Rule 164, resulting in the free writing prospectus becoming an illegal prospectus, and a violation of Section 5 of the 1933 Act. Statements disclaiming that the information is accurate and complete or requiring investors to acknowledge that they have understood the disclosures have historically been disfavored by the SEC and, if used, would prevent reliance on Rule 164.

The filing requirement normally applies to the issuer itself. If, however, the free writing prospectus was not prepared by or on behalf of the issuer and if the free writing prospectus does not otherwise include material information about the issuer or its securities provided by or on behalf of the issuer, the issuer would not be required to file the free writing prospectus. Information prepared by another party only on the basis of issuer information or derived from issuer information is not be required to be filed. However, any free writing prospectus used or referred to by an offering participant must be filed if it is distributed "in a manner reasonably designed to lead to its broad unrestricted dissemination."[32] The SEC will not consider a dealer's communications exclusively with its own customers, regardless of number, as such a dissemination. The filing requirement applicable to offering participants is independent of the issuer's obligation.

Rule 433(d)(5)(ii) requires a free writing prospectus that describes the final terms of the offering to be filed within two days of the later of the establishment of final terms or the first use of the prospectus describing the final terms.

[31] See supra footnote 23.

[32] See Rule 433(d)(1)(ii) under the 1933 Act.

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The exceptions to the filing requirement include provisions designed to prevent some substantively duplicative filings. A free writing prospectus including only provisional offering terms is not required to be filed. A free writing prospectus for an issuer of asset-backed securities may also be subject to Regulation AB and associated rules. Similarly, any free writing prospectus used in securities offerings in business combinations may be filed pursuant to Rule 425 under the 1933 Act.

Written Communications

In addition to written materials and radio or television presentations, all of which are included in the statutory definition, "written communications" include all graphic communications. All radio and television presentations are deemed to be written communications, without regard to the manner of transmission.

Graphic Communications

"Graphic communications" include all forms of electronic media. These include audio and video tapes, fax transmissions, e-mail and Internet web sites, among other things. For example, "blast" voice mails (*i.e.*, recorded voice messages transmitted to many telephones), are graphic communications. Telephone conversations or conference calls and personal voice mail messages from live telephone calls are not graphic communications. An exception is made in the definition of graphic communications for live real-time transmissions of roadshow presentations to live audiences. When recorded and retransmitted through an issuer's web site, however, the communication would be considered a graphic communication.

Primary Offering Document

The primary offering document is referred to as a "prospectus" if the offering is a public offering registered under the 1933 Act, and is what is normally referred to as an "offering memorandum" or an "offering circular" (but generally not a prospectus) if the offering is not 1933 Act-registered. If the securities are offered under a program or shelf registration, there is normally a "base" prospectus or offering memorandum and one or more supplemental prospectuses or offering memoranda describing the specific terms of each individual offering.

The contents of the offering documents vary depending upon the type of offering, the type of security and the type of issuer. The disclosure requirements of the 1933 Act and the SEC's rules thereunder establish the form and content requirements for prospectuses used in connection with a 1933 Act-registered offering.[33] While the 1933 Act contains no information requirements for private placements and other exempt offerings, in Rule 144A offerings where U.S. counsel is required to deliver 10b-5 statements regarding the offering documents (particularly offerings of long-term, fixed-income securities and equity securities), market practice generally is to follow the disclosure requirements for 1933 Act-registered offerings to the extent possible. This practice helps protect transaction participants against potential investor claims.

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[33] See Chapter 3 (*The Securities Registration and Reporting Process*), Chapter 4 (*Disclosure Requirements*) and Chapter 5 (*Shelf Registration*) of this volume.

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There are exempt offerings where the offering documents do not satisfy the disclosure requirements for 1933 Act-registered offerings. For example, the offering documents for commercial paper and most extendible note offerings normally contain a very short description of the issuer and a description of securities and tax consequences and other matters that are material to an investment in those securities. In those instances, no 10b-5 statement from U.S. counsel is required. The rationale behind this is that these types of securities are less risky to investors because they have a short term and are highly rated and the natural investor base is very sophisticated, so risk of loss is disproportionately lower than the cost of generating sizable offering documents. In other cases, such as bank issuers or U.S. municipal bond issuers, a different disclosure and regulatory scheme applies, and disclosure is provided to the extent required by and in accordance with the requirements of that scheme.

In many cases, the underwriters or agents wish to market the offering and build a book of interested investors before committing to purchase the securities from the issuer. In that case, the underwriters or agents will use a preliminary offering document that includes all the required information other that the pricing information, such as interest or dividend rate and sales price, which will be determined and agreed upon by the issuer and the underwriters or agents following the marketing and book building process. In the case of offerings under a program or shelf, the base offering document and any base supplemental offering documents may be used to market the securities without a separate preliminary offering document if the terms of the securities being marketed are sufficiently described in those documents. Customarily, upon completion of the marketing efforts, a terms sheet setting forth the terms of the offering and the securities is agreed upon by the issuer and the underwriters and distributed to potential investors that have shown interest in purchasing the securities, and their orders are confirmed.

The filing obligations with respect to prospectuses, prospectus supplements, terms sheets and other offering materials with respect to a 1933 Act-registered securities offering is discussed in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

Prospectus Delivery

In one of the most significant changes to affect the mechanics of a securities offering, Securities Offering Reform, in most cases, abolished the requirement for delivery of the final prospectus to purchasers. Noting the widespread use of the Internet, the SEC accepted the proposition that the accessibility by electronic means to the disclosure documents required by the 1933 Act should be treated as the equivalent of delivery to investors. The SEC's acceptance of the access-equals-delivery model does have some limits. It does not extend to all registered offerings or to all types of documents required to be delivered to investors under the federal securities laws.

Also as a part of Securities Offering Reform, liability under Section 12(a)(2) of the 1933 Act for misstatements and omissions is based on the information "conveyed" to investors only at the time the contract of sale is made; later disclosures, such as in the final prospectus, are not considered. This led to a significant increase in the use of pre-sale offering materials.

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Prospectus Delivery Generally

Pursuant to Rule 172 under the 1933 Act, a prospectus meeting the requirements of Section 10(a) will be deemed to accompany or precede the delivery of a security sold under a 1933 Act registration statement if such a prospectus is timely filed with the SEC's electronic filing system. Failed attempts to file made in good faith and with reasonable efforts will be deemed to satisfy the rule if the issuer files the prospectus as soon as practicable.

Rule 172 expressly permits sending confirmations under Rule 10b-10 under the 1934 Act and notices of allocations of sale before the final prospectus is filed. The SEC specifically noted that the relief provided by Rule 172 would extend to the market-making prospectus, the offering document required when a dealer makes a market in securities of an affiliate, provided only that a current final prospectus is filed with the SEC.

A dealer's obligation to deliver a preliminary prospectus to investors in IPOs, which is required by Rule 15c2-8 under the 1934 Act, may not be discharged through Rule 172. It is also important to note that, except for WKSIs and seasoned issuers, actual delivery of a prospectus permitted by Section 10 (or, at least, provision of a live hyperlink) is required as a condition to use of a free writing prospectus.

Rule 172 is unavailable for investment company issuers and business development company issuers and in cases where the issuer or an underwriter or participating dealer is the subject of a pending SEC proceeding in connection with the offering. The rule also does not affect prospectus delivery requirements in business combinations and exchange offerings or in employee benefit plan offerings registered on Form S-8.

Disclosure Duty

A disclosure duty is created by Rule 173 under the 1933 Act. In any transaction covered by Section 5(b)(2) of the 1933 Act, which includes all registered sales by issuers and underwriters, not later than two business days following the completion of such sale, there must be delivered to purchasers a copy of the final prospectus or, in lieu of such prospectus, a notice to the effect that the sale was made pursuant to a registration statement or in a transaction in which a final prospectus would have been required to have been delivered in the absence of Rule 172. Most underwriters deliver the notice in lieu of the final prospectus, and include the notice in the Rule 10b-10 confirmation. Alternatively, the final prospectus may be delivered. A person required to provide notice under Rule 173 must honor any request from its purchasers for a copy of the final prospectus. In such a case, settlement of the purchase may still proceed before delivery of the final prospectus.

Rules 172 and 173 are independent, which is to say that compliance with Rule 173 is not necessary to establish the exemption from prospectus delivery. Inter-dealer transactions and transactions ineligible under Rule 172 are not subject to Rule 173.

Prospectus Delivery for Trades on a Securities Exchange

Rule 153 under the 1933 Act affords relief from the prospectus delivery requirements of the 1933 Act for sales to brokers and dealers in transactions effected on national securities

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exchanges, including NASDAQ, or through alternative trading systems. The conditions to the rule are that the related registration statement is effective, that the SEC has not taken certain administrative actions in respect of the offering under Section 8 or 8A of the 1933 Act (such as a stop order), and that the prospectus satisfying Section 10(a) is filed in fact with the SEC. No filing with the exchange or other market is required.

Information Incorporated by Reference

In many cases offering documents "incorporate by reference" information contained in other documents filed with the SEC or otherwise publicly available. As a general matter, information incorporated by reference into offering documents is considered part of the offering documents and therefore part of the disclosure package on which an investor makes its decision. Incorporation by reference makes it easier to draft offering documents as the information to be incorporated has already been prepared with a view to being used for an offering in the U.S. capital markets. It is also makes updating a program or shelf much easier and enables an issuer to use the same information about itself in multiple contexts.

1933 Act-Registered Offerings

In the case of 1933 Act-registered offerings, issuers that are reporting companies under the 1934 Act and are eligible to incorporate by reference information into their prospectuses may do so by referring investors to the information they file with or, in some cases, submit to the SEC under the 1934 Act. The SEC's web site (http://www.sec.gov) is easily accessible and its IDEA system (http://idea.sec.gov) contains the 1933 Act and the 1934 Act filings made by reporting issuers. Issuers registering an offering on a Form S-1 or F-1 registration statement may incorporate by reference their prior 1934 Act filings after they have filed an annual report required by Section 13(a) or Section 15(d). Any issuer that registers an offering on a Form S-3 or Form F-3 registration statement incorporates by reference its prior and future 1934 Act filings (in the case of Form F-3, only filings the issuer designates) into its 1933 Act prospectus.[34]

Private Placements, Including Rule 144A Offerings

In the case of offering documents used in private placements, particularly Rule 144A offerings, it is not uncommon for 1934 Act reporting issuers to incorporate information by reference to the 1934 Act reports they file with the SEC, particularly issuers that frequently offer and sell securities in the U.S. capital markets. In the last few years, particularly in connection with securities offerings by issuers that have de-registered from the 1934 Act, a practice has developed whereby offering documents used in private placements have incorporated by reference information contained on a cul-de-sac on the issuer's web site or a special web site maintained by the issuer. The information on the cul-de-sac or special web site is typically updated in much the same way as the issuer would update its 1934 Act information. These cul-de-sacs or special web sites contain no links to any other web site, although other web sites

[34] As described in Chapter 13 (*Canadian Issuers*) of this volume, the SEC allows Canadian issuers that register on the Canadian issuer-only 1933 Act registration forms (Forms F-7, F-8, F-9 and F-80) available under MJDS to incorporate by reference information they have filed with or submitted to the SEC under the 1934 Act. As described in Chapter 14 (*Foreign Governmental Issuers*) of this volume, foreign governmental issuers may incorporate by reference information filed with the SEC on Form 18-K.

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such as an issuer's main web site may contain links to the cul-de-sac or special web site, and essentially function as an electronic component of the offering documents.

We have seen at least two approaches to such cul-de-sacs. In our experience, the most prevalent approach is that the cul-de-sac contains only information about the issuer that is prepared assuming it will be reviewed by a U.S. investor, does not refer to any particular offering, is freely accessible by any party and, in essence, serves as a substitute for the SEC's web site. Another approach, which appears more frequently in the structured finance market, is that the cul-de-sac is password protected, is accessible only by investors being offered the particular securities and, in addition to information about the issuer, contains specific information about the securities offering.

Other Information in the Disclosure Package

Any additional information that may be used to market an offering of securities in the U.S. capital markets, such as e-mails, cover letters and roadshow materials, may also be considered part of the disclosure package for 1933 Act liability purposes, as noted in the discussion in this chapter below under the heading "—Limitations on Publicity."

Disclosure Package at Time of Sale

As discussed in Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume, for purposes of establishing disclosure liability under Section 12(a)(2) of the 1933 Act for material misstatements or omissions of material information, Rule 159 under the 1933 Act provides that the relevant disclosure is the information conveyed to the investor up to the point, known as the "time of sale," when the investor becomes committed to purchase the securities. In most cases, the time of sale is considered to be when the investor tells its broker it will purchase the offered securities. As a result, since the disclosure package for a marketed securities offering at the time of sale is typically not the final prospectus or other final offering document but rather the preliminary offering document or base offering document or documents and any other information, including the terms sheet with pricing information and, in certain cases, roadshow materials, distributed by the issuer or the underwriter and received by the investor at or prior to the time it commits to purchase the offered securities, it is that disclosure package (and not the final prospectus or other offering document) that constitutes the basis for establishing disclosure liability under Section 12(a)(2) of the 1933 Act. In the case of securities purchased by underwriters without having broadly solicited prospective investors (known as "bought" deals), the final prospectus or offering document would still constitute the basis for disclosure liability under Section 12(a)(2) of the 1933 Act (so long as it was delivered at or prior to the time of sale). In all registered offerings, disclosure liability under Section 11 of the 1933 Act will be based upon the prospectus.

DUE DILIGENCE

Due diligence refers to the appropriate level of investigation to be performed in connection with a U.S. securities offering. The level of diligence required in a particular offering will vary depending, among other things, on the type of offering, the securities offered, the issuer

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involved and the sophistication of the potential investors and their level of involvement in the offering process.

It is generally acknowledged that a 1933 Act-registered offering requires the most rigorous due diligence. The level of due diligence performed in connection with some 1933 Act-exempt offerings, such as offerings by U.S. branches of non-U.S. banks and Rule 144A offerings, is comparable to that performed in connection with 1933 Act-registered offerings. The time and effort required to perform due diligence will depend upon the nature of the issuer and the complexity of its business, as well as whether the lead underwriters and their counsel have performed a due diligence investigation of the issuer in the recent past. Accordingly, an initial public offering by an issuer that operates primarily in politically or economically unstable parts of the world or whose business is in a volatile industry may require due diligence procedures that are more comprehensive than those employed in connection with an offering by a 1934 Act-registered issuer with a stable business that frequently accesses the public U.S. capital markets.

Due diligence in connection with offerings of such securities as commercial paper, U.S. bank certificates of deposit and extendible notes are generally regarded as the least rigorous. In most of these cases, due diligence is limited to the underwriters or agents checking their internal knowledge about the issuer, including any research on the issuer, and brief discussions with management at the time of the offering.

In connection with U.S. traditional private placements, the investors themselves perform the diligence.

Origins and Purpose

The practice of employing due diligence procedures to verify the information contained or incorporated by reference in offering documents originates from the 1933 Act registration statement and prospectus liabilities imposed by Sections 11 and 12(a)(2) of the 1933 Act, and the due diligence defenses thereunder available to underwriters.[35] Although establishment of the due diligence defense under Sections 11 and 12(a)(2) depends on the type of information in the registration statement and the prospectus that is alleged to be false or misleading, an underwriter generally will not be liable with respect to disclosure in a registration statement or a prospectus if the underwriter performed a reasonable investigation and neither believed nor had grounds to believe that the documents contained a material misstatement or omitted material information. Given the importance of this defense, underwriters and their counsel have developed "due diligence" procedures designed to enable them to demonstrate that they have performed a "reasonable investigation" or taken "reasonable care" so as to establish the due diligence defense.

[35] These provisions, as well as other liability provisions under U.S. securities law, are discussed in detail in Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume.

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The purpose of due diligence in any securities offering can be summarized as follows:

- verify that the disclosure regarding the issuer is complete and correct and consistent with the applicable disclosure standards, which may involve more than U.S. disclosure standards if the offering is made or the securities are listed outside the United States;

- ensure that there are no impediments to the offering (*e.g.*, no pre-emptive rights, no covenants that prohibit the offering, no third-party consents required, the issuer satisfies the corporate governance requirements of Sarbanes-Oxley, if applicable, the issuer satisfies any non-U.S. requirements, etc.);

- reduce the risk that the securities that the investors receive are less valuable than they expected when they agreed to purchase the securities, thereby increasing the likelihood of claims against the issuer and the underwriters;

- establish a due diligence defense to any claim involving the offering; and

- ultimately, providing fair disclosure to investors and protecting the reputation of the issuer and the underwriters.

Main Aspects of Due Diligence

It is customary for the underwriters or agents and their U.S counsel to lead and frame the due diligence process, although the issuer and its U.S. counsel, the issuer's auditors, any foreign counsel and any required experts (*e.g.*, patent counsel, engineers, etc.) also participate in the due diligence process. Due diligence also benefits the issuer to the extent that it polishes the disclosure to avoid any material misstatements or omissions and thereby reduces the risk of a claim being made by an investor.

The main aspects of due diligence, which have been developed over the years with the benefit of custom, practice and case law, include the following:

Interviews with the Issuer's Management, its Auditors and sometimes its Audit Committee and Directors' and Officers' Questionnaires. These usually cover questions previously submitted by the underwriters or their U.S. counsel as well as questions that arise during a due diligence interview. These interviews usually occur at the beginning of the U.S. offering process or the establishment of a program or a shelf, ideally early in the drafting process for the offering documents, and are updated during the offering process or during the life of the program or the shelf. In some cases, particularly IPOs, the directors and principal officers of an issuer respond to a questionnaire to ensure accurate disclosure about such matters as their compensation and any conflicts of interest with the issuer, in addition to affirming their qualification to be employed or engaged by an issuer with 1933 Act-registered securities or U.S. securities exchange-listed securities.

Reviewing the Documents of the Issuer and its Subsidiaries. In most offerings, U.S. counsel to the underwriters submits a document request list to the issuer and its counsel, there is a call or meeting to discuss the document request list (which lists all documents that are

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believed to be material to the issuer and its subsidiaries) to focus the review process on those documents that are material, and U.S. counsel to the underwriters and the issuer typically thereafter review the documents. This document review ideally occurs early in the drafting process for the offering documents and is updated during the offering process or during the life of the program or the shelf. The documents reviewed are generally extensive, tailored to the particular issuer and, at a very high level, include the organizational documents, board and committee minutes and presentations, directors' and officers' questionnaires, material instruments and agreements, accountants' letters to management and management responses, attorney's litigation letters to accountants and litigation files of the issuer and its subsidiaries.

Sarbanes-Oxley Due Diligence. If an issuer is a 1934 Act reporting company, through a combination of document review and interviews with management, the U.S. counsel to the underwriters will perform a due diligence review on compliance by the issuer with the corporate governance and other requirements of Sarbanes-Oxley and the SEC's rules thereunder.

Drafting and Negotiating Sessions. Perhaps the best due diligence is conducted at the drafting sessions for the offering documents, where the underwriters and their U.S. counsel have the ability to review and discuss the issuer's disclosure, and the negotiations over the transaction documents, particularly the representations and warranties contained in the underwriting agreement and, in the case of a debt securities offering, the covenant package, where the underwriters and even the issuer may become aware for the first time of matters that are material to the offering. The due diligence benefits of drafting issuer disclosure and negotiating issuer representations, warranties and debt covenants are obviously not as great in the case of 1934 Act reporting issuers, issuers that have "standard" underwriting agreements or issuers of investment grade securities.

Backup. U.S. underwriters' counsel also often submits a backup list to the issuer in order to verify the source of industry statistics, market share and similar data included in the offering documents. Backup data requested may also include, where material, issuer information such as number of employees, number of offices and other statistical information about the issuer that the issuer's auditors are not able to comfort. Other forms of backup include visiting the major sites where an issuer conducts its business to confirm their existence and condition and contacting the issuer's suppliers and customers. These other forms of backup generally apply to industrial companies that are first-time issuers in the U.S. capital markets, though in some cases it may be appropriate to periodically repeat some or all of these procedures.

Experts and Other Third Parties. In some cases, the presentation of an issuer's business or financial condition is dependent on experts. This is the case, for example, in the mining and natural resources industries where independent engineers are responsible for developing or verifying reserves and other similar data. Also, some offering documents contain or incorporate by reference an industry, country or regulatory report prepared by a third party. In such cases, in addition to interviewing the issuer's management on these matters, the underwriters and their U.S. counsel will interview the independent expert or other third party, verify its independence and credentials and receive, at the closing of a stand-alone offering, a program or a shelf and at periodic updates of a program, a signed report or certification from the independent expert as to the report or data.

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Auditors' Comfort Letter. This letter is intended to provide the underwriters or agents with comfort on at least four areas: (i) the auditor is independent; (ii) any interim financial statements are prepared on the same basis as the audited annual financial statements; (iii) the financial information contained or incorporated by reference in the offering documents has been accurately derived from the issuer's accounting records; and (iv) on a negative assurance or, in certain cases, specified-procedures basis, the existence and quantification of any negative changes in specified financial performance and condition measures since the most recent financial information about the issuer included or incorporated by reference in the offering documents or the most recent comparable financial reporting period. The comfort letter is generally in the applicable form established pursuant to Statement on Auditing Standards No. 72 ("SAS 72").[36] Comfort letters are typically delivered at the time of the pricing of a stand-alone offering and updated in short form at the closing.

In order to obtain a comfort letter for a Rule 144A offering, the underwriters or agents are required by the auditor to deliver a letter to the issuer's auditor representing that the due diligence procedures being followed in the Rule 144A-offering process are similar to those that would be followed in the context of a 1933 Act-registered offering. In some cases, in order to obtain a comfort letter where a Regulation S offering is combined with a Rule 144A offering or 1933 Act-registered offering, the underwriters or agents may be required by the auditor to enter into an arrangement letter with the issuer's auditors which, among other things, establishes SAS 72-type procedures for the Regulation S offering. In any such case, two comfort letters are typically delivered, one for the U.S. offering and one for the Regulation S offering.

Comfort letters, and any required representation letters and arrangement letters, are also typically delivered at the time of the establishment of a program or shelf, each time the program or shelf is updated with financial information for a new annual or interim fiscal period and, in some cases, at the time of a sizable take down off the program or shelf.

Closing Papers, Legal Opinions and 10b-5 Statements. Closing papers include (i) signed transaction documents (unless previously delivered at the establishment of the program or shelf), (ii) third party certification of the issuer's corporate existence and, if applicable, good standing in the jurisdictions in which it operates, (iii) an issuer secretary's certificate that certifies the issuer's organizational documents, transaction resolutions and authorizations, completeness of the minutes of the issuer and its subsidiaries, the incumbency of officers signing the transaction documents and closing papers, (iv) a bring down certificate pursuant to the underwriting agreement, normally signed by the issuer's CEO and CFO or similar officers, that confirms satisfaction of the underwriting agreement's closing conditions and re-affirms representations and warranties, (v) any additional certificates needed to support the legal opinions being delivered or to "bridge gaps" in the comfort underwriters receive from the issuer's auditors, legal counsel or otherwise and (vi) cross-receipts if securities are being sold.

The issuer's U.S. and non-U.S. counsel deliver opinions that address (i) corporate matters such as the issuer's corporate existence, capitalization and ownership of subsidiaries, the absence of defaults and violations by the issuer and of material litigation against the issuer, and any regulatory and similar disclosure in the offering memorandum, (ii) transactional matters such as

[36] The text of SAS 72 is available at http://www.aicpa.org/download/members/div/auditstd/AU-00634.PDF.

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the issuer's authorization of the transaction, the validity of the transaction documents and the securities being sold, the accuracy of the description of the securities and the transaction documents and any tax or similar disclosure about the securities, compliance with or exemption from the 1933 Act registration requirements, compliance with SEC form requirements (if 1933 Act-registered), all consents and filings for the offering and sale have been obtained, the offer and sale does not contravene or conflict with any of the issuer's material contracts or organization documents or any applicable laws or regulations and, in some cases, the absence of a requirement for the issuer to register under the 1940 Act and (iii) any additional issues that may be relevant to the issuer or that may have arisen during the course of the U.S. offering process.

In addition to delivering legal opinions, U.S. counsel to the issuer and U.S. counsel to the underwriters may be asked to deliver a "10b-5 statement" to the underwriters that confirms nothing has come to such counsel's attention to cause it to believe that the registration statement (in the case of a 1933 Act-registered offering) or the offering documents (in the case of a 1933 Act-exempted offering) contain or incorporate by reference any material misstatement or omit any material information. 10b-5 statements typically carve out financial and sometimes statistical information, as well as "expertized" information,[37] and are not "opinions" as the matters are not, strictly speaking, opinions as to legal matters but rather a statement of a belief as to factual matters. However, as a result of having to deliver a 10b-5 statement with respect to information contained or incorporated by reference in the offering documents, the U.S. counsel plays a very active role not only in the drafting of the offering documents, but also ensuring that the other aspects of due diligence are conducted to such counsel's satisfaction, hence the 10b-5 statement is viewed by many as a valuable due diligence component.

Closing papers, legal opinions and 10b-5 statements are typically delivered at the closing of a stand-alone offering, at the time of the establishment of a program or shelf and each time the program or shelf is updated with financial information for a new annual or interim fiscal period and, in some cases, at the time of a sizable take down off the program or shelf.

For a further discussion of issues that arise in connection with due diligence for program or shelf registrations, see Chapter 5 (*Shelf Registration*) of this volume.

LIMITATIONS ON PUBLICITY

There are at least two important reasons to limit publicity in connection with an offering of U.S. securities. The first is that the 1933 Act and the SEC's rules thereunder regulate the manner of offering securities in the U.S. capital markets, including permissible publicity about an offering, and it is important that none of the transaction participants violate those rules, as to do so could result in a delay or cancellation of the offering, the expulsion of an underwriter from the syndicate or possible liability or enforcement action. The second is that the information published could inadvertently become part of the disclosure package and thus potentially subject the issuer and the underwriters or agents to liability for such information.

[37] Potential liabilities with respect to "expertized" information are discussed under the heading "1933 Act Registration Statement Liability—Due Diligence Defense" in Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume.

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The SEC's disclosure package approach is its way of attempting to be realistic regarding the information for which issuers and underwriter should have liability. Most issuers publish an enormous amount of information about themselves, much of which is available on their web site or in public filings that are also accessible via the Internet. Much of that information, particularly in the case of non-U.S. issuers, is not prepared with the disclosure requirements of the 1933 Act in mind. Also, many securities firms have research departments that generate a significant amount of information regarding issuers for whom they act as underwriters or agents on U.S. offerings that is not prepared with the disclosure requirements of the 1933 Act in mind. In this context, the SEC adopts an approach whereby the issuer and potentially the underwriters or agents are liable under Sections 11 or 12(a)(2) of the 1933 Act for any information that, based on the SEC's rules, is included in the disclosure package and are not liable under Section 11 or 12(a)(2) of the 1933 Act for anything else.

Once an issuer and an underwriter or agent commence work on a U.S. offering, without consulting U.S. counsel, the transaction parties should not discuss or otherwise publicize the offering outside the working group and any regulatory and securities exchange participants in the transaction. In addition, the issuer and the underwriters or the agents need to ensure, based on the advice of U.S. counsel, that their other activities, be they corporate announcements, research reports, analysts presentations or other communications, do not violate the SEC's manner of offering rules or inadvertently result in adding unintended information to the disclosure package.

Particularly in the case of IPOs, but in other cases as well, U.S. issuer's or underwriters' counsel would normally provide guidance on the publicity guidelines to be followed during the process of preparing for and carrying out a securities offering involving the U.S. capital markets. Where the offering involves multiple jurisdictions, particularly if the issuer is a foreign private issuer, such guidance would address the issues that often arise due to competing regulatory schemes that may, for example, require publicity even though the SEC's rules would prohibit the publicity. Like many U.S. law firms, Sidley regularly provides guidance on this subject for our clients.

In limiting their publicity and as part of the due diligence process, U.S. issuers need to be mindful of their market disclosure obligations under Regulation FD, which is discussed in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume. Regulation FD does not apply to foreign private issuers, though it is instructive to foreign private issuers and many non-U.S. jurisdictions impose similar continuous disclosure obligations that need to be considered.

Rules That Apply to a 1933 Act-Registered Offering

In the case of a 1933 Act-registered offering, with some exceptions for WKSIs that may use pre-filing free writing prospectuses as discussed below, it is a violation of the registration requirements of the 1933 Act to make any offers before filing a registration statement and, after filing the registration statement, to make written offers other than by means of a prospectus, which includes a red herring. This is called "gun jumping." Gun jumping could result in the cancellation or delay of an offering or the expulsion of one or more underwriters from an offering. It should be noted that, even though a particular form of communication is not gun

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jumping, the contents of that communication may nevertheless become part of the disclosure package for 1933 Act liability purposes.

Permitted publicity about a 1933 Act-registered offering includes the following, as well as the matters discussed in this chapter below under the headings "—Research Reports" and "—Roadshows."

Pre-Filing Notice of Proposed Registered Offering. Rule 135 under the 1933 Act permits advance notice of an offering to the market if the notice states that the offering will only be made by means of a prospectus and contains no more than the name of the issuer, the title, amount and basic terms of the securities offered and a brief statement of the manner and purpose of the offering. The notice cannot name the underwriters. This notice would generally be issued prior to the filing of the registration statement with the SEC and is normally published when the issuer determines the offering is material to its existing securityholders.

Post-Filing Notice of Registered Offering. Pursuant to Rule 134 under the 1933 Act, once an issuer has filed a registration statement for a 1933 Act-registered offering, it is not gun jumping to publish a limited announcement concerning the issuer (such as its name, place of formation, address and telephone number) and the securities being offered (such as designations and ranking, CUSIP number and listing information). The intended application of offering proceeds and type of underwriting may be included in the announcement, but only if the same information has been disclosed in the prospectus forming part of the 1933 Act registration statement. Issuers of asset-backed securities may identify parties such as the servicer, sponsor or depositor and may include information concerning the asset class of the transaction and any credit enhancement. Rule 134 allows identification of underwriters in the syndicate generally, as well as the managers of the offering. The dates, times and locations of roadshows may be included in the announcement. Offering procedures, such as subscription procedures in on-line offerings, are specifically permitted to be disclosed.

The availability of Rule 134 is conditioned on the availability of a prospectus permitted by Section 10 of the 1933 Act. In the SEC's view, the prospectus for an issuer's initial public offering is not such a prospectus unless it includes a *bona fide* estimate of the price to the public. Amended Rule 134, as interpreted by the SEC, may be used by an IPO issuer before an estimate of the pricing range if the communication relying on the rule does not include any other information that would be dependent on the public offering price. Such prohibited information is not confined to the price itself. In the case of fixed-income securities, such information includes final maturity, interest rate, yield and any rating assigned to the securities.

Rule 134 requires the inclusion of legends informing readers of the availability of the prospectus. Notices complying with the rule are deemed not to be prospectuses or free writing prospectuses.

Issuer Communications More than 30 Days Prior to Filing. Rule 163A under the 1933 Act provides that any communication made by an issuer more than 30 days before the filing of a registration statement that does not reference a registered securities offering is not considered gun jumping, though it may constitute part of the disclosure package for purposes of liability under Section 12(a)(2) of the 1933 Act. The issuer must take reasonable steps to prevent further

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distribution of the communication during the 30-day period. Rule 163A is not available in connection with M&A transactions or to investment companies, business development companies or current or certain former blank check, shell or penny stock companies. Rule 163A, among other things, provides an SEC-sanctioned "cooling off" period for any gun jumping activity that occurs while preparing for an SEC-registered offering.

Free Writing Prospectuses. Free writing prospectuses used as discussed above may be used without causing a gun jumping violation.

Regularly Released Business and Forward-Looking Information. Rule 168 under the 1933 Act provides that it is not gun jumping when 1934 Act reporting issuers (other than investment companies and business development companies), certain foreign private issuers[38] and, except in the case of forward-looking information, certain participants in ABS transactions publish factual or forward-looking information. "Factual business information" is defined to include information about the issuer, its business or financial developments, advertisements or other information about its products or services and dividend notices. "Forward-looking information" is defined to include projections of financial measures, statements about plans and objectives for future operations, statements about future economic performance (including MD&A-type information) and related assumptions. The communication may not contain information about the offering. Also, an issuer may only take advantage of this rule if it has previously released or disseminated factual business information in the ordinary course of its business and the timing, manner and form in which the information is released is materially consistent with its similar past communications. While the requirement for "ordinary course" communication may not prohibit communications made on "an unscheduled or periodic basis," the issuer should take into account the nature of the event triggering the communication in assessing the availability of this rule.

News Media and Selling Materials. Rule 433 under the 1933 Act provides that historical information concerning the issuer, specifically identified as such and segregated in a separate section of the issuer's web site, will not be considered a current offer of securities unless used in connection with a pending offering. As a result, an issuer that maintains a properly identified archive of press releases, for example, need not be concerned that the historical information included in the archive will be subject to the free writing prospectus rules. Publications and broadcasts concerning a registered offering that constitute offers will be considered a form of free writing prospectus if the issuer or an offering participant "provided, authorized, or approved information" to a publisher or broadcaster of the information.

Covered media communications are subject to a filing requirement within four days after the issuer or offering participant becomes aware of the dissemination of the communication. The legending requirement of the rule would be satisfied through inclusion of the prescribed notice on the filed document.

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[38] Any foreign private issuer that (a) satisfies the registrant requirements of Form F-3 (other than reporting history) and (b) either (i) has a public float of at least U.S.$75 million or (ii) is issuing non-convertible investment grade debt securities *and* (c) either (i) has had its equity securities trading for at least twelve months on a designated offshore securities market or (ii) has a worldwide common equity market value held by non-affiliates of at least U.S.$700 million.

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Rule 433(f) generally requires that the publisher or broadcaster of the information must be independent of the issuer and any other person participating in the distribution. An exception is made for issuers in the business of publishing or broadcasting whose publications may include business and financial news. To rely on Rule 433, such an issuer must have established policies and procedures making editorial content of its publications and broadcasts independent of securities offering activities and any publication or broadcast relying on the rule must have been made in the ordinary course.

Rule 433 does not affect the use of sales literature (*i.e.*, written offering materials used after the effective date of a registration statement). Subject to the prior or contemporaneous delivery of a prospectus satisfying Section 10(a), such materials are not considered to be any type of prospectus under the statutory definition of the term.

Offshore Press-Related Communications. Rule 135e under the 1933 Act permits a non-U.S. issuer to provide journalists with access to information that discusses a "present or proposed offering of securities" if the information is provided at a press conference held outside the United States, in meetings held outside the United States or in written press-related materials released outside the United States. Perhaps the most important condition to the availability of this rule is there must be a *bona fide* offering offshore in addition to the U.S. offering. A second, somewhat unexpected, condition is that both foreign and U.S. journalists must be given access to the communication. Conference calls are covered by Rule 135e but if a participant is calling in from the United States, the rule is not available. Inclusion of research in written press-related materials does not cause those materials, including the research, to lose the safe harbor protection. Any press-related material must include the legends required by this rule.

Rules that Apply to Non-1933 Act-Registered Offerings, including Rule 144A Offerings

The SEC's publicity rules for unregistered offerings are of primary importance to private placements pursuant to Section 4(2) of the 1933 Act, particularly Rule 144A offerings, where it is important that publicity does not impact the issuer's ability to take advantage of the private placement exemption. While there are a number of applicable conditions to this exemption, as discussed in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume, the most important in this context is that there not be a public offering (*i.e.*, that neither the issuer nor any other transaction participant offer or sell the securities by any form of general solicitation or general advertising).

Permitted publicity about a 1933 Act-registered offering includes the following, as well as the matters discussed in this chapter below under the headings "—Research Reports" and "—Roadshows." In addition, the SEC publicity rules for a 1933 Act-registered offering may be considered by analogy by U.S. counsel in determining whether a particular communication would impact the private placement exemption or the Regulation S exemption or whether a particular communication should be considered part of the disclosure package.

Notice of Proposed, Pending or Completed Unregistered Offerings. Rule 135c under the 1933 Act, like Rule 135, its counterpart for registered offerings, is intended to permit the issuer to inform existing securityholders of information it considers material to them. Under the safe

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harbor of Rule 135c under the 1933 Act, a non-U.S. issuer that is required to file 1934 Act reports or is exempt from such filing requirements pursuant to Rule 12g3-2(b) may publish a notice that it proposes to make, is making or has made an offering of securities not registered or required to be registered under the 1933 Act so long as such notice (i) is not used for the purpose of conditioning the U.S. capital markets, (ii) states that the securities will not be and have not been registered under the 1933 Act and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements and (iii) contains no more than specified information that identifies the issuer and the securities. A copy of such notice must be filed with the SEC under the 1934 Act or made available pursuant to Rule 12g3-2(b), as the case may be.

RESEARCH REPORTS

Recommendations and other research reports relating to a non-U.S. issuer may not be distributed in the United States until after the completion of the securities offering unless the issuer and the research reports meet the requirements of Rules 137, 138 or 139 under the 1933 Act. Where the U.S. offering is part of an international offering, these restrictions generally also apply to the international underwriters.[39]

Recommendations and other reports published by brokers and dealers can raise issues under Section 5 of the 1933 Act when published around the time of a registered securities offering. Rules 137, 138 and 139 immunize certain recommendations and reports from characterization as illegal offerings or as impermissible types of prospectuses. All three rules are safe-harbor regulations.

Research by Non-Participating Broker or Dealer

Rule 137 covers any broker or dealer communications when the broker or dealer has not participated and does not participate in a registered securities distribution and does not propose to do so. The broker or dealer may not have received, directly or indirectly, any compensation for the publication or distribution of the report from any person with an interest or participation in the issuer's securities offering or in its securities. This rule specifies the types of payments that are permitted and forbidden.

The communication in question must have been made in the ordinary course of the broker's or dealer's business. The rule is available for reports concerning any issuer other than an issuer that is, or has been in the past three years, a blank check or shell issuer or a penny stock issuer. The rule permits the publication of research on initial public offerings by disinterested parties. Distribution of independent research by an offering participant, however, is not permitted.

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[39] The practice with respect to the distribution of research reports outside the United States may vary, subject to local laws, in cases in which the non-U.S. offering is not registered under the 1933 Act. In connection with international securities offerings, various underwriters have adopted procedures for distributing research reports outside the United States prior to commencement of the offering. These procedures are designed to ensure that the reports are not distributed in the United States prior to or during the offering.

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Research by Participating Broker or Dealer

Rule 138 provides a dispensation from Section 5 for participants in a distribution of securities who have published research in certain circumstances. What the rule contemplates is a mismatch between the securities that are the subject of the distribution and the securities that are the subject of the research. To illustrate, if a dealer has published a report concerning an issuer's non-convertible debt securities or preferred stock, the report will not be construed as an offering before the filing of a registration statement or as an illegal form of prospectus if the dealer then participates in the registered distribution of the issuer's common stock. To rely on this rule, the broker or dealer must have published reports on the type of security in the past, although it need not have reported on the issuer's securities. The issuer in question must be current in its periodic reports with the SEC, although the rule will also allow reports for certain large foreign issuers whose securities are widely traded to satisfy this requirement.

The rule is unavailable for the securities of any issuer that is or has been within the past three years a blank check issuer, a shell issuer or a penny stock issuer. Rule 138 provides that reports allowed by the rule will not be considered forms of communications that could jeopardize reliance on the exemptions for unregistered sales exclusively to certain institutional purchasers under Rule 144A or exclusively outside the United States under Regulation S.

Issuer and Industry Research Reports

Rule 139 covers the publication of both issuer and industry research reports. Subject to satisfaction of the rule's conditions, a broker or dealer may participate in an issuer's registered offering even though it has recently published research on the issuer or on the issuer's industry. The research will not be considered a prospectus or an offering of the issuer's securities before the filing of a registration statement.

Issuer-Specific Reports as Covered by Rule 139(a)(1). Issuer-specific reports are covered by Rule 139(a)(1) if the issuer is either an issuer eligible to make primary offerings on Form S-3 or F-3 or a foreign private issuer that would be eligible to make an offering on Form F-3 except for the 1934 Act reporting requirement of the form. The method for identifying eligible issuers is complex.

For WKSIs and seasoned issuers, the time for determination is the later of the date the issuer most recently filed a registration statement on Form S-3 or F-3 and the date of the most recent amendment filed for the purpose of satisfying Section 10(a)(3), which specifies the maximum age of information permitted in a prospectus. Because the staff of the SEC construes an issuer's filing of its annual report on Form 10-K or 20-F to be the equivalent of the filing of such an amendment, the 10-K or 20-F filing date will be used for purposes of this determination. As of that date, the issuer's common equity held by unaffiliated persons must have been at least U.S.$75 million or the issuer must be offering investment grade securities. "As of the date of reliance" in Rule 139, which means the date the broker-dealer publishes the report and each date thereafter it distributes the report, the issuer must have timely filed all 1934 Act reports on Form 10-K or 10-Q or, for foreign private issuers, Form 20-F. The rule is available notwithstanding delinquencies in filing current reports on Form 8-K or 6-K.

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For non-reporting foreign private issuers, the issuer must satisfy either the U.S.$75 million market capitalization test or the investment grade securities test. Equity securities of a qualifying foreign private issuer must be traded on a "designated offshore securities market" (a listing of important foreign exchanges is included in Rule 902 under Regulation S) or the worldwide market value of the issuer's common equity securities held by unaffiliated persons must be at least U.S.$700 million. These tests must be applied as of the date of reliance.

Rule 139 is not available for issuer-specific reports concerning any issuer that is or that has been in the past three years a blank check issuer, a shell issuer or a penny stock issuer. The report relying on Rule 139(a)(1) must have been published in the regular course of business by the broker or dealer. Although Rule 139 does not require that the report has been published with "reasonable regularity," the rule will not be available for the initiation (or re-initiation following a discontinuation in coverage) of research. At least one previous report must have been published before Rule 139 will be available. Neither the rule nor the SEC's commentary suggests what would constitute a "discontinuation" in coverage. Rule 139A, a parallel rule for research concerning issuers of asset-backed securities, also does not contain a "reasonable regularity" condition. Rule 139 does not require that the recommendation in a report be no more favorable than in prior reports. Nor does the rule require that the previously published or distributed report cover the same securities of the issuer that are the subject of the registered offering.

Industry Reports as Covered by Rule 139(a)(2). The inclusion of a reference to an issuer or its securities in a report including "similar information with respect to a substantial number of issuers in the issuer's industry" or a "comprehensive list of securities currently recommended by the broker or dealer" will not be construed as an illegal offer or prospectus, subject to a number of conditions. The issuer in question must either be an issuer required to file 1934 Act reports or a foreign private issuer described in Rule 139(a). The disqualifications of blank check issuers, shell issuers and penny stock issuers apply to the same extent as under Rule 139(a).

The issuer under consideration or its securities must be "given no materially greater space or prominence" compared to other issuers or securities included in the report. The protected report must be published in the regular course of business and may not be the first such report by the broker or dealer or the first report following discontinuation of similar reports.

Like Rule 138, Rules 139(b) and (c) provide that reports permitted by the rules will not be considered improper communications in connection with exempt offerings under Rule 144A or Regulation S.

ROADSHOWS

As part of their efforts to market securities, particularly in the case of IPOs and other significant debt and equity offerings, the lead underwriters often organize a "roadshow." A roadshow may be "physical" or "electronic" or both. Organized properly, roadshows should not present a gun jumping problem for a 1933 Act-registered offering or present a problem for the private placement and offshore offering exemptions provided by Section 4(2) and Rule 144A and Regulation S.

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Physical Roadshows

Physical roadshows involve a series of meetings at which selected members of the issuer's management make presentations to invited guests, which typically include institutional investors, money managers and securities salespersons. One-on-one meetings with important investors may also be arranged. In the case of 1933 Act-registered offerings, unless the issuer is a WKSI, these marketing efforts may begin only after the registration statement has been filed.[40]

Roadshows are permitted in connection with 1933 Act-registered offerings because oral offers may be made once a registration statement is filed. Sufficient quantities of the latest version of the preliminary prospectus should be available at each roadshow presentation, and the preliminary prospectus should be the only written material provided to attendees at the presentation. While information not included in the preliminary prospectus may be presented at a roadshow, the scope and content of such presentations should be cleared with U.S. legal counsel before the roadshow begins and is generally limited to information contained in or derivable from the offering documents.

Electronic Roadshows

Electronic roadshows, sales presentations for securities offerings transmitted by means of the Internet, have become commonplace since the SEC first acquiesced to the practice in no-action correspondence beginning in 1997.

For purposes of Rule 164 and Rule 433 under the 1933 Act, 1933 Act-registered offering roadshows transmitted electronically are included within the definition of written communications and therefore constitute free writing prospectuses and are therefore part of the disclosure package. Live transmissions in real time of roadshows to a live audience are treated only as oral communications and are not free writing prospectuses, nor are accompanying visual aids, unless provided in a separate file designed to be available to be copied or downloaded separately.

SEC Filing Requirements

In the case of a 1933 Act-registered offering, electronic roadshows that constitute written communications must be filed with the SEC if the issuer is not required to file 1934 Act reports at the time the registration statement is filed (*i.e.*, an IPO) and the issuer does not make at least one *bona fide* version of a roadshow, covering the same general areas regarding the issuer, its management, and the securities offered as other versions of the roadshow, available to any person without restriction through a graphic communication, such as an openly accessible Internet posting.

Rule 433(e)(1) provides that any information included on an issuer's web site or hyperlinked from a third-party web site will be subject to the filing rules applicable to a free

[40] It is important to note that although a WKSI may make offers prior to the filing of a registration statement under the 1933 Act, underwriters and agents may not do so on its behalf.

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writing prospectus if the information constitutes an offer and if the information is not otherwise exempt from filing.

Whether treated as an oral or written communication and whether or not required to be filed, an electronic roadshow will be considered part of the issuer's disclosure package for purposes of 1933 Act liability.

STABILIZATION AND REGULATION M[41]

It is a basic premise of the U.S. securities laws that securities should not be distributed in a market that has been stimulated by the activities of persons having an interest in the distribution. In order to ensure that securities are distributed in a market free from manipulation, the SEC adopted Regulation M,[42] which prohibits certain activities in connection with a securities offering.

Regulation M consists of six rules. Rule 100 sets forth applicable definitions. Rules 101 through 105 are collectively intended to prevent persons having an interest in an offering (*i.e.*, the issuer, the underwriters, selling securityholders and certain related parties) from conditioning the market in order to facilitate the distribution. The general prohibitions of the rules are subject to various exceptions that are designed to permit an orderly distribution of securities and limit disruption of the market for the securities in distribution. When a portion of an international distribution is made in the United States, the SEC takes the position that Regulation M has extraterritorial effect, applying not only to the U.S. portion of the distribution but also to the distribution of securities outside the United States.

Restrictions on the Activities of Issuers, Selling Securityholders and their Affiliated Purchasers

Rule 102 of Regulation M governs the activities of an issuer or selling securityholder during a distribution[43] effected by it or on its behalf, as well as the activities of certain parties deemed to be "affiliated purchasers" of the issuer or selling securityholder. In general, Rule 102 prohibits persons subject to the rule from directly or indirectly bidding for, purchasing or attempting to induce any person to bid for or purchase, the security that is the subject of the distribution ("subject security"), and any security into which the subject security may be converted, exchanged or exercised, or which, under the terms of the subject security, may in

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[41] This section contains a summary of Regulation M. The full text of Regulation M may be found at 17 C.F.R Section 242.100, et seq.

[42] See SEC Release No. 34-38067 (Dec. 20, 1996) (http://www.sec.gov/rules/final/34-38067.txt).

[43] For purposes of Regulation M, a "distribution" is defined as an offering of securities that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods. In the case of a shelf registration, each individual offering from the shelf would be individually examined to determine whether the elements of a distribution were present (*i.e.*, depending upon the magnitude of the particular offering and the existence of special selling efforts and selling methods). Shelf registrations are discussed at length in Chapter 5 (*Shelf Registration*) of this volume.

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whole or in significant part determine the value of the subject security ("reference security"), during the applicable restricted period.[44]

The commencement of the restricted period to which an issuer or selling securityholder and its affiliated purchasers are subject depends upon the nature of the distribution and the characteristics of the particular security. In the case of a distribution involving a merger, acquisition or exchange offer, the restricted period begins on the day proxy solicitation or offering materials are first disseminated to the securityholders. In other distributions, the commencement of the restricted period depends upon the worldwide average daily trading volume ("ADTV")[45] of the particular security, as well as the public float value of the issuer's securities. For securities with an ADTV value of U.S.$100,000 or more of an issuer whose common equity securities have a public float value of U.S.$25 million or more, the restricted period will commence one business day prior to the pricing of the subject security. For all other securities, the restricted period will begin five business days prior to the pricing of the subject security. In all cases, the restricted period continues until the distribution is completed.[46]

Certain types of securities are excepted from the prohibitions of Rule 102. This means that persons subject to Rule 102 may continue their trading activities in these securities without regard to the restrictions and limitations otherwise imposed by the rule. These securities are: (i) investment grade non-convertible securities and investment grade asset-backed securities; (ii) "exempted securities," as defined in Section 3(a)(12) of the 1934 Act; (iii) face-amount certificates issued by a face-amount certificate company and redeemable securities issued by an open-end management investment company or unit investment trust; and (iv) "actively traded reference securities" (*i.e.*, reference securities with an ADTV value of at least U.S.$1 million issued by an issuer whose common equity securities have a public float value of at least U.S.$150 million, provided that the reference securities are not issued by the issuer of the security in distribution, or by any affiliate of the issuer).

Rule 102 also excepts various activities from the general prohibitions of the rule. This means that the issuer or selling securityholder and its affiliated purchasers may engage in these activities during the restricted period. Among other things, the rule excepts odd-lot transactions, exercises of options, warrants, rights or conversion privileges, certain unsolicited purchases and transactions in Rule 144A securities.[47] The exception for transactions in securities eligible for

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44 For example, in a distribution of warrants to purchase common stock, Rule 102 would restrict bids for, purchases of and inducements to bid for or purchase, both the warrants (the subject security) and the underlying common stock (the reference security). Similarly, Rule 102 would restrict bids for, purchases of and inducements to bid for or purchase, the common stock of a non-U.S. issuer during a distribution of the issuer's ADRs in the United States. In contrast, the rule does not restrict activity with respect to a derivative security (*e.g.*, an option or warrant) during a distribution of the underlying security.

45 The worldwide average daily trading volume during the two full calendar months immediately preceding, or any 60 day consecutive calendar days ending within the ten calendar days preceding, the filing of the registration statement or, if there is no registration statement or if the distribution involves the sale of securities on a delayed basis pursuant to Rule 415 under the 1933 Act, the pricing of the security.

46 In the case of a merger, acquisition, or exchange offer, the distribution will be deemed to be completed after all valuation and shareholder election periods have ended.

47 Offerings pursuant to Rule 144A under the 1933 Act are discussed in detail in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

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resale under Rule 144A may be of particular interest to non-U.S. issuers. The exception permits transactions in Rule 144A securities during a distribution of such securities provided that offers and sales of such securities within the United States are made solely to: (i) QIBs, or to persons reasonably believed to be QIBs, in transactions exempt from registration under the 1933 Act;[48] or (ii) persons not deemed to be "U.S. persons" for purposes of Regulation S, during a concurrent Rule 144A distribution to QIBs. The exception covers both the Rule 144A security in distribution and any reference security.

Restrictions on the Activities of Distribution Participants and their Affiliated Purchasers

Rule 101 under Regulation M governs the activities of persons participating in a distribution of securities, other than the issuer or selling securityholder (*e.g.*, underwriters and prospective underwriters). The rule also governs the activities of any "affiliated purchaser" of the distribution participants. As with Rule 102, Rule 101 prohibits persons subject to the rule from directly or indirectly bidding for, purchasing or attempting to induce any person to bid for or purchase, the subject security or any reference security during the applicable restricted period.

As with Rule 102, the restricted period to which a distribution participant and its affiliated purchasers are subject depends upon the nature of the distribution, as well as the characteristics of the particular security involved. For distributions involving a merger, acquisition or exchange offer, the restricted period for the underwriter will be the same as the restricted period for the issuer or selling securityholder (*i.e.*, from the time proxy solicitation or offering materials are first disseminated to the securityholders until such time as all valuation and shareholder election periods have ended). In other distributions, however, the underwriter will frequently be subject to a restricted period shorter than that to which the issuer or selling securityholder is subject.

In the case of "actively-traded securities" (*i.e.*, securities with an ADTV value of at least U.S.$1 million that are issued by an issuer whose common equity securities have a public float value of at least U.S.$150 million), provided the securities are not issued by the underwriter or any affiliate of the underwriter, there is no restricted period. For securities with an ADTV value of U.S.$100,000 or more of an issuer whose common equity securities have a public float value of U.S.$25 million or more, the underwriter will be restricted beginning on the *later of*: one business day prior to the pricing of the subject security, or such time as the underwriter becomes a distribution participant. For all other securities, the restricted period for an underwriter will begin on the *later of* five business days prior to the pricing of the subject security or such time as the underwriter becomes a distribution participant. The restricted period for an underwriter will continue until the underwriter has distributed its allotment and any stabilization arrangements and trading restrictions in connection with the distribution have been terminated.[49]

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48 This includes offshore offerings exempt from registration pursuant to Regulation S, as well as private placements in the U.S. exempt from registration pursuant to Section 4(2) of the 1933 Act or Rule 144A or Regulation D thereunder.

49 An underwriter will not be deemed to have completed its participation if a syndicate overallotment option is exercised in an amount in excess of the net syndicate short position at the time of such exercise.

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As with Rule 102, Rule 101 excepts certain securities from the restrictions of the rule. These securities include the same securities excepted from Rule 102 except for the "actively traded securities" mentioned above with respect to Rule 101 and the "actively traded reference securities" mentioned under the description of Rule 102 above.

Although many of the provisions of Rule 101 are substantially analogous to those of Rule 102, Rule 101 contains certain additional exceptions intended to accommodate distribution participants' significant role in the marketplace and their comparatively lesser interest in manipulating an offering. As with 102, Rule 101 includes exceptions for odd-lot transactions, exercises of options, warrants, rights or conversion privileges, certain unsolicited purchases and Rule 144A transactions. Rule 101 also contains exceptions for unsolicited brokerage transactions, for the publication or dissemination of research in compliance with Rules 138 or 139 under the 1933 Act, certain "baskets" of securities and *de minimis* transactions, NASDAQ passive market-making activities in compliance with Rule 103 of Regulation M, and stabilizing transactions in compliance with Rule 104 of Regulation M. The exception for Rule 144A transactions (which is identical to the exception contained in Rule 102) and the exceptions for NASDAQ passive market-making activities and stabilizing transactions are likely to be of primary importance to an underwriter of the securities of a non-U.S. issuer.

Affiliated Purchasers of Issuers, Selling Securityholders and Distribution Participants

For purposes of Regulation M, any person acting in concert with a distribution participant, issuer or selling securityholder in connection with the acquisition or distribution of a subject security or reference security, and any affiliate (including a separately identifiable department or division) of a distribution participant, issuer or selling securityholder that directly or indirectly controls such person's purchases of a subject security or reference security, whose purchases are controlled by such person, or whose purchases are under common control with such person, is deemed to be an "affiliated purchaser." In addition, any affiliate (including a separately identifiable department or division) of a distribution participant, issuer or selling securityholder that regularly purchases securities for its own account or the account of others, or that recommends or exercises investment discretion with respect to the purchase or sale of securities (a "financial services affiliate"), is deemed to be an "affiliated purchaser" of the entity with which it is affiliated. An affiliated purchaser is restricted in the same manner as the distribution participant, issuer or selling securityholder with which it is affiliated.[50]

Certain financial services affiliates of a distribution participant, issuer or selling securityholder may, however, be excepted from the "affiliated purchaser" definition, and thereby avoid the restrictions otherwise imposed by Rules 101 and 102, provided certain conditions are satisfied. As a preliminary matter, the financial services affiliate may not, during the applicable restricted period, act as a market maker (other than as a specialist in compliance with the rules of a national securities exchange), or engage as a broker or a dealer in solicited transactions or proprietary trading, in a subject security or reference security. This effectively means that any affiliate engaged in these activities will be deemed to be an affiliated purchaser, regardless of

[50] Thus, an affiliated purchaser of an issuer or selling securityholder is subject to the restrictions of Rule 102 under Regulation M, and an affiliated purchaser of a distribution participant is subject to Rule 101.

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whether the remaining conditions of the exception are satisfied. The second condition of the exception requires that the distribution participant, issuer or selling securityholder maintain and enforce written policies and procedures reasonably designed to prevent the flow of information to or from the financial services affiliate that might result in a violation of Regulation M. The distribution participant, issuer or selling securityholder must also obtain an annual, independent assessment of the operation of such policies and procedures. The third and final condition to the exception requires that the financial services affiliate have no officers or employees (other than clerical, ministerial or support personnel) in common with the distribution participant, issuer or selling securityholder that direct, effect or recommend transactions in securities for either entity.

NASDAQ Passive Market Making

In connection with the distribution of a security authorized for quotation on NASDAQ (a "NASDAQ security"), Rule 103 of Regulation M permits an underwriter that is a registered NASDAQ market maker to engage in passive market-making transactions on NASDAQ during the restricted period of Rule 101 when market making by the underwriter would otherwise be prohibited. The purpose of the rule is to address liquidity problems that might otherwise occur during the distribution of a NASDAQ security if underwriters or their affiliates who are NASDAQ market makers in the security were required to withdraw as market makers during the restricted period. The exception afforded by the rule is not available during any at-the-market or best efforts offering, nor is the exception available for any security for any time in which a stabilizing bid is in effect.

Assuming the exception is available, Rule 103 generally limits the passive market maker's bids and purchases to the highest current independent bid (*i.e.*, the bid of a NASDAQ market maker who is not participating in the distribution). In addition, the rule limits a passive market maker's net purchases of the security on any given day during the restricted period to the greater of: (i) 30% of the market maker's ADTV in the security or (ii) 200 shares. The rule also prohibits the passive market maker from displaying a bid size in excess of the minimum quotation size for the security, as determined by NASDAQ rules, or the passive market maker's remaining purchasing capacity for the day, whichever is less, except that a passive market maker whose purchasing capacity is below 100 shares may display a bid size of 100 shares. Finally, the rule requires that the passive market maker notify FINRA in advance of its intention to engage in passive market making, and the prospectus for any registered offering in which any passive market maker intends to effect transactions in a subject security or reference security must disclose information relating to the passive market-making activity.

Stabilizing Transactions

Rule 104 of Regulation M governs stabilizing and certain aftermarket syndicate activities in connection with an offering of securities, and requires that all persons engaged in these activities follow the conditions of the rule. Although activity in compliance with the rule's conditions is an excepted activity under Rule 101, the rule also applies to persons and offerings that may not be subject to Rule 101 (*e.g.*, the rule applies to offerings that do not satisfy the "magnitude" and "special selling efforts and selling methods" elements of a distribution).

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Stabilizing is defined in Rule 100 of Regulation M as "the placing of any bid, or the effecting of any purchase, for the purpose of pegging, fixing or maintaining the price of a security." Rule 104 prohibits all stabilizing in connection with at-the-market offerings, and limits stabilizing bids and purchases in other offerings to those necessary to prevent or retard a decline in the market price of a security. In the U.S. capital markets, stabilizing transactions are typically effected exclusively by the lead or managing underwriter, and the lead or managing underwriter usually reserves the right to stabilize on behalf of all the members of the underwriting syndicate.

As a general matter, Rule 104 requires that priority be given by any person stabilizing to independent bids at the same price, regardless of the size of the bid at the time that it is entered. The rule also provides that no sole distributor, syndicate or group may maintain more than one stabilizing bid in any one market at the same price at the same time. Rule 104 also imposes numerous conditions upon the price and manner in which stabilizing bids and purchases are initiated and maintained:

(a) Maximum stabilizing price permitted under the rule. Regardless of the following provisions, the maximum price at which stabilizing is permitted under the rule is the *lower of*: (1) the offering price of the security or (2) the stabilizing bid for the security in the principal market when the principal market is open or, when the principle market is closed, the stabilizing bid in the principal market at its previous close.

(b) Initiation when the principal market is open. After the opening of quotations for the security in the principal market, stabilizing may be initiated in any market at a price no higher than the last independent transaction price for the security in the principal market if (1) the security has traded in the principal market on the day stabilizing is initiated or on the most recent prior day of trading in the principal market and (2) the current asked price in the principal market is equal to or greater than the last independent transaction price.[51]

(c) Initiation when the principal market is closed. Immediately before the opening of quotations for the security in the market where stabilizing will be initiated, stabilizing may be initiated at a price no higher than the *lower of*: (i) the price at which stabilizing could have been initiated in the principal market for the security at its previous close or (ii) the most recent price at which an independent transaction in the security has been effected in any market since the close of the principal market. After the opening of quotations in the market in which stabilizing is to be initiated, stabilizing may be initiated at a price no higher than the *lower of*: (i) the price at which stabilization could have been initiated in the principal market for the security at its previous close or (ii) the last independent transaction price for the security in that market, if the security has traded in that market on the day stabilizing is initiated, or on the last preceding business day,

[51] If both of the foregoing conditions are not satisfied, stabilizing may be initiated in any market after the opening of quotations in the principal market at a price no higher than the highest current independent bid for the security in the principal market.

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and the current asked price in that market is equal to or greater than the last independent transaction price.[52]

(d) Initiation when there is no market for the security. If no *bona fide* market for the subject security exists at the time stabilizing is initiated, no stabilizing shall be initiated at a price in excess of the offering price.

(e) Initiating prior to determination of the offering price. If stabilizing is initiated prior to the determination of the offering price, stabilizing may be continued after determination of the offering price at the price at which stabilizing then could be initiated.

(f) Maintenance and carrying over of a stabilizing bid. Once initiated, a stabilizing bid which has not been discontinued may be maintained, or carried over into another market, regardless of changes in the independent bids or transaction prices for the security.

(g) Increasing, reducing and resuming a stabilizing bid. A stabilizing bid may be increased to a price no higher than the highest current independent bid for the security in the principal market if the principal market is open. If the principal market is closed, a stabilizing bid may be increased to a price no higher than the highest independent bid in the principal market at that market's previous close. A stabilizing bid may be reduced, or carried over into another market at a reduced price, regardless of changes in the independent bids or transaction prices for the security. Once discontinued, a stabilizing bid may not be resumed at a price higher than the price at which stabilizing then could be initiated.

(h) Adjustments to reflect exchange rates. If a stabilizing bid is expressed in a currency other than the currency of the principal market for the security, such bid may be initiated, maintained or adjusted to reflect the current exchange rate, consistent with the provisions of the rule.[53]

(i) Adjustments to reflect ex-dividend, ex-rights or ex-distribution. If a security begins to trade ex-dividend, ex-rights or ex-distribution, the stabilizing bid must be reduced by an amount equal to the value of the dividend, right or distribution.[54]

(j) Stabilizing of components. If two or more securities are offered as a unit, the component securities may not be stabilized at prices the sum of which exceeds the then permissible stabilizing price for the unit.

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[52] If both of these conditions are not satisfied, stabilizing may be initiated at a price no higher than the highest current independent bid for the security in the market where stabilizing is being effected.

[53] If adjusting the bid in this manner causes the bid to be at or below the midpoint between two trading differentials, the rule requires the stabilizing bid to be adjusted downward to the lower differential.

[54] See supra footnote 42.

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Paragraph (g) of Rule 104 provides that certain offshore stabilizing transactions intended to facilitate an offering in the United States will not be deemed to violate Rule 104 if no stabilizing is effected in the United States, stabilizing outside the United States is effected in a jurisdiction with statutory or regulatory provisions governing stabilizing that are comparable to the provisions of Rule 104 (as determined by the SEC pursuant to rule, regulation or order)[55] and no stabilizing is effected at a price above the offering price in the United States, except to the extent permitted under Rule 104 to reflect the current exchange rate.

Rule 104 also imposes certain notification, disclosure and record keeping requirements upon persons subject to the rule. Any person intending to display or transmit a stabilizing bid is required to provide prior notice to the market on which such bid will be effected. The person must disclose the bid's purpose to the person with whom the bid is entered. In addition, any person effecting a syndicate covering transaction[56] or imposing a penalty bid[57] is required to provide prior notice to the self-regulatory organization with direct authority over the principal market in the United States for the security for which the syndicate covering transaction is effected or the penalty bid is imposed. The rule further requires any person subject to the rule who sells, or purchases for the account of another, a security that has been or may be stabilized, to deliver to the purchaser at or before the completion of the transaction a prospectus, offering circular, confirmation or other document containing a statement indicating that the underwriter may effect stabilizing transactions in connection with the offering of securities. Finally, persons subject to Rule 104 must keep such information and make such notifications as are required by Rule 17a-2 under the 1934 Act.

"Exempted securities," as defined in Section 3(a)(12) of the 1934 Act, are excepted from the conditions and limitations of Rule 104. The rule also excepts securities eligible for resale under Rule 144A, provided that the Rule 144A-eligible securities are offered or sold in the United States solely to (i) QIBs, or persons reasonably believed to be QIBs, in a transaction exempt from registration under the 1933 Act or (ii) persons not deemed to be "U.S. persons" for purposes of Regulation S during a concurrent Rule 144A distribution to QIBs.

Short Selling in Connection with a Public Offering

Whereas Rules 101 through 104 of Regulation M generally govern the activities of the issuer, selling securityholders, underwriters and other distribution participants (as well as their respective affiliated purchasers), Rule 105 of Regulation M currently governs an investor's right

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55 For purposes of this provision, the SEC currently recognizes the stabilization regulations of the U.K. Financial Services Authority.

56 Defined in Regulation M as the placing of any bid or the effecting of any purchase on behalf of the sole distributor or the underwriting syndicate or group to reduce a short position created in connection with the offering.

57 Defined in Regulation M as an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions.

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to receive an allocation of equity securities in certain U.S. public offerings if the investor sold the offered securities short in the days immediately preceding pricing.[58]

Rule 105 applies only to offerings that meet all of the following criteria: (i) the offering is for "equity securities," including convertibles and equity-linked notes (in contrast, offerings of "straight debt," whether or not rated investment grade, are excluded); (ii) the offering is conducted on a firm-commitment basis (*i.e.*, the rule does not apply to "best efforts" or contingent offerings); and (iii) the offering is either a SEC registered offering for cash or a Regulation A or E offering for cash (*i.e.*, the rule does not apply to private placements, including Rule 144A sales). In this regard, Rule 105 applies to a somewhat different universe of offerings than do Rules 101 and 102 of Regulation M. While Rule 105 only applies to certain public offerings, the rule's application is not confined to those public offerings that rise to the level of a Regulation M "distribution."[59]

For those offerings subject to Rule 105, an investor may not purchase the offering shares if the investor effected any "short sales" of the securities that are the subject of the offering during the rule's "restricted period," unless the investor is able to claim one of the rule's exceptions.

Importantly, the Rule 105 "restricted period" is calculated independently of the "restricted period" applicable to Rules 101 and 102 of Regulation M (discussed above). The Rule 105 restricted period is the *shorter of* (i) the period commencing five business days prior to the pricing of the offering and ending with such pricing or (ii) the period commencing with the initial filing of the registration statement (or a notification on Forms 1-A or 1-E) and ending with the pricing.

There are three separate and distinct exceptions to Rule 105's general prohibition. An investor who sold the subject securities short during the rule's restricted period may still purchase in the offering if it is able to satisfy one of these exceptions, each of which imposes a number of specific conditions and limitations: (i) the *bona fide* purchase exception; (ii) the separate accounts exception; and (iii) the investment company exception. A general summary of these exceptions is set forth below.

Bona Fide Purchase Exception. An investor may still receive an allocation in the offering if it makes one or more *bona fide* purchase(s) of the security. Among other things, such *bona fide* purchase(s) must: (i) all be reported trades and take place after the last of the investor's Rule 105 restricted period short sales; (ii) be at least equivalent to the aggregate amount of the investor's Rule 105 restricted period short sale(s); and (iii) be completed no later than the end of

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58 Rule 105 was significantly amended effective October 9, 2007. See SEC Release No. 34-56206 (Aug. 6, 2007) (http://www.sec.gov/rules/final/2007/34-56206.pdf). Previously, Rule 105 generally prohibited investors from using offering shares to cover a short sale of a security if they effected any short sales of the security in the days immediately preceding the pricing of the offering — the prohibited activity was the "covering" of the short sales — not the receiving of the allocation. Effective as of October 9, 2007, the amended rule does not focus upon how the offering shares are used. Rather, the amended rule generally prohibits receipt by an investor of an allocation if the investor sold the security short in the days immediately preceding pricing unless the investor is eligible to claim one of the rule's exceptions.

59 See supra footnote 43 for Regulation M's definition of "distribution."

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the regular trading session on the business day prior to the day of pricing (in other words, the investor cannot have effected any short sales of the security on the day of pricing).

Separate Accounts Exception. The separate accounts exception allows a person to purchase offered securities in one account where there was a short sale in another, separate account if decisions regarding securities transactions for each account are made separately and without any coordination of trading or cooperation among or between the accounts (in other words, one account is not "tainted" by the short selling activity of the other account). This exception is of course not available where the account seeking the allocation has also sold the security short during the Rule 105 restricted period.

Investment Company Exception. Under this exception, a registered investment company (or any series of such investment company), may purchase an offered security even if a separate series of that same investment company, or an affiliated investment company (including a series of such affiliated investment company), sold the security short during the Rule 105 restricted period. The exception is similar in principle to the "separate accounts" exception but relies upon existing regulations under the 1940 Act and prohibitions to ensure the "separateness" and lack of coordination between or among the funds (or series).

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CHAPTER 2

PRE-OFFERING MATTERS

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GENERAL

An issuer that has decided to offer securities in the U.S. capital markets must prepare its team for the legal, regulatory and market practice issues that lie ahead, some of which may require the issuer to take corporate action in anticipation of its securities offering. Discussed in this chapter are some preliminary matters that should be addressed by an issuer to ensure that it is prepared for its first offering in the U.S. capital markets.[1]

Given the broad range of securities that issuers may choose to offer to raise capital and funding in the U.S. capital markets, it is hard to generalize about the matters addressed in this chapter. As noted in Chapter 1 (*The U.S. Offering Process*) of this volume, in certain instances, such as bank certificates of deposit issued by U.S. banks, commercial paper and extendible notes, the offering documents contain little disclosure and the transaction documents are relatively standard, so the amount of time and effort needed to offer and sell those securities in the U.S. capital markets should be relatively short and easy. At the other end of the spectrum, an issuer's first offering of 1933 Act-registered securities or securities offered on a Rule 144A basis with full disclosure is a significant exercise.[2]

PREPARING THE TEAM

A U.S. securities offering requires a cooperative relationship among the issuer, the issuer's auditor, the securities firms[3] that will be selling the issuer's securities and their respective legal advisers. Many issuers accessing the U.S. capital markets for the first time have previously only borrowed money from banks, governments and supranational organizations and, in the case of businesses, raised equity capital from private U.S. investors. These first-time

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[1] For a description of the U.S. tax matters that non-U.S. issuers should address in preparation for a securities offering in the U.S. capital markets, see *Accessing the U.S. Capital Markets – Securities Products*.

[2] See *Accessing the U.S. Capital Markets – Securities Products*, which provides a detailed analysis of pre-offering matters that are most relevant in this instance.

[3] As sellers of an issuer's securities, securities firms may act in varying capacities including firm-commitment underwriters, best-efforts underwriters, selling agents and brokers. Their role in any particular transaction will depend upon a combination of the needs of the transaction and the customary practice in the segment of the capital markets that the issuer intends to access.

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issuers are accustomed to negotiated transactions and the absence of the investor protections that would otherwise be afforded by U.S. securities laws and regulations. The market-driven pricing and disclosure-based liabilities that are (to varying degrees) part of every U.S. securities offering require the relationships among all parties to be largely cooperative, not adversarial.

Officers of an issuer accustomed to establishing the terms of a financing in a privately negotiated transaction or with the benefit of an exemption from U.S. securities laws should rely upon the issuer's professional advisers' assistance to understand the requirements of regulatory schemes designed to protect investors and market practices. An issuer must be prepared for the amount of work required for its first U.S. securities offering and the importance of adhering to the agreed timetable. For issuers accessing the U.S. capital markets for the first time, it is important to note that, with the experience they gain from their first U.S. securities offering, additional U.S. securities offerings will be significantly easier and less expensive.

PREPARING THE BUSINESS PROFILE

To facilitate its offering, an issuer that is raising funds in the U.S. capital markets for the first time may be advised by securities firms to refine its business profile, establish corporate governance and legal compliance procedures consistent with international practices and clarify its business strategy. One prominent example of this is the process undertaken by the businesses in the People's Republic of China (the "PRC") that have incorporated and raised equity by offering securities in the international capital markets. Many of these PRC businesses have traditionally operated as social entities, providing their employees not only with work but also with housing, education, medical facilities and other social services and infrastructure. Securities firms have advised many of these PRC businesses that the social services and infrastructure aspects of their business detract from their profitability and would result in a reduced valuation by securities investors. As a result, before these PRC businesses incorporate and offer shares in the international capital markets, they generally have separated their social services and infrastructure from their core business.

An issuer may also be advised to reorganize its business and consider disposing of certain business segments in order to provide a more focused investment for investors or to dispose of significant potential liabilities. One example of this is the reorganization of certain cement businesses to exclude asbestos-related business segments.

When accessing the international capital markets for project or infrastructure financing, a sponsor will normally form a special-purpose company to develop, construct, finance and operate the project. Under this approach, all tangible and intangible assets associated with the project are transferred to the special-purpose company, and pledged or mortgaged to investors (in the case of debt securities), with no recourse (or only limited recourse, on terms to be agreed upon) to the assets of the sponsor. Because their return will be directly dependent upon the business developed by the special-purpose company to which they have contributed, investors can be expected to closely scrutinize the development and operation of the business of this type of company.

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SELECTING A CORPORATE FORM AND A JURISDICTION OF INCORPORATION

In some cases, businesses have established a holding company or a subsidiary in order to issue securities in the U.S. capital markets. Sometimes this is due to legal, tax or other issues in the home jurisdiction that make it more desirable to raise capital or obtain financing through another vehicle. In other cases, a new issuer is established to attract additional investors that would otherwise be unable to invest in the original issuer. Examples of the use of vehicles such as holding companies and subsidiaries are described below:

- Several issuers have raised equity through holding companies established in the British Virgin Islands, Bermuda, the Channel Islands or the Cayman Islands. There are a variety of reasons for this. Some issuers have done so to obtain a corporate form in a jurisdiction with defined shareholder rights that is better known to international securities investors than that of the issuer's home country. Other issuers have done so to avoid troublesome requirements that their domestic legal systems would otherwise impose. Other businesses with substantial international business have set up holding companies in low-tax offshore jurisdictions to minimize their corporate tax liability through deconsolidation or other structures or, in the case of an initial public offering by a closely-held issuer, to minimize the tax liability of the group of shareholders that will control the issuer following completion of the offering.

- For certain types of financings in the U.S. capital markets, such as commercial paper programs and other investment grade debt offerings, debt issued by a Delaware finance subsidiary and guaranteed by a non-U.S. parent company generally increases the number of eligible investors because many U.S. institutional investors are limited by corporate policy or otherwise in the amount of non-U.S. securities they may hold.

- An offshore finance subsidiary may provide a convenient way to enhance the credit rating of securities through over-collateralization, guarantees, insurance or bank letters of credit. The securities issued by these vehicles have been generally limited to debt securities and preferred stock. This approach has been used by businesses for many reasons, including minimizing the disclosure about the business, obtaining a lower cost of funds due to the credit enhancement, securitization of financial assets and deconsolidation of substantial assets, and other tax planning purposes. Finance subsidiaries used for these purposes have been incorporated in Delaware if the offering is primarily in the U.S. capital markets, and in low-tax jurisdictions such as the Cayman Islands or the Netherlands Antilles if elsewhere.

- An offshore finance subsidiary can also be used to circumvent or minimize withholding, transfer or similar taxes, or restrictions on the ability of a non-U.S. business to issue securities.

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PREPARING THE CORPORATE ENTITY

Issuers offering securities in the U.S. capital markets, particularly those registering securities under the 1933 Act for the first time, may be required to modify their legal documentation and accounting procedures in order to meet the standards required by U.S. investors. Also, additional contracts or other documentation of business or government arrangements may be required to protect the issuer or provide more comfort to investors. Examples of such items include:

- Existing undocumented agreements and understandings material to an issuer's business may be required to be documented. This has been particularly common in corporatizations and privatizations, where documentation has been required to address such matters as property rights, water rights, energy rights and purchase and sale arrangements that had previously been represented by unwritten understandings between the issuer and other businesses or government officials.

- Existing documentation may be required to be revised in order to provide the degree of specificity and certainty required by U.S. investors. For example, if a key purchase or supply contract contains material uncertainties, the issuer may be asked by the securities firms or advised by its lawyers to restate or supplement the contract in order to avoid the marketing or legal risks associated with those uncertainties.

- Existing financing documentation may be required to be revised or provisions thereof waived to accommodate the securities offering, or the issuer may choose to use its intention to access the U.S. capital markets as a basis for renegotiating more favorable terms with its existing lenders.

- An issuer may be required to alter its corporate governance policies, legal compliance procedures or internal audit procedures, or take other action in order to list its securities on a U.S. securities exchange or to improve the marketability of its securities. For example, many non-U.S. issuers offering securities for the first time are managed by a board of directors that includes no independent (or non-management) directors. The rules of the NYSE, the NYSE Alternext US and NASDAQ require the board of directors of listed companies to consist of a majority of independent directors. Pursuant to the requirements of Rule 10A-3 under the 1934 Act, which implements Sarbanes-Oxley, no security is eligible for listing unless each member of its audit committee is independent. Furthermore, the definition of "independent" bars any audit committee member from qualifying as "independent" if he or she is considered an "affiliated person" of the listed company or any subsidiary, or accepts any consulting, advisory or other compensatory fee from the issuer other than director or committee fees. There is no *de minimis* exception to this prohibition. The listing requirements of the NYSE, the NYSE Alternext US and NASDAQ are addressed in Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

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- It may be desirable for an issuer to enter into employment contracts with key personnel if they are critical to the continued success of its business, or could become significant competitors to the issuer, or both. It is not uncommon for securities firms to request such agreements to enable them to better market the securities of a business that has been started and is currently being managed by one or more private entrepreneurs.

- Because, in addition to an issuer itself, executive officers and directors of an issuer are potentially liable when an issuer offers securities in the United States, the issuer should take steps to protect its executive officers and directors from this liability to the extent permitted by the law of the issuer's jurisdiction. Possible sources of protection include an indemnity by the business and the purchase of officers' and directors' liability insurance.

- The SEC requires issuers to file electronically through its IDEA system (available at http://idea.sec.gov), the successor to EDGAR, most of their securities documents, including registration statements under the 1933 Act and registration statements, periodic reports and other documents under the 1934 Act, subject to a limited, first-time filing exception for 1933 Act and 1934 Act registration statements.[4] In preparation, issuers must complete and execute the SEC's Form ID to obtain the necessary access codes to file on the IDEA system.

THE COVENANT STRUCTURE FOR DEBT OFFERINGS

In the case of investment grade debt securities, covenant packages are generally much less restrictive than covenant packages typically found in bank loan financings for similarly situated issuers. Affirmative covenants usually include limitations on liens and sale and leaseback transactions, and a provision that addresses mergers, consolidations and the sale by the issuer of all or substantially all of its assets.

In the case of debt securities rated below investment grade, the securities will pay a higher coupon (so-called "high-yield" debt), and will contain a more restrictive set of covenants as compared to investment grade debt that, in addition to those referred to above, may include limitations on the issuer's (and its subsidiaries') ability to incur additional debt, limitations on the payment of dividends and other restricted payments, and limitations on asset dispositions, transactions with affiliates and the entering into of derivative transactions. High-yield debt issuers may also be required to offer to repurchase the debt securities under certain circumstances, including most frequently a change in control.

High-yield debt covenants are generally subject to extensive negotiation, and vary considerably depending on the financial and business circumstances of the issuer. It is critical (particularly for longer maturity high-yield debt instruments) that an issuer's covenants be tailored to the particular needs of its business, as it is conducted at the time of the offering and likely to develop over the period the securities are outstanding, given that changes to covenants typically require the consent of at least a majority of securityholders. The complexity of these

[4] See Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

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packages is such that the issuer, in consultation with its U.S. counsel, must develop a sophisticated compliance strategy.

Some high-yield debt offerings, particularly those by issuers financing major expansion programs or other projects, have been secured by assets of the issuer or a guarantor. Such secured transactions are particularly problematic in emerging markets where the legal framework for perfecting and enforcing secured interests has not been fully developed.[5]

Investment grade debt offerings by issuers in cyclical industries (such as oil and gas), from certain volatile markets (such as issuers organized in developing countries) or in certain other industries (such as real estate investments) may require additional covenants designed to address investors' concerns about the particular circumstances that apply.

THE 1940 ACT

In preparing for a securities offering in the U.S. capital markets, issuers must ensure that they are not required to register as an investment company under the 1940 Act. Because the 1940 Act embodies a broad regulatory scheme intended primarily for mutual funds, unit investment trusts and closed-end investment companies, it contains requirements that are not consistent with the business of a normal operating company. The 1940 Act regulates, among others, each issuer that (i) is engaged in the business of investing, reinvesting or trading securities or holding or owning securities and (ii) owns or proposes to acquire investment securities (exclusive of U.S. federal government securities and cash items) having a value exceeding 40% of the value of the issuer's unconsolidated total assets.[6]

ACCOUNTING MATTERS

An issuer that makes a 1933 Act-registered public offering or a Rule 144A offering of its securities to a broad group of QIBs in the U.S. capital markets must also provide investors with audited annual financial statements and interim financial statements that are appropriate for the type of offering involved.

The SEC now permits financial statements of foreign private issuers prepared using IFRS as issued by the IASB without reconciliation to U.S. GAAP. The SEC requires all other foreign private issuers to provide financial statements prepared in accordance with, or reconciled to, U.S. GAAP. Where a U.S. GAAP presentation is required, most foreign private issuers choose the reconciliation alternative. Preparation of the financial statements for a foreign private issuer for

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5 *Accessing the U.S. Capital Markets – Securities Products* discusses the covenant packages for high yield debt securities in much greater detail. Chapter 11 (*REITs*) of this volume discusses covenant packages for REITs.

6 The 1940 Act is further discussed in Chapter 9 (*1940 Act-Exempt Issuers*) and Appendix A (*Determining whether an Issuer is a Prima Facie Investment Company or Exempt Pursuant to Rule 3a-1 under the Investment Company Act of 1940*) of this volume.

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its first U.S. securities offering may therefore affect not only the timing of the offering but also the valuation of the issuer.[7]

Foreign private issuers must also be cognizant of Regulation G, which requires public companies that disclose or release "non-GAAP financial measures" (any published statements using financial presentations not conforming to GAAP) to include in that disclosure or release a presentation of the most directly comparable GAAP financial measure, and a reconciliation of the disclosed non-GAAP financial measure to the most directly comparable GAAP financial measure.[8] Regulation G does not apply to a disclosure of a non-GAAP financial measure that is made by or on behalf of a registrant that is a foreign private issuer if the following conditions are satisfied: (i) the securities of the registrant are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States; (ii) the non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with generally accepted accounting principles in the United States; and (iii) the disclosure is made by or on behalf of the registrant outside the United States, or is included in a written communication that is released by or on behalf of the registrant outside the United States. This exclusion applies notwithstanding the existence of one or more of the following circumstances: (i) a written communication is released in the United States as well as outside the United States, so long as the communication is released in the United States contemporaneously with or after the release outside of the United States and is not otherwise targeted at persons located in the United States; (ii) non-U.S. journalists, U.S. journalists or other third parties have access to the information; (iii) the information appears on one or more web sites maintained by the issuer, so long as the web sites, taken together, are not available exclusively to, or targeted at, persons located in the United States; or (iv) following the disclosure or release of the information outside the United States, the information is included in a submission by the foreign private issuer to the SEC made under cover of a Form 6-K.

On a number of occasions, underwriters have been unable to market a transaction in the U.S. capital markets, or significantly altered their pricing of the transaction, because the foreign private issuer's financial condition and results of operation under its local GAAP and under U.S. GAAP differed substantially. For example, gains on the sale of real property are sometimes treated as ordinary income under non-U.S. GAAP, but only as extraordinary income under U.S. GAAP, which has resulted in some foreign private issuers having substantially lower ordinary income under U.S. GAAP. Another difference between U.S. GAAP and the GAAP of many non-U.S. countries is that, in many cases, revaluation of assets allowed under non-U.S. GAAP is not permitted under U.S. GAAP. This has sometimes resulted in foreign private issuers having a significantly lower, and sometimes negative, net worth when they prepare their financial statements in accordance with (or reconcile them to) U.S. GAAP.

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7 For further information regarding the preparation of financial statements, including the necessity of reconciliation to U.S. GAAP, see the discussion under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 8: Financial Information" in Chapter 4 (*Disclosure Requirements*) of this volume.

8 For further information on Regulation G and its requirements, see the discussion under the heading "Disclosure Regarding Non-GAAP Financial Measures" in Chapter 4 (*Disclosure Requirements*) of this volume.

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Preparation of financial statements for the corporatizations and privatizations of non-U.S. government-owned enterprises is an extremely time-consuming process. In some cases, the foreign private issuer may not have separate accounts, or may have accounts on a basis which requires substantial accounting as well as audit work. In such a case, it is important that the securities firms and the accountants working on the transaction provide the foreign private issuer with a clear understanding of the financial statements that are necessary to market the transaction and comply with applicable accounting requirements, respectively, in order to minimize the amount of accounting and auditing work required to prepare the issuer for the U.S. capital markets.

Chapter 4 (*Disclosure Requirements*) of this volume discusses the financial statement requirements for a 1933 Act-registered offering. Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume discusses the audit, auditor and audit committee requirements of Sarbanes-Oxley.

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SECTION II: REGISTERED PUBLIC OFFERINGS

The process for registering and listing securities and updating 1933 Act-registered programs and shelf registration statements for public offerings in the U.S. capital markets is among the most rigorous in the world and has provided the U.S. capital markets with ample depth and strength. This is attributable not only to the high disclosure and other standards prescribed by the SEC for 1933 Act-registered offerings, but also to the development of the unregistered Rule 144A securities market for QIBs and other sophisticated investors, which has evolved to have disclosure and other standards that closely approximate those established for 1933 Act-registered offerings. Accordingly, Section II should be of equal interest to issuers contemplating accessing the 1933 Act-registered market and those contemplating accessing the unregistered Rule 144A market.

Section II addresses the registration and reporting process of the 1933 Act and the 1934 Act, including the forms used, the filing and information requirements and the special regime that applies to programs and shelf registration. With the adoption in 2005 of Securities Offering Reform, including the establishment of the WKSI issuer category, and subsequent rule making by the SEC,[1] the SEC has continued to focus on increasing the ease of registering a securities offering without compromising the high disclosure standards that exist in the U.S. capital markets.

Section II also addresses the process of listing securities on a U.S. securities exchange.

[1] See, *e.g.*, SEC Release No. 33-8959 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf).

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CHAPTER 3

THE SECURITIES REGISTRATION AND REPORTING PROCESS

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REGISTRATION UNDER THE 1933 ACT

Section 5 of the 1933 Act applies to all offers and sales of securities in the United States. Except for exempt securities and exempt transactions,[1] all lawful offers and sales must be the subject of a 1933 Act registration statement.

Before an issuer may publicly offer securities in the United States, unless the securities or the transactions in which they are offered are exempt, it must register the offer and sale of the securities under the 1933 Act. Securities are considered registered when the registration statement that covers the securities becomes effective, which occurs upon an order by the SEC or, for certain offerings, automatically under the SEC's rules. The most important part of a 1933 Act registration statement is the prospectus, the central disclosure document concerning the issuer and its offering.[2] The 1933 Act itself requires this prospectus to be delivered to each purchaser in the public offering, although the SEC's rules dispense with actual delivery in most types of offerings if it is filed with the SEC and thus universally available through the Internet.

The business, financial and other disclosure required to be disclosed in a prospectus (in some cases, through incorporation by reference) will depend on the registration form the issuer uses. These forms include the S-series (which are primarily used by U.S. issuers) and F-series (which are primarily used by foreign private issuers).

- **"S" Forms**. Any issuer, other than a foreign sovereign government or political subdivision thereof and investment companies required to register under the 1940 Act, may use Form S-1. Form S-1 is the SEC's residual form of 1933 Act registration. The form calls for presentation of all business, financial and offering information to be included in the prospectus, although certain reporting companies may incorporate by reference historical and financial information from 1934 Acts reports. Form S-3, the form used for most financing transactions, can be used by mature reporting companies and permits the incorporation by reference of both historical and prospective 1934 Act reports, which, under the correct conditions, will allow the issuer to make securities sales at any time in delayed and continuous offerings. For WKSIs, Form S-3 may be used to effect an

[1] See Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

[2] The prospectus performs a function similar to an EU Prospectus Directive-compliant prospectus used in connection with a regulated market listing or public offering of securities in the European Economic Area, or "listing particulars" or similar document that may be used for the purpose of listing securities on other non-U.S. securities exchanges.

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automatic shelf registration statement, providing the maximum in financing flexibility. Issuers that register their securities offerings under the 1933 Act on the S-series forms, whether or not any securities are registered under the 1934 Act, must file annual reports including audited annual financial statements on Form 10-K, quarterly reports including unaudited financial statements on Form 10-Q and current reports on specified material developments on Form 8-K. The disclosure requirements for the SEC's S-series forms and the corresponding 1934 Act reporting forms are taken principally from Regulation S-K, for narrative disclosures, and Regulation S-X, for financial statement form and content.

- **"F" Forms**.[3] Any foreign private issuer, other than investment companies required to register under the 1940 Act, may use Form F-1. Form F-1 is comparable to Form S-1, but its disclosure requirements are drawn mainly from Form 20-F, the 1934 Act registration and reporting form. Form 20-F acts as the equivalent of Regulations S-K and S-X for foreign private issuers. The requirements of the Form are designed to resemble typical listing particulars, an accommodation to home-country regulation and practice. Like Form S-1, Form F-1 allows incorporation by reference of prior 1934 Act reports as a method of disclosure after the issuer has filed an annual report as required by Section 13(a) or 15(d). Form F-3 is comparable to Form S-3, allowing forward incorporation by reference of 1934 Act reports for delayed and continuous offerings and, for WKSIs, can be used as an automatic shelf registration statement. Outside the MJDS, which is available to Canadian companies, issuers that register their securities offerings under the 1933 Act on the F-series forms, whether or not their securities are registered under the 1934 Act, must file annual reports including audited annual financial statements on Form 20-F and current reports on Form 6-K.[4] Most disclosure requirements for foreign private issuers are found in Form 20-F. In recent years, particularly since the enactment in 2002 of Sarbanes-Oxley, more disclosure items from Regulations S-K have been imposed on foreign private issuers.

- **SEC's Multi-jurisdictional Disclosure System ("MJDS")**. As part of the MJDS, 1933 Act Forms F-7, F-8, F-9, F-10 and F-80 allow eligible Canadian issuers, other than investment companies required to register under the 1940 Act, to offer their securities publicly in the United States using a prospectus prepared and reviewed in Canada in accordance with requirements of Canadian law. These forms, and the information required to be filed on 1934 Act Forms 40-F and 6-K, rely largely, although not exclusively, on the disclosure requirements of Canadian regulation. The 1933 Act registration and 1934 Act reporting requirements for Canadian issuers that elect to use the MJDS are discussed in Chapter 13 (*Canadian Issuers*) of this volume. Because MJDS imposes the fewest additional disclosure requirements, most eligible issuers elect to use these forms.

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[3] Copies of the various "F" Forms are available at http://www.sec.gov/about/forms/secforms.htm#1933forms.

[4] Form 6-K lacks any prescribed disclosures. Instead, it requires non-U.S. issuers to file with the SEC such information, including interim financial statements, as may be required and released in their home markets.

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- **Foreign Governmental Issuers**. Foreign governmental issuers may and, in the case of foreign sovereign governments and political subdivisions, must file in accordance with Schedule B to the 1933 Act and may, but are not required to, file 1934 Act annual reports on Form 18-K under Section 15(d) of the 1934 Act. Foreign government issuers listing securities on U.S. exchanges must make annual Form 18-K filings. The 1933 Act registration and 1934 Act reporting requirements for foreign governmental issuers is discussed in Chapter 14 (*Foreign Governmental Issuers*) of this volume. Foreign governmental issuers that are not foreign sovereign governments or political subdivisions, generally government-sponsored enterprises, invariably elect the use of Schedule B and Form 18-K because of their minimal disclosure prescriptions in preference to other forms for registration and reporting.

THE SECURITIES REGISTRATION PROCESS

The registration process for a public offering begins when an issuer and the securities firm or firms underwriting the issuer's securities in the United States agree in principle to conduct an offering.

If a non-U.S. issuer's securities are represented by ADRs, the ADRs must be registered on 1933 Act registration statement Form F-6,[5] whether or not a public offering or listing is made in the United States.

A 1933 Act registration statement must comply with the disclosure requirements of the 1933 Act and SEC regulations. Because the issuer, its directors and certain of its officers, and the underwriters for the offering are exposed to potential liability for deficient disclosure in a 1933 Act registration statement, including the prospectus, the 1933 Act registration statement must be satisfactory to all these persons. The preparation of a 1933 Act registration statement for a public offering usually includes due diligence investigations designed to ensure adequate disclosure and, because the 1933 Act makes adequate investigation a defense to responsibility for material misstatements and omissions, to protect the specified parties from liability.[6]

It is difficult to predict with precision how long it will take to prepare a 1933 Act registration statement. A key factor is whether the non-U.S. issuer has previously filed a 1933 Act registration statement or an annual report with the SEC on Form 10-K, 18-K, 20-F or 40-F, or has previously prepared an offering document for an offering in the U.S. capital markets or capital markets elsewhere in the world. Registration statements for initial public offerings in the U.S. necessarily require months from the commencement of preparation until the order of effectiveness from the SEC.

A non-U.S. issuer that has previously filed a 1933 Act registration statement or an annual report on Form 10-K, 18-K, 20-F or 40-F will, of course, understand the preparation of 1933 Act

[5] Registration of ADRs on Form F-6 is discussed in detail in *Accessing the U.S. Capital Markets – Securities Products*.

[6] For further information on due diligence, see the discussion under the heading "Due Diligence" in Chapter 1 (*The U.S. Offering Process*) of this volume.

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disclosure much better than an inexperienced issuer and ordinarily will need less time working with the underwriters to produce a 1933 Act registration statement containing sufficient disclosure. Indeed, in most instances, once an issuer has been through the process of registering an offering of securities under the 1933 Act, subsequent offerings in the U.S. capital markets should not be substantially more difficult than an offering into the capital markets of its home jurisdiction.

Securities Offering Reform

Securities Offering Reform, a comprehensive set of rule and Form changes adopted by the SEC in 2005, effected many significant changes to the registration process, including the following:

- any WKSI (but not underwriters or dealers acting for it) may make oral or written offers of securities for capital raising transactions before filing a 1933 Act registration statement without violating the 1933 Act's otherwise strict prohibition against offering securities before the filing of a 1933 Act registration statement;
- any other eligible issuer may use a free writing prospectus after the filing of a 1933 Act registration statement, subject to the filing, delivery, notice and record keeping conditions in Rule 433;
- WKSIs may file automatic shelf registration statements, which are
  - effective upon filing;
  - not subject to pre-effective review by the staff of the SEC;
  - required to contain minimal content beyond the business and other information incorporated by reference from the issuer's 1934 Act reports;
  - can be amended without the review of the staff of the SEC to include any type of securities and to add eligible subsidiaries of the WKSI as additional issuers; and
  - permit upfront or "pay as you go" filing fee arrangements;
- in the case of shelf registration statements for all eligible issuers,
  - there is no limit on the amount of the securities that may be registered on a shelf registration statement, except for certain offerings by issuers ineligible to use Form S-3 or F-3, which are limited to the amount the issuer reasonably believes will be sold within two years of the effective date;
  - shelf registration statements for delayed primary offerings, mortgage-backed securities and certain continuous offerings are subject to a conditionally extendible three-year limitation; and

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  - securities can be sold off the shelf immediately upon effectiveness;

- because investors are deemed, pursuant to Rule 159, to have made their investment decision based on the information conveyed to them at the time they agree to purchase securities, and not at the later time of confirmation or delivery, liability for information is determined as of the earlier date; as a result, dealers now use Bloomberg messages or another electronic form of free writing prospectus to convey pricing information not later than that date; and

- a final prospectus generally no longer needs to be delivered to investors provided the final prospectus is filed with the SEC.

Plain English Disclosure

With the objective of making prospectuses more readable, the SEC requires the use of "plain English" writing principles for the front and back cover pages, summary and risk factors sections of prospectuses, and requires the use of certain writing techniques in the entire prospectus. These sections should be drafted so that disclosure is easy to read and highlights important information for investors. The rule encourages the use of pictures, logos, charts, graphs and other similar design features.

The prospectus as a whole is required to be clear, concise and understandable. The SEC's staff strongly encourages the use of plain English writing techniques in the entire prospectus. However, in certain highly technical matters such as indenture covenants, or conversion or exchange provisions that apply to offered securities or engineering or other data applicable to an issuer's business, the use of plain English may not be appropriate.[7]

Electronic Filing and Fees

The 1933 Act registration statement (including the transaction documentation) is filed with the SEC. A filing fee, if applicable, must be paid to the SEC's account with U.S. Bank, N.A., by wire transfer, certified or cashier's check or eligible money order. All registration statements must be in electronic format and filed by means of the SEC's IDEA system. Issuers also must file in electronic format as correspondence all letters in response to staff comments on the filing and other related correspondence. The filing fee is calculated pursuant to Section 6(b) of the 1933 Act and can vary from year-to-year. The current fee can be determined from the SEC's annual notice in the Federal Register or from "Fee Rate Advisory" press releases available on the SEC's web site.[8]

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[7] SEC guidance relating to plain English can be found in the SEC Division of Corporation Finance Updated Staff Legal Bulletin No. 7 (June 7, 1999) (http://www.sec.gov/interps/legal/cfslb7a.htm).

[8] See http://www.sec.gov/news/press.shtml. As of the date of publication of this volume, the SEC is operating under a continuing resolution that maintains the 2008 fiscal year fee rate of U.S.$39.30 for each U.S.$1 million of securities sold until five days after the enactment of the SEC's regular appropriation for the 2009 fiscal year, at which time the rate will increase to U.S.$55.80 for each U.S.$1 million of securities sold (http://www.sec.gov/news/press/2008/2008-232.htm).

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As mentioned above, WKSIs using automatic shelf registration statements are eligible for the "pay as you go" system created under the securities offering reform rules. This permits WKSIs to defer payment of the registration fee until the securities are taken down from the shelf registration.

Staff Review and Comment

For registration statements other than automatic shelf registration statements, the SEC staff will normally advise the issuer within two to five days after the filing whether the registration statement will be reviewed in whole or in part. If the registration statement is not selected for review, the SEC staff will generally declare the registration statement effective within forty-eight hours after being requested to do so.

As a matter of policy, the SEC staff will accept draft registration statements from non-U.S. issuers for review on a confidential basis if the non-U.S. issuer is entering the registration and reporting system for the first time. Under this process, the staff will accept the draft submissions in paper form. This informal process is available both for initial public offerings and for first-time exchange listings not accompanied by a securities offering. In either event, it is recommended practice for non-U.S. issuers wishing to avail themselves of the pre-filing submission process to contact the Office of International Corporate Finance within the SEC's Division of Corporation Finance beforehand.

Almost all first-time issuers receive full review. Subsequent 1933 Act registration filings are selected for review on the basis of unannounced standards set by the SEC staff, as well as on a random basis.[9] A filing may also be selected by the SEC staff for a partial review (*e.g.*, limited to the terms of the security being offered or the plan of distribution) or for a review to determine whether the issuer has complied with SEC staff comments on a prior filing or recently adopted rules. Full review for an issuer normally will result in the receipt of a "comment letter" from the staff of the SEC approximately thirty days after filing. After responses have been made to the staff's comments, which may entail additional correspondence and the filing of one or more amendments to the registration statement, the SEC staff will, upon request, declare the registration statement effective.

FINRA Review

Generally, only 1933 Act-registered offerings are subject to review by FINRA, and, even then, not all 1933 Act-registered offerings are subject to FINRA review. Before deciding whether or not to file with FINRA, U.S. legal counsel should be consulted.

Unless the offering is specifically exempted, specified documents and information must be filed with FINRA to enable it to review the terms of the offering and determine whether the underwriting arrangements are fair and reasonable. The review process is undertaken concurrently with the 1933 Act registration process. If FINRA review is required, the SEC generally will not declare a registration statement effective unless FINRA has determined that

[9] Sarbanes-Oxley requires the SEC to review each issuer's filings at least every three years.

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the underwriting arrangements are fair.[10] FINRA's fairness review is conducted pursuant to prescribed standards.

FINRA review is a routine procedure for most offerings underwritten by major securities firms. Although the issuer will be responsible for the filing fees, the managing underwriter for the offering and its counsel will have the responsibility to assure that the filing is made.

All documents that are required to be filed with FINRA under FINRA Rule 5110 must be filed electronically using FINRA's Corporate Offerings Business Regulatory Analysis System ("COBRA"), with limited exceptions. All documents that are filed electronically with the SEC will be treated as filed with FINRA. Documents relating to certain non-U.S. issuers who file manually with the SEC are also permitted to be filed manually with FINRA. All filings with FINRA are confidential.

Solicitations of Interest

After the filing of a registration statement and prior to effectiveness, the underwriters are permitted to solicit indications of interest from U.S. investors through the distribution of copies of the preliminary prospectus or "red herring" included in the 1933 Act registration statement. Before effectiveness, underwriters may seek indications of interest from investors, a practice that informs the pricing process for the issuer and underwriters. Thus, when the review process is completed and the SEC staff is prepared to declare the registration statement effective, the underwriters will be in a position to agree with the issuer on the prices at which they will purchase the securities from the issuer and resell them to the public.

Shelf Registration

To avoid unpredictable delays resulting from the SEC's review process, a foreign private issuer eligible to use Form F-3 has the option of registering securities before they are actually intended for sale and putting them "on the shelf," as discussed in Chapter 5 (*Shelf Registration*) of this volume. Foreign governmental issuers that file on Schedule B are also eligible for shelf registration in certain circumstances, as discussed in Chapter 14 (*Foreign Governmental Issuers*) of this volume. By registering an offering of securities prior to commencement of the offering, shelf registrations greatly enhance the ability of issuers to sell securities in the U.S. capital markets.

[10] Effectiveness of automatic shelf registration statements is not conditional upon FINRA review; however, such shelf registration statements are subject to FINRA review, and FINRA usually will review them within 24 hours of filing.

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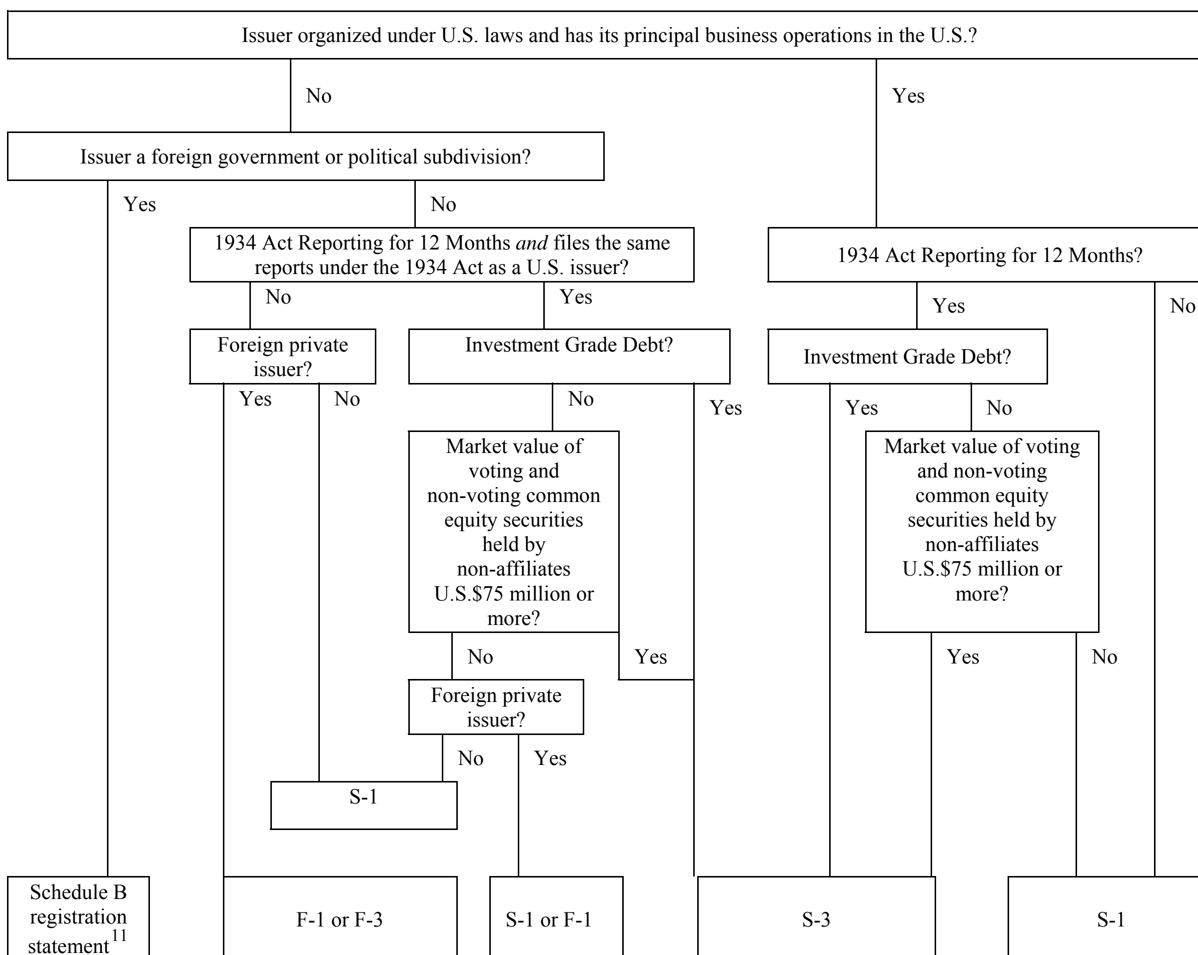
Summary Form Eligibility Chart

Set forth below is a chart that summarizes the eligibility requirements for the SEC's 1933 Act forms.



Eligibility Requirements of Forms F-1 and F-3[12]

Discussed below are the eligibility requirements of 1933 Act registration statements on Forms F-1 and F-3. MJDS registration forms for eligible Canadian issuers are discussed in Chapter 13 (*Canadian Issuers*) of this volume. The principal significance of being able to use Form F-3 is that, in lieu of requiring complete financial and business disclosure, the prospectus incorporates by reference the issuer's Form 20-F. Form F-3 also incorporates by reference future 20-F filings, a feature of the form that generally keeps the prospectus current and therefore usable at any time. At the issuer's election, the prospectus may also incorporate any Form 6-K (see below) that it has furnished to the SEC.

[11] See Chapter 14 (*Foreign Governmental Issuers*) of this volume for a discussion on the use of Schedule B registration statements by foreign governmental issuers.

[12] See supra footnote 3.

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Form F-1

Form F-1 is the form of registration statement for foreign private issuers that have not been registrants under the 1934 Act for at least one year or are not otherwise eligible to use Form F-3. It is the standard form for foreign private issuers, other than Canadian issuers, entering the U.S. capital markets for the first time.

Form F-3

Form F-3 is available to foreign private issuers that satisfy the following registrant and transaction requirements:

Registrant Requirements:

(1) the issuer has securities listed on a U.S. securities exchange, or is otherwise subject to the reporting requirements of the 1934 Act, and has filed at least one annual report on Form 20-F, Form 10-K or, if applicable, Form 40-F;

(2) during the twelve months immediately preceding the filing of a registration statement, the issuer has been subject to the 1934 Act reporting requirements and has made all required 1934 Act filings in a timely manner;

(3) since the end of the most recent fiscal year for which an annual report on Form 20-F has been filed, neither the issuer nor any of its consolidated subsidiaries has failed to pay any dividend or sinking fund installment payment on preferred stock or defaulted on payment of any indebtedness or long-term lease rentals, which defaults in the aggregate are material to the financial position of the registrant and its consolidated and unconsolidated subsidiaries, taken as a whole;

(4) if the issuer is a majority-owned subsidiary, Form F-3 may be used if:

- the subsidiary itself meets the requirements of the form;
- the parent meets the registrant requirements of the form and the conditions of the transaction requirement (2) below;
- the securities being registered are non-convertible securities other than common equity and the parent meets the registrant and applicable transaction requirements of the form and provides a full and unconditional guarantee of the payment obligations on the subsidiary's securities being registered;
- the parent meets the registrant and applicable transaction requirements of the form and the securities of the subsidiary being registered are full and unconditional guarantees of the payment obligations on the parent's non-convertible securities, other than common equity, being registered; or

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- the parent meets the registrant and applicable transaction requirements of the form and the securities of the subsidiary being registered are guarantees of the payment obligations on the non-convertible securities, other than common equity, being registered by another majority-owned subsidiary of the parent where the parent provides a full and unconditional guarantee of such non-convertible securities.

Transaction Requirements:

(1) securities offered for cash, provided the aggregate market value worldwide of the voting and non-voting common equity held by non-affiliates of the issuer is the equivalent of U.S.$75 million or more;

(2) non-convertible securities offered for cash if at least one nationally recognized statistical rating agency has rated the security as investment grade;

(3) offerings by selling securityholders, including securities acquired by standby underwriters in connection with the call or redemption by the issuer of warrants or a class of convertible securities;

(4) securities to be offered upon the exercise of outstanding rights granted by the issuer, pursuant to a dividend or interest reinvestment plan or upon conversion of outstanding convertible securities or the exercise of outstanding warrants issued by the issuer or its affiliate; or

(5) limited primary offerings of securities by an issuer, other than a shell company, that has at least one class of common equity listed on a U.S. national securities exchange.

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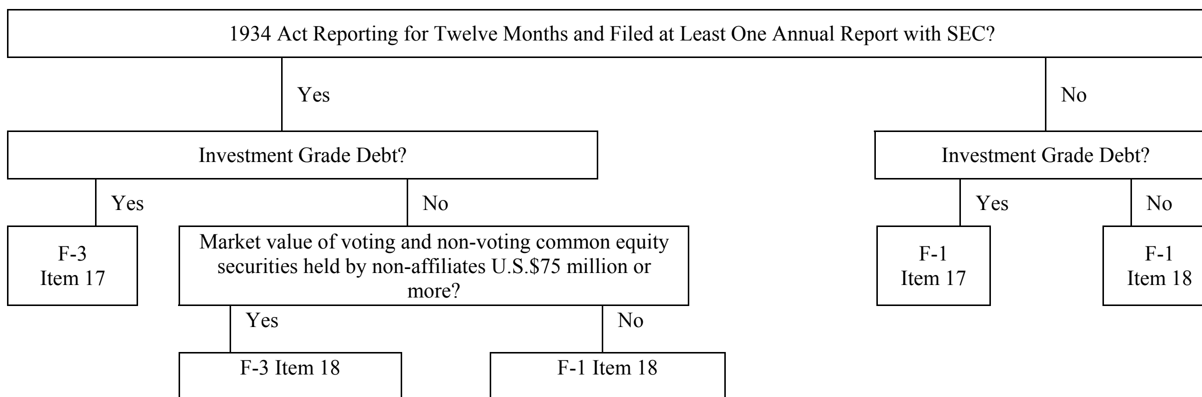
Summary Chart

Set forth below is a chart that summarizes the eligibility requirements of Forms F-1 and F-3 and the applicability of the financial statement requirements set forth in Items 17 and 18 of Form 20-F. [13]



REGISTRATION AND REPORTING UNDER THE 1934 ACT

General

Registration

Before an issuer can list securities (including securities represented by ADRs) on a U.S. securities exchange, the securities must be registered under the 1934 Act. Forms 10, 20-F and 40-F can be used to register the securities under the 1934 Act. Alternatively, Form 8-A, an abbreviated 1934 Act registration statement, can be used by an issuer to register securities under the 1934 Act if the issuer has been filing reports under the 1934 Act or if the listing is being done in connection with a public offering registered under the 1933 Act. Form 18 is available for foreign governmental issuers to register securities under the 1934 Act.

Subsequent Reporting

Once a foreign private issuer has listed its securities on a U.S. securities exchange, or has registered a public offering of its securities under the 1933 Act, it must then file reports with the

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13 Form F-1 requires financial information to be provided in accordance with either Item 17 or Item 18 of Form 20-F, as appropriate. However, the SEC in 2008 adopted rule changes that, beginning with fiscal years ending on or after December 15, 2009, eliminate Instruction 3 of Form 20-F, which permitted the exclusion of certain segment data required by U.S. GAAP, meaning that issuers will thereafter need to report segment data in accordance with Item 18. In addition, the same rule changes eliminate, beginning with fiscal years ending on or after December 15, 2011, the "short-form" U.S. GAAP reconciliation permitted under Item 17. This means that, starting in fiscal years ending on or after December 15, 2011, issuers will be required to reconcile all disclosures called for by U.S. GAAP and Regulation S-X under Item 18. It is anticipated that this will likely provide a greater incentive for issuers to adopt IFRS as issued the by the IASB, which is not subject to reconciliation, as discussed in Chapter 4 (*Disclosure Requirements*) of this volume. See SEC Release No. 33-8959 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf).

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SEC pursuant to the 1934 Act to keep the information on file with the SEC (and therefore available to the market place) reasonably current. If a foreign private issuer's 1934 Act reporting obligation is the result of a 1933 Act registration of securities and it has no listed securities, its 1934 Act reporting obligations only apply to the fiscal year during which the securities were registered and each subsequent fiscal year at the beginning of which such securities are held of record by 300 or more persons that reside in the United States, or, in the case of equity securities, those equity securities satisfy certain maximum U.S. trading and non-U.S. trading and listing requirements.[14]

Notwithstanding that the 1934 Act may permit a company to stop reporting to the SEC, underwriters may contractually require an issuer to file 1934 Act reports voluntarily during the life of the securities to facilitate secondary market liquidity in the securities or an issuer may wish to continue filing 1934 Act reports even though it is eligible to terminate registration.

An issuer that does so, however, does not maintain eligibility to use Form S-3, F-3 or the SEC's other short-form 1933 Act registration statements that permit incorporation by reference to 1934 Act reports, as that eligibility is dependent on the issuer being *required* to report under the 1934 Act. However, an issuer may find it useful to continue to report under the 1934 Act to facilitate Rule 144A offerings. Another reason some issuers continue to file 1934 Act reports is that, once a sufficient 1934 Act disclosure framework has been established by an issuer, it generally is easier to maintain that framework than to let it lapse and only opportunistically update the disclosure.

Reports filed with the SEC under the 1934 Act are subject to staff review. While such review had been historically infrequent, Sarbanes-Oxley requires the SEC to review each public company's filings at least once every three years. If the SEC fully reviews a 1933 Act registration statement that incorporates 1934 Act reports by reference (such as Form F-3), the SEC will usually comment on the incorporated reports. Such comments are frequently prospective only. However, the SEC staff may, and sometimes does, insist that 1934 Act reports to be amended to respond to its comments as a condition to making the 1933 Act registration effective. If an issuer disagrees with the staff's comment, it may respond by explaining its views in correspondence rather than amending the report. If the staff remains unsatisfied and the issuer continues to disagree, the disagreement itself may be required to be disclosed if the dispute is material.

1934 Act Reporting Forms for "S" Filers

The 1934 Act reporting forms for "S" filers are set forth in Forms 10-K, 10-Q and 8-K and are part of the SEC's integrated disclosure system.[15] These are discussed in greater detail in *Accessing the U.S. Capital Markets – U.S. Issuers*.

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[14] See Chapter 7 (*Ongoing Reporting and Other Requirements*) and Chapter 18 (*De-Registering under the 1934 Act*) of this volume.

[15] This discussion does not include other 1934 Act forms that apply to filing requirements that may apply to 1934 Act registrants, such as reporting requirements under Sections 13 and 16 of the 1934 Act, that are outside of the SEC's integrated disclosure system. For a discussion of some of those requirements, see

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1934 Act Reporting Forms for "F" Filers

The 1934 Act reporting forms for "F" filers are set forth in Forms 20-F and 6-K and are part of the SEC's integrated disclosure system.[16]

Annual Reports: Disclosure Requirements of Form 20-F

Form 20-F is divided into a cover page and four parts. When used as an annual report, Form 20-F must be filed with the SEC within six months after the end of the issuer's fiscal year. Beginning with fiscal years ending on or after December 15, 2011, the report will be required to be filed with the SEC not later than four months from its fiscal year end. The information requirements of Form 20-F are discussed in detail in Chapter 4 (*Disclosure Requirements*) of this volume.

The information and documents furnished on or incorporated by reference in Form 20-F are considered "filed" for purposes of Section 18 of the 1934 Act and are subject to the liability provisions of that section.[17]

Interim Reports: Disclosure Requirements of Form 6-K

A foreign private issuer is also required to furnish to the SEC on Form 6-K any information not contained in its latest Form 20-F on file with the SEC that the issuer (1) makes or is required to make public in its home country; (2) files or is required to file with a non-U.S. stock exchange on which its securities are traded and which was made public by that exchange; or (3) distributes or is required to distribute to its securityholders, where in the case of (1), (2) or (3) such information is material to the foreign private issuer and its subsidiaries and relates to:

- changes in business, management or control;
- acquisitions or dispositions of assets;
- bankruptcy or receivership;
- changes in the certifying accountants;
- financial condition and results of operation;
- material legal proceedings;
- changes in securities or in the security for securities registered under the 1934 Act, defaults on senior securities, and material changes in the amount of outstanding securities or indebtedness;

Chapter 7 (*Ongoing Reporting and Other Requirements*) and Chapter 19 (*Acquisitions by Non-U.S. Entities*) of this volume.

[16] See supra footnote 14.

[17] See Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume for a description of liabilities under the 1934 Act.

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- results of the submission of matters to a vote of securityholders;
- transactions with directors, officers or principal securityholders, and the granting of options or payment of other compensation to directors or officers; and
- any other information that the issuer deems of material importance to securityholders.

The report on Form 6-K is required to be furnished to the SEC promptly after its public dissemination in the home country.

Information required to be furnished pursuant to Form 6-K, if originally published in a language other than English, must be translated into English if it consists of (a) press releases, (b) communications or materials distributed directly to securityholders (except for offering documents relating entirely to securities offerings outside the United States) and (c) documents disclosing annual audited or interim consolidated financial information. Other documents may be provided in the form of an English summary instead of a full English translation.

Form 6-K must be furnished promptly after the material contained in the report is made public as described. The information and documents furnished on Form 6-K shall not be deemed to be "filed" for purposes of Section 18 of the 1934 Act or otherwise subject to the liability provisions of that section.

INFORMATION REPORTING UNDER RULE 12g3-2(b) FOR FOREIGN PRIVATE ISSUERS

A foreign private issuer may become subject to the SEC's requirements even though it has never made a public offering or listed securities in the United States. Section 12(g) of the 1934 Act, as modified by Rule 12g-1 under the 1934 Act, requires registration of any class of equity securities if it is held of record by 500 or more persons on a worldwide basis and if its issuer has more than U.S.$10 million in assets.

However, Rule 12g3-2(a) exempts a foreign private issuer from the reporting requirements of the 1934 Act if it does not have a class of equity securities held of record by 300 or more persons resident in the United States. Record ownership is construed to include beneficial owners under 12g3-2(a), including ADR holders and street name accounts. Rule 12g3-2(b) exempts any foreign private issuer from the reporting requirements of the 1934 Act, regardless of how many U.S. residents hold its securities, provided it makes available to U.S. investors in accordance with the rule the information the issuer provides to investors in its home country and satisfies certain other conditions. The availability of Rule 12g3-2(b) is limited to foreign private issuers that do not have securities listed on a U.S. securities exchange and, unless they satisfy the de-registration requirements discussed in Chapter 18 (*De-Registering under the 1934 Act*) of this volume, have not offered securities in the U.S. capital markets in a 1933 Act-registered public offering. Rule 12g3-2(b)'s primary purpose is to prevent the creation of a 1934 Act reporting obligation for an issuer that has not voluntarily entered the public securities markets of the United States, while still ensuring that home-country information is available to assist U.S. investors.

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For foreign private issuers, the Rule 12g3-2(b) exemption may be useful primarily for establishing an unlisted ADR facility for secondary trading of its securities in the United States or for satisfying the information delivery requirements of Rule 144A or both.[18]

Disclosure Requirements of the Exemption

A foreign private issuer can qualify for the Rule 12g3-2(b) exemption automatically and without regard to the number of its U.S. shareholders by posting on the Internet certain information, including information the issuer has made or is required to make public pursuant to law or stock exchange regulation in its home jurisdiction or the jurisdiction of its principal securities market or has distributed or is required to distribute to its securityholders. Press releases may be required to be so published under the rule.

The rule describes the types of information required to be made public as information material to an investment decision, such as:

- results of operations or financial condition;
- changes in business;
- acquisitions or dispositions of assets;
- issuance, redemption or acquisitions of its securities;
- changes in management or control;
- the granting of options or the payment of other compensation to directors or officers; and
- transactions with directors, officers or principal securityholders.

Establishing the Exemption

Electronic Publishing Requirement

Until recently, Rule 12g3-2(b) required the submission of written materials to the SEC both to claim and to maintain the exemption from registration. Amendments adopted in 2008 significantly revised the terms of the exemption, substituting electronic publication for paper filings and effectively removing the SEC staff from the administration of the rule.[19] For any issuer claiming the exemption under the old system that is unable to meet the requirements under the amended rules, the SEC has provided a transition period until October 2011, by which time such issuers may be required to become 1934 Act registrants.

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[18] Rule 12g3-2(c) under the 1934 Act provides a separate exemption from the 1934 Act registration and reporting requirements for ADRs registered on Form F-6, but not the underlying securities of the issuer.

[19] See SEC Release No. 34-58465 (Sept. 5, 2008) (http://www.sec.gov/rules/final/2008/34-58465.pdf).

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Pursuant to the recent rule changes, a foreign private issuer may claim the Rule 12g3-2(b) exemption if:

- the issuer is not required to file reports under 1934 Act Section 13(a) or 15(d);
- the issuer currently maintains a listing of the subject class of securities on one or more exchanges in a foreign jurisdiction that, either singly or together with the trading of the same class of the issuer's securities in another foreign jurisdiction, constitutes the primary trading market[20] for those securities; and
- unless claiming the exemption in connection with or following its recent 1934 Act de-registration, the issuer has published specified non-U.S. disclosure documents, required to be made public from the first day of its most recently completed fiscal year, in English on its web site or through an electronic information delivery system generally available to the public in its primary trading market.

English Language Requirement

A foreign private issuer must publish certain material information in English, including but not limited to information the issuer has made public or been required to make public pursuant to the laws of the country of its incorporation, organization or domicile, information that the issuer has filed or has been required to file with the principal stock exchange in its primary trading market and information that the issuer has distributed or has been required to distribute to its securityholders.

At minimum, the issuer must publish the following material information in the English language:

- annual report and annual financial statements;
- interim reports that include financial statements;
- press releases; and
- all other communications and documents distributed directly to securityholders of each class of securities to which the exemption relate.

Generally, brief English descriptions or English versions of specified non-U.S. disclosure documents instead of English translations are not permitted, unless the issuer is also allowed to submit an English summary for a non-U.S. disclosure document under cover of Form 6-K or pursuant to Rule 12b-12(d)(3).

[20] With respect to Rule 12g3-2(b), an issuer's "primary trading market" means that (a) at least 55% of the trading in the subject class of a securities on a worldwide basis took place in, on or through the facilities of a securities market or markets in a single non-U.S. jurisdiction or in no more than two non-U.S. jurisdictions during the issuer's most recently completed fiscal year and (b) if a foreign private issuer aggregates the trading of its subject class of securities in two non-U.S. jurisdictions, the trading for the issuer's securities in at least one of the two non-U.S. jurisdictions is greater than the trading in the United States for the same class of the issuer's securities.

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Form 15F Method

Under Rule 12g3-2(e), a foreign private issuer that has filed a Form 15F to terminate its 1934 Act registration or duty to file reports under Sections 12(g), 13 or 15(d) of the 1934 Act with respect to any class of securities is automatically entitled to qualify for the Rule 12g3-2(b) exemption, without having to apply to the SEC, upon effectiveness of the termination of its obligation to file 1934 Act reports, generally 90 days after filing the Form 15F. To take advantage of the Form 15F method, the issuer must include in its Form 15F the address of the web site where the information required by Rule 12g3-2(b) will be published.

Maintaining the Exemption

To maintain the Rule 12g3-2(b) exemption, the foreign private issuer must promptly post on its web site or an electronic delivery system available to the public in its primary trading market the same information specified in the prior fiscal year on an ongoing basis and for each subsequent fiscal year. Additionally, a foreign private issuer must publish electronically its non-U.S. disclosure documents promptly after the information has been made public, pursuant to its home jurisdiction laws, non-U.S. stock exchange rules or shareholder meeting rules and practices.

Rule 12g3-2(b) exemption will remain in effect so long as an issuer continues compliance with the requirements to publish its non-U.S. disclosure documents, or, more specifically, until an issuer:

- no longer electronically publishes the specified non-U.S. disclosure documents required to maintain the exemption;
- no longer maintains a listing for the subject class of securities on one or more exchanges in a primary trading market (either because it is no longer listed in its primary trading market or because the one or two foreign jurisdiction in which it trades no longer qualifies as its primary trading market); or
- registers a class of securities under Section 12 of the 1934 Act or incurs reporting obligations under Section 15(d) of the 1934 Act.

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CHAPTER 4

DISCLOSURE REQUIREMENTS

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GENERAL

The SEC has integrated the disclosure requirements for all issuers under the 1933 Act and the 1934 Act. This means that one set of disclosure rules applies under both Acts. As a result, the information that an issuer is required to include (or incorporate by reference to a 1934 Act report) in a prospectus used to sell securities is based on the information that the issuer is required to disclose in its 1934 Act reports.

The SEC's basic 1933 Act disclosure forms are the "S" forms. Issuers that register their securities offerings under the 1933 Act on an "S" form registration statement file annual reports with the SEC under the 1934 Act on Form 10-K. While "S" forms may be used by foreign private issuers, foreign private issuers are also eligible to register their securities offerings under the 1933 Act on an "F" form registration statement and file annual reports with the SEC under the 1934 Act on Form 20-F or, in the case of certain Canadian issuers, 40-F. As discussed in this chapter below under the heading "—Disclosure Requirements for 'F' Form Issuers," most foreign private issuers choose to register their securities offerings on "F" forms and file annual reports on Form 20-F or, in the case of certain Canadian issuers, Form 40-F, as that registration and reporting regime is intended to be less burdensome for foreign private issuers.

DISCLOSURE REQUIREMENTS FOR "S" FORM ISSUERS

Relationship between "S" Forms and Form 10-K

Form 10-K is the form to be used by an issuer for annual reports pursuant to Section 13 or 15(d) of the 1934 Act for which no other form is prescribed.[1] The annual report on Form 10-K provides a comprehensive overview of the issuer's business and financial condition and includes audited financial statements.

An issuer using a Form S-1 registration statement that is eligible to, and elects to, incorporate by reference its prior filings under the 1934 Act must incorporate by reference into the prospectus, among other documents, the issuer's latest annual report on Form 10-K filed pursuant to the 1934 Act that contains financial statements for the issuer's latest fiscal year for which a Form 10-K was required to have been filed.

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[1] A copy of Form 10-K and related instructions is available on the SEC's web site at http://www.sec.gov/about/forms/form10-k.pdf.

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An issuer using a Form S-3 registration statement must incorporate by reference into the prospectus the issuer's latest annual report on Form 10-K filed pursuant to the 1934 Act that contains financial statements for the issuer's latest fiscal year for which a Form 10-K was required to have been filed. Furthermore, a Form S-3 prospectus automatically incorporates by reference all reports including, among others, annual reports on Form 10-K subsequently filed by the issuer under the 1934 Act, and is generally kept current by information contained in such reports.

Form 10-K is not a blank form for filling in required information. It is meant to be a guide only for the preparation of the relevant annual report. It expressly notes the requirements of Rule 12b-20 under the 1934 Act that "[i]n addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."

Disclosure Requirements of Form 10-K

The disclosure requirements of Form 10-K are discussed in Chapter 4 (*Disclosure Requirements*) of *Accessing the U.S. Capital Markets – U.S. Issuers*.

DISCLOSURE REQUIREMENTS FOR "F" FORM ISSUERS

The "F forms" that foreign private issuers may file under the 1933 Act and the 1934 Act require a level of disclosure that is generally similar to that required by the "S" Forms and Form 10-K, although the "F" forms and related 1934 Act forms generally have less burdensome disclosure requirements, including the following:

- The financial statements for an "S" form filer must be prepared in accordance with U.S. GAAP, while the financial statements for an "F" form filer may be prepared in accordance with IFRS as issued by the IASB or, if different, its home country accounting principles. Home country financial statements not prepared in accordance with IFRS as issued by the IASB must be accompanied, however, by either (i) financial statements prepared in accordance with U.S. GAAP or (ii) a discussion of material variations between its home country accounting principles and U.S. GAAP and a reconciliation of certain net income and balance sheet information to U.S. GAAP.

- The financial statements for an "S" form filer must be updated on a quarterly basis, while the financial statements of an "F" form filer needs to be updated only annually and whenever the issuer makes interim information publicly available in its home country.[2]

[2] However, as discussed in further detail in this chapter below under the heading "—Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 8: Financial Information," a non-U.S. issuer will be effectively blacked out of the U.S. public capital markets at the time of a prospective offering if its annual financial disclosure is more than 15 months old or, in the case of an initial U.S. public offering, 12 months old.

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- "S" form filers and, for the fiscal years ending on or after December 15, 2009, "F" form filers must disclose information in their financial statements for the last three years for each of their operating segments. For fiscal years ending prior to December 15, 2009, "F" form filers are permitted to provide more limited segment disclosure and are only required to comply with the standard for "S" form filers if they are engaged in a primary public offering of equity or debt securities (other than non-convertible investment grade debt or preferred stock) in the United States.

- "S" form filers must disclose individual compensation to the principal executive officer and principal financial officer whose total annual salary and bonus exceeds U.S.$100,000 and named executive officers whose total compensation exceeds U.S.$100,000, as well as compensation to directors, while "F" form filers are required to disclose only compensation to management as a group and not individually unless the issuer is required in its home country to disclose individual compensation information or in fact makes such information publicly available.

Relationship Between 1933 Act "F" Forms and Form 20-F

Form 20-F is the basic disclosure form for most foreign private issuers.[3] The form may be used as an annual report by foreign private issuers that are required to file annual reports or registration statements under the 1934 Act. Form 20-F also sets forth the disclosure requirements that must be followed in connection with a securities offering registered under the 1933 Act on Form F-1, F-3 or F-4.

Form 20-F states in its general instructions that it is not a blank form for filling in required information. It is meant to be a guide only for the preparation of the relevant registration statement or annual report. It expressly notes the requirements of Rule 12b-20 under the 1934 Act that "[i]n addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."

The remainder of this section describes:

- The disclosure requirements of Form 20-F, which include items that apply (i) only when the issuer is engaged in a securities offering registered with the SEC, (ii) only when the issuer is using the form as a basis for an annual report under the 1934 Act and (iii) in both situations; and

- The additional disclosure requirements of Form F-3.

[3] A copy of Form 20-F and related instructions is available on the SEC's web site at http://www.sec.gov/about/forms/form20-f.pdf. See Rule 3(b)-4 under the 1934 Act and Rule 405 under the 1933 Act for the definition of foreign private issuer and *An Overview of U.S. Securities Regulators and Laws* in this volume for a further discussion.

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Disclosure Requirements of Form 20-F

Preparation of the required disclosure about the issuer is probably the single most important exercise in the registration process under the 1933 Act and the 1934 Act. Once this disclosure has been properly prepared and internal procedures have been developed by the issuer for updating this disclosure, issuers should be able to minimize the burden of preparing subsequent 1933 Act and 1934 Act registration statements and 1934 Act annual and interim reports. This has been done by many foreign private issuers, who coordinate much of this activity with the preparation of their existing annual and interim reporting requirements. Some foreign private issuers draft their domestic annual reports in a manner that complies with the requirements of Form 20-F, thereby obviating the need to prepare a separate document. Proper ongoing information disclosure compliant with SEC rules would make Form F-3 available to the issuer, which entitles it to incorporate by reference into its latest Form 20-F virtually all the information discussed in this section. Issuers generally should also maintain their disclosure current so that they can quickly access the Rule 144A markets.

In addition to the information requirements discussed below, an issuer may have to report information required by the SEC's industry guides or other special disclosure rules for electric and gas utilities, oil and gas operations, bank holding companies, real estate limited partnerships and property-casualty insurance underwriters.[4]

When Form 20-F is used as an annual report under the 1934 Act, for fiscal years ending before December 15, 2011, it must be filed with the SEC within six months after the end of the fiscal year covered by the report and for fiscal years ending on or after December 15, 2011 it must be filed with the SEC within four months after the fiscal year covered by the report. [5]

The following summary refers to the various items in Form 20-F. Some of these items apply only when the issuer is engaged in a securities offering registered with the SEC under the 1933 Act and not when the issuer is using the form as a basis for its annual report under the 1934 Act. Also, the following is only a summary and Form 20-F may have changed since the following was prepared.[6]

Form 20-F is the principal disclosure form for annual reports under the 1934 Act and registration statements under the 1934 Act in connection with securities listings. Form 20-F is also used as a reference for the disclosure requirements of "F" form registration statements used to register securities offerings under the 1933 Act. However, as indicated in italics below, not all

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4 These industry guides are available on the SEC's web site at http://www.sec.gov/about/forms/industryguides.pdf. On December 31, 2008, the SEC adopted rules that contain amendments, effective January 1, 2010, intended to modernize and update the SEC's oil and gas disclosure requirements. Among these amendments are the revision of Industry Guide 2 and its codification in Regulation S-K. See SEC Release No. 33-8995 (Dec. 31, 2008) (http://www.sec.gov/rules/final/2008/33-8995.pdf).

5 See SEC Release No. 33-8969 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf). As mentioned in footnote 2 above, however, a failure to file within three months of the end of the fiscal year covered could result in the issuer being effectively blacked out of the U.S. public capital markets due to the information requirements described in this chapter below under the heading "—Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20 F—Item 8: Financial Information."

6 See supra footnote 3 for a hyperlink to the current version of Form 20-F and related instructions.

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of the following items apply in each such case. Where not specified, the item applies in all such cases.

Item 1: Identity of Directors, Senior Management and Advisers

Item 1 of Form 20-F is designed to identify those individuals involved in the issuer's listing or registration and therefore requires a list of the names, business addresses and functions of the issuer's directors and senior management, as well as the names and addresses of its principal bankers and legal advisers (if this information is required to be disclosed outside the United States) and, for the three preceding years, its auditors.

Item 1 does not apply if Form 20-F is being used only as an annual report under the 1934 Act.

Item 2: Offer Statistics and Expected Timetable

Item 2 of Form 20-F requires information regarding a securities offering, including important dates relating to that offering. Specifically, it requires the expected amount of the offering, including the expected offering price or the method of determining the price, the offering method and the amount of securities to be offered.

For all offerings, and separately for each group of targeted potential investors, Item 2 requires the following information to the extent applicable to the offering procedure:

(1) The time period during which the offer will be open, and where and to whom purchase or subscription applications should be addressed; describe whether the purchase period may be extended or shortened, and the manner and duration of possible extensions or possible early closure or shortening of this period; describe the manner in which the latter shall be made public. If the exact dates are not known when the document is first filed or distributed to the public, describe arrangements for announcing the final or definitive date or period.

(2) Method and time limits for paying up securities; where payment is partial, the manner and dates on which amounts are due to be paid.

(3) Method and time limits for delivery of equity securities (including provisional certificates, if applicable) to subscribers or purchasers.

(4) In the case of pre-emptive purchase rights, the procedure for the exercise of any right of pre-emption, the negotiability of subscription rights and the treatment of subscription rights not exercised.

(5) A full description of the manner in which results of the distribution of securities are to be made public, and when appropriate, the manner for refunding excess amounts paid by applicants (including whether interest will be paid).

Item 2 does not apply if Form 20-F is being used only as an annual report under the 1934 Act or a registration statement under the 1934 Act.

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Item 3: Key Information

Selected Financial Data

Selected historical financial data, generally for the five most recent fiscal years (or such shorter period that the issuer has been in operation) and for any interim periods presented, consisting of specified income statement and balance sheet information in the same currency as the financial statements, must be included pursuant to this item. Selected financial data for either or both of the earliest two years of the five-year period may be omitted if the issuer represents that such information cannot be provided, or cannot be provided on a restated basis, without unreasonable effort or expense. Items included in the selected financial data presented should be expressed in the same manner as the corresponding line items in the issuer's financial statements, and should include, at a minimum, net sales or operating revenues; income (loss) from operations; income (loss) from continuing operations; net income (loss); net income (loss) from operations per share; income (loss) from continuing operations per share; total assets; net assets; capital stock (excluding long-term debt and redeemable preferred stock); number of shares as adjusted to reflect changes in capital; dividends declared per share in both the currency of the financial statements and the host country currency, including the formula used for any adjustments to dividends declared; and diluted net income per share. Per share amounts must be determined in accordance with the body of accounting principles used in preparing the financial statements.

The selected financial data may be presented using the accounting principles in the issuer's primary financial statements, but unless those financial statements are presented according to IFRS as issued by the IASB, the issuer must include in this summary reconciliations of the selected financial data to U.S. GAAP. However, financial measures that are neither required by the issuer's primary financial statements nor U.S. GAAP need not be presented in selected financial data. Please refer to discussions in this chapter below under the heading "—Disclosure Regarding Non-GAAP Financial Measures."

Exchange Rates

Where the issuer's financial statements are prepared in a currency other than the U.S. dollar, Form 20-F requires disclosure of the exchange rate between the financial reporting currency and the U.S. dollar, using the exchange rate designated by the United States for this purpose, if any, at the latest practicable date, the high and low exchange rates for each month during the previous six months; and for the five most recent financial years and any subsequent interim period for which financial statements are presented, the average rates for each period, calculated by using the average of the exchange rates on the last day of each month during the period.

Capitalization and Indebtedness

This sub-item requires a statement of capitalization and indebtedness (distinguishing between guaranteed and not guaranteed, and secured and unsecured indebtedness) as of a date no earlier than 60 days prior to the date of the prospectus on an actual basis and as adjusted for the

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sale of new securities and the intended application of the net proceeds of such sale. Indebtedness also includes indirect and contingent indebtedness.

The SEC staff has recognized that the capitalization table is ordinarily derived from the most recent balance sheet required under Item 8, which may be as much as nine months old, and that the capitalization table age requirement, as written for foreign private issuers, is also considerably more stringent than the 135-day window customarily used by U.S. issuers in their prospectuses. As a result, consistent with historical practice, the SEC staff will not object if a foreign private issuer presents its capitalization table as of the same date as the most recent balance sheet required by Item 8 or otherwise contained in the registration statement. If there have been significant subsequent changes in capitalization such as debt or equity issuances, recapitalizations or special dividends, the issuer should reflect these changes in "as adjusted" columns or footnotes to the table.

Capitalization and indebtedness information does not need to be provided if Form 20-F is being used only as an annual report under the 1934 Act.

Use of Proceeds

This sub-item requires a statement of the estimated net amount of the proceeds broken down into each principal intended use, including the order of priority of such intended uses, if the anticipated proceeds will not be sufficient to fund all the proposed purposes, in which case additional statements of the amount and sources of other funds needed must be included. If the issuer has no specific plans for the proceeds, it should discuss the principal reasons for the offering. If the proceeds are being used directly or indirectly to acquire assets, other than in the ordinary course of business, the issuer must describe the assets and their cost. If the proceeds may or will be used to finance acquisitions of other businesses, the issuer must give a brief description of such businesses and information on the status of the acquisitions. If a material part of the proceeds will be used to repay indebtedness, the issuer must describe the interest rate and maturity of such indebtedness and (if such indebtedness was incurred within the past year) the uses to which the proceeds of such indebtedness were put.

Use of proceeds information does not need to be provided if Form 20-F is being used only as an annual report under the 1934 Act or as a registration statement under the 1934 Act.

Risk Factors

This sub-item requires disclosure (in a section headed "Risk Factors") of any risk factors that are specific to the issuer or its industry and that make the offering speculative or one of high risk. Foreign private issuers should describe their risk factors concisely and explain clearly how each risk affects them and their securities. The SEC also encourages, but does not require, issuers to list their risk factors in the order of their priority to them.

Item 4: Information on the Issuer

Item 4 requires disclosure of:

- the issuer's legal and commercial name and the date of its incorporation;

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- the domicile and legal form of the issuer, the legislation under which the issuer operates, its country of incorporation and the address and telephone number of its registered office (or principal place of business if different from its registered office), including the name and address of the issuer's agent in the United States, if any;

- the important events in the development of the issuer's business (*e.g.,* information concerning the nature and results of any material reclassification, merger or consolidation of the issuer or any of its significant subsidiaries; acquisitions or dispositions of material assets other than in the ordinary course of business; any material changes in the mode of conducting the business; material changes in the types of products produced or services rendered; name changes; or the nature and results of any bankruptcy, receivership or similar proceedings with respect to the issuer or significant subsidiaries);[7]

- a description, including the amount invested, of the issuer's principal capital expenditures and divestitures (including interests in other companies), since the beginning of the issuer's last three financial years to the date of the offering or listing document;

- information concerning the principal capital expenditures and divestitures currently in progress, including the distribution of these investments geographically (home and abroad) and the method of financing (internal or external);

- an indication of any public takeover offers by third parties in respect of the issuer's shares or by the issuer in respect of other companies' shares which have occurred during the last and current financial year, including a statement of the price or exchange terms attaching to such offers and the outcome;

- a business overview of the issuer, including a description of the issuer's operations and principal activities, including the main categories of products sold and/or services performed for each of the past three years (with a description of new products and/or services introduced and the state of development of new products and/or services to the extent they have been publicly disclosed), the issuer's principal markets (with a breakdown of revenues by category of activity and geographic market for each of the past three years), its exposure to seasonality, the sources and availability of raw materials, including a description of whether prices of principal raw materials are volatile, the issuer's marketing channels (including an explanation of any special sales methods, such as installment sales), its intellectual property and industrial, commercial or financial contracts (including contracts with customers or suppliers) or new manufacturing processes, where such factors are material to the issuer's business or profitability, the basis for any statements made regarding its competitive position and the

[7] If Form 20-F is being used only as an annual report under the 1934 Act, only events since the beginning of the issuer's last full financial year up to the latest practicable date need be included.

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material effects of government regulation on the issuer's business, identifying the regulatory body (disclosure of the operating segment and geographic market information called for under Item 4 is a prerequisite for being able to use financial statements under Item 17[8]);

- a brief description of the issuer's organizational structure, including a listing of the issuer's significant subsidiaries, names of such subsidiaries, their countries of incorporation or residence, proportions of ownership interest and, if different, proportions of voting power held; and
- a description of the issuer's property, plants and equipment, such as material tangible fixed assets, including leased properties, holding structure of such assets, the nature of any major encumbrances, the assets' productive capacity and extent of utilization, a description of the size and uses of the property, the products produced, the location, any environmental issues that may affect the issuer's utilization of such assets, and a description of any material plans to construct, expand or improve the issuer's facilities with a discussion of the nature or reason for the plan, an estimate of the amount of expenditures including the amount of expenditures already paid, a description of the method of financing the activity, the estimated dates of start and completion of the activity, and the increase of production capacity anticipated after completion.

If the issuer is not a reporting company and has a short operating history (*i.e.*, it has not received revenue from operations during each of the three fiscal years immediately prior to its filing of a Form 20-F annual report or a Form F-1 registration statement), the issuer must provide information about its plan of operations as follows:

- if the Form 20-F annual report or Form F-1 registration statement is filed prior to the end of the issuer's second fiscal quarter, a description of its plan of operation for the remainder of the fiscal year; or
- if the Form 20-F annual report or Form F-1 registration statement is filed subsequent to the end of the issuer's second fiscal quarter, a description of its plan of operation for the remainder of the fiscal year and for the first six months of the next fiscal year.

Disclosure of such plan of operations should include:

- in the case of a registration statement on Form F-1, a description of the issuer's opinion as to the period of time that the proceeds from the offering will satisfy its cash requirements and whether in the next six months it will be necessary to raise additional funds to meet the expenditures required for operating its business, including the specific reasons for such opinion with categories (not amounts) of expenditures and sources of cash resources identified;

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[8] See discussion on Item 17 in this chapter below under the heading "—Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 17: Financial Statements."

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- a description of material product research and development to be performed during the period covered in the plan of operations;
- any anticipated material acquisition of plant and equipment, including their capacities;
- any anticipated material changes in number of employees in the various departments; and
- other material areas which may be peculiar to the issuer's business.

Item 4A: Unresolved Staff Comments

Item 4A is applicable to a reporting company only, including a foreign private issuer that has become a reporting company under the 1934 Act. If the issuer is a WKSI, a large accelerated filer or an accelerated filer and has received written comments from the SEC staff regarding its periodic reports under the 1934 Act not less than 180 days before the end of its fiscal year to which its Form 20-F annual report relates, and such comments remain unresolved, the issuer must disclose the substance of any such unresolved comments that the issuer believes to be material. The issuer may also disclose other information including its position with respect to any such comment.

Item 5: Operating and Financial Review and Prospects

Item 5 of Form 20-F is intended to provide management's explanation of factors that have affected the issuer's financial condition and results of operations for the historical periods covered by the financial statements as well as management's assessment of factors and trends that are expected to have a material effect on the issuer's financial condition and results of operations in future periods. It requires a description of the issuer's financial condition, changes in its financial condition and results of operations for each year and interim period for which financial statements are required, including the causes of material changes from period to period in financial statement line items. The information provided must relate to each of the issuer's business segments.

Item 5 is similar to the MD&A that is a standard part of disclosure by U.S. issuers. The instructions to this item of Form 20-F refer expressly to the SEC's interpretations of the MD&A requirements for U.S. issuers. For further information on the SEC's interpretation of MD&A requirements, refer to Appendix C (*Summary of SEC Releases on MD&A*) of this volume.

As a result of the acceptance by the SEC of filings of financial statements of foreign private issuers prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP, a foreign private issuer filing financial statements that comply with IFRS as issued by the IASB, in responding to Item 5 disclosure requirements, need not repeat information contained in its financial statements that comply with IFRS as issued by the IASB and should instead provide disclosure that satisfies the objectives of the Item 5 disclosure requirements.

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Without affecting the issuer's obligation to provide all information necessary for an investor's understanding of the issuer's financial condition, changes in financial condition and results of operations, the issuer must provide the following specific information:

Operating Results

The issuer must provide information regarding significant factors materially affecting its income from operations, including unusual or infrequent events or new developments and indicating the extent to which income was so affected. The issuer must also describe any other significant components of revenue or expenses necessary to enable an investor to understand the issuer's results of operations.

- If there have been material changes in net sales or revenues, the issuer must provide a narrative discussion of the extent to which such changes were due to changes in prices or changes in the volume or amount of products or services being sold or to the introduction of new products or services.

- The issuer must describe the impact of inflation, if material, with special requirements for issuers whose reporting currency is of a country that has experienced hyperinflation.

- The issuer must provide information regarding the impact of foreign currency fluctuations, if material, and the extent to which it hedges its foreign currency exposures.

- The issuer must provide information regarding any governmental economic, fiscal, monetary or political policies or factors that have materially affected, or could materially affect, directly or indirectly, its operations or investments by U.S. persons.

Liquidity and Capital Resources

The issuer must provide information regarding its short-term and long-term liquidity, including a description of its internal and external sources of liquidity, and a statement by the issuer that, in its opinion, the working capital is sufficient for the issuer's present requirements or, if not, how it proposes to provide the additional working capital needed, and an evaluation of the sources and amounts of its cash flows (including any restriction on the ability of its subsidiaries to transfer funds to the issuer and the impact or expected impact of such restrictions on the ability of the issuer to meet its cash obligations). The information must include the issuer's material commitments for capital expenditures as of the end of the latest financial year and any subsequent interim period and an indication of the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments.

Form 20-F also requires information on the level of borrowings at the end of the period under review, the seasonality of borrowing requirements and the maturity profile of borrowings and committed borrowing facilities, with a description of any restrictions on their use, as well as information regarding the type of financial instruments used, the maturity profile of debt, currency and interest rate structure. The discussion also should include funding and treasury

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policies and objectives in terms of the manner in which treasury activities are controlled, the currencies in which cash and cash equivalents are held, the extent to which borrowings are at fixed rates and the use of financial instruments for hedging purposes.

The SEC has cautioned against disclosures that are "overly general" as compared to those that are "detailed and tailored to the company's individual circumstances." It has also emphasized that issuers are required to identify circumstances that could materially affect liquidity if such circumstances are "reasonably likely" to occur.

Research and Development

The issuer must describe its research and development policies for the last three years (where significant), including the amount spent on issuer-sponsored research and development in each of the last three years.

Trend Information

The issuer should identify the most significant recent trends in its production, sales and inventory, the state of its order book and costs and selling prices since the latest fiscal year. The issuer should also discuss, for at least the current fiscal year, any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on its net sales or revenues, income from continuing operations, profitability, liquidity or capital resources, or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition.

Off-Balance Sheet Arrangements

The issuer should discuss, in a section labeled "Off-Balance Sheet Arrangements," such arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The disclosure should include the following information to the extent necessary to an understanding of such arrangements and effects, and should also include such other information that the issuer believes is necessary for such an understanding:

- the nature and business purpose to the issuer of such off-balance sheet arrangements;
- the importance to the issuer of such off-balance sheet arrangements in respect of its liquidity, capital resources, market risk support, credit risk support or other benefits;
- the amounts of revenues, expenses and cash flows of the issuer arising from such arrangements; the nature and amounts of any interests retained, securities issued and other indebtedness incurred by the issuer in connection with such arrangements; and the nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) of the issuer arising from such

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arrangements that are or are reasonably likely to become material and the triggering events or circumstances that could cause them to arise; and

- any known event, demand, commitment, trend or uncertainty that will result in or is reasonably likely to result in the termination, or material reduction in availability to the issuer, of its off-balance sheet arrangements that provide material benefits to it, and the course of action that the issuer has taken or proposes to take in response to any such circumstances.

This portion of Form 20-F defines "off-balance sheet arrangement" to mean any transaction, agreement or other contractual arrangement to which an entity unconsolidated with the issuer is a party, under which the issuer has:

- any obligation under a guarantee contract that has certain characteristics as specified in U.S. GAAP accounting rules, except as discussed above with respect to issuers that prepare their financial statements in accordance with IFRS as issued by the IASB;

- a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to such entity for such assets;

- any obligation under a derivative instrument that is both indexed to the issuer's own stock and classified in stockholders' equity, or not reflected, in the issuer's statement of financial position; or

- any obligation, including a contingent obligation, arising out of a variable interest in an unconsolidated entity that is held by, and material to, the issuer, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the issuer.

Except as discussed above with respect to issuers that prepare their financial statements in accordance with IFRS as issued by the IASB, the identification of certain of these arrangements depends on the application of U.S. GAAP accounting rules. The issuer must disclose the nature and business purpose of the disclosed arrangements, their importance to the issuer's liquidity, capital resources or risk support and specified quantitative information on the arrangements.

Tabular Disclosure of Contractual Obligations

The issuer must also provide tabular disclosure as of the latest fiscal year end balance sheet date with respect to its known contractual obligations. Form 20-F requires disclosure of the amounts, aggregated by type of contractual obligation. The issuer may disaggregate the specified categories of contractual obligations using other categories suitable to its business, but the presentation must include all of the obligations of the issuer that fall within the specified categories. Categories of contractual obligations include, for example, long-term debt obligations, capital or finance lease obligations, operating lease obligations, purchase obligations and other long-term liabilities reflected on the issuer's balance sheet.

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As used in this portion of Form 20-F, the term "purchase obligation" means an agreement to purchase goods or services that is enforceable and legally binding on the issuer that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The tabular presentation may be accompanied by footnotes to describe provisions that create, increase or accelerate obligations, or other pertinent data to the extent necessary for an understanding of the timing and amount of the issuer's specified contractual obligations.

Critical Accounting Estimates

Auditors are required to report all critical accounting policies and practices to the audit committee of the issuer. This should include, "at a minimum, [a] discussion of critical accounting estimates and the selection of initial accounting policies," along with discussion of why estimates or policies are or are not considered critical and how current and anticipated future events impact those determinations.[9] The SEC expects that the communications regarding critical accounting policies will include an assessment of management's disclosure along with significant proposed modifications by the accountants that were not included.

Forward-Looking Information

The SEC has increasingly emphasized MD&A's forward-looking aspects, and many of its new requirements contemplate forward-looking information. In January 2003, it eliminated a longstanding instruction to the effect that forward-looking information was not required in MD&A.[10]

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[9] See SEC Release No. 33-8183 (Jan. 28, 2003) (http://www.sec.gov/rules/final/33-8183.htm).

[10] See SEC Release No. 33-8182 (Jan. 28, 2003) (http://www.sec.gov/rules/final/33-8182.htm) at III.H. The safe harbor provided in Section 27A of the 1933 Act and Section 21E of the 1934 Act applies to forward-looking information provided pursuant to Form 20-F Item 5.E. (off-balance sheet arrangements) and 5.F. (contractual obligations), provided that the disclosure is made by: (i) an issuer; (ii) a person acting on behalf of the issuer; (iii) an outside reviewer retained by the issuer making a statement on behalf of the issuer; or (iv) an underwriter, with respect to information provided by the issuer or information derived from information provided by the issuer. The safe harbor covers financial projections, goals for future operations, predictions of economic performance, underlying assumptions, SEC-mandated projections, such as MD&A, and reports of outside consultants retained to assess an issuer's forward-looking statements. The safe harbor does not apply to statements made in U.S. GAAP financial statements or in connection with IPOs, tender offers or partnership offerings. Interestingly, when the SEC adopted the amendments to its rules to require disclosure of off-balance sheet arrangements in the MD&A by both U.S. and foreign private issuers, it rationalized the treatment by stating that "Section 401(a) of the Sarbanes-Oxley Act does not distinguish between foreign private issuers and U.S. companies" and that, "for Form 20-F annual reports, the existing MD&A-equivalent requirements for foreign private issuers currently mirror the substantive MD&A requirements for U.S. companies." The SEC further stated that, "[t]o encourage the type of information and analysis necessary for investors to understand the impact of off-balance sheet arrangements and to reduce the burden of estimating the payments due under contractual obligations," it included a safe harbor for forward-looking information in such amendments. While the SEC explicitly eliminated its long-standing instruction in its MD&A rules to the effect that forward-looking information was not required, it let its instruction to Item 5 of Form 20-F continue to stand, saying that "[w]e encourage you to supply forward-looking information, but that type of information is not required."

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Item 6: Directors, Senior Management and Employees

Item 6 of Form 20-F is intended to provide information regarding the issuer's directors and managers that will allow investors to assess these individuals' experience, qualifications and levels of compensation, as well as their relationship with the issuer. Information concerning the issuer's employees is also required.

As to directors and senior management (including employees on whose work the issuer is dependent, such as scientists or designers), the issuer must disclose their names, dates of birth or ages (if required to be reported in the issuer's home country or otherwise publicly disclosed by the issuer), business experience (including, in the case of directors, other principal directorships), functions and areas of experience with the issuer, their outside business activities, the nature of any family relationship among such individuals and any arrangements with major shareholders or other persons that resulted in the selection of any of such individuals.

The issuer must disclose compensation and benefits, including contingent or deferred compensation, paid or accrued for the last full fiscal year to its directors and members of its administrative, supervisory or management bodies, including the amount of compensation paid and benefits in kind granted to such persons by the issuer and its subsidiaries for services in all capacities to the issuer and its subsidiaries by any person. Disclosure on an individual basis is not required unless individual disclosure is required in the issuer's home country or is otherwise publicly disclosed by the issuer.

The issuer must describe any bonus or profit-sharing plan and the basis upon which such persons participate in the plan and the details of any stock options as well as the total amounts set aside or accrued to provide pension, retirement or similar benefit plans.

The issuer must also disclose such individuals' share ownership in the issuer as of the most recent practicable date as well as information relating to their stock options. If any individual beneficially owns less than 1% of the class of shares in question and that individual's share ownership has not previously been disclosed to the public or to shareholders, the issuer may indicate that such individual's ownership is less than 1% without providing specific information as to that person's individual share ownership.

The issuer must describe the tenure and expiration of term, if any, of its directors and members of its administrative, supervisory or management boards, the details of any service contracts providing for post-employment benefits for directors (or an appropriate negative statement) and details regarding the issuer's audit committee and remuneration committee (including the names of committee members and a summary of the terms of reference under which such committees operate). If the issuer is a reporting company and its entire board of directors is acting as its audit committee, the issuer should disclose this fact.

The issuer must provide either the number of employees at the end of the period or the average for the period for each of the past three financial years (and changes in such numbers, if material) and, if possible, a breakdown of persons employed by main category of activity and geographic location. The issuer should also disclose any significant change in the number of employees and information regarding the relationship between management and labor unions. lf

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the issuer employs a significant number of temporary employees, the disclosure should include the number of temporary employees on average during the most recent financial year.

Item 7: Major Shareholders and Related Party Transactions

Item 7 of Form 20-F requires the issuer to provide information regarding its major shareholders and other persons who may control the issuer. It also requires disclosure of information regarding transactions between the issuer and persons affiliated with the issuer and whether the terms of such transactions are fair to the issuer. These standards may require disclosure of related party transactions not required to be disclosed under the body of accounting principles used in preparing the financial statements. This standard is not intended to address the thresholds at which shareholders are required, on a continuing basis, to disclose their beneficial ownership of securities.

Major Shareholders

The issuer must, to the extent that the information is known to the issuer or can be ascertained from public filings, identify persons by name who beneficially own 5% or more (or such lesser percentage as is required to be disclosed in the issuer's home country) of its voting securities (or an appropriate negative statement if there are no major shareholders), including the number of shares and the percentage owned by such persons, and any significant change in the percentage ownership of any major shareholders during the past three years. Any differences in voting rights of major shareholders (or an appropriate negative statement that there are not such differences) must also be disclosed.

The issuer must provide information as to the portion of each class of its securities held in the United States and the number of record holders in the United States.

If the issuer knows that it is controlled directly or indirectly by any person or persons, it must disclose the identity of such person or persons as well as the nature of such control, including the amount and proportion of capital held giving a right to vote. It must also disclose any arrangements known to it that may at a subsequent date result in a change of control of the issuer.

Related Party Transactions

The issuer must disclose information about any transactions or loans between the issuer and certain persons, including the specific information detailed below, for the period since the beginning of its last three financial years up to the date of the document. These persons include the issuer's affiliates, any persons who have significant influence over the issuer, key management personnel of the issuer (and close members of their families) as well as any company in which any such person has a substantial interest. Shareholders beneficially owning a 10% interest in the voting power of the issuer are presumed to have a significant influence on the issuer. Form 20-F requires disclosure of:

- the nature and extent of any transactions or presently proposed transactions which are material to the issuer or the related party, or any transactions that are unusual

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in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the issuer or any of its parent or subsidiaries was a party.

- the amount of outstanding loans (including guarantees of any kind) made by the issuer, its parent or any of its subsidiaries to or for the benefit of any of the related parties listed above. The information given should include the largest amount outstanding during the period covered, the amount outstanding as of the latest practicable date, the nature of the loan and the transaction in which it was incurred, and the interest rate on the loan.

With respect to loans made to related parties by an issuer that is engaged in the lending business, to the extent that such insider loans are not disclosed as non-accrual, past due, restructured or potential problems under Industry Guide 3,[11] the issuer may disclose by a statement, if true, that the loans in question (A) were made in the ordinary course of business; (B) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons; and (C) did not involve more than the normal risk of collectibility or present other unfavorable features.

If the issuer, its parent or any of its subsidiaries is a "foreign bank" that has made the loan, the issuer must identify the director, senior management member, or other related party required to be described by this Item who received the loan, and describe the nature of the loan recipient's relationship to the foreign bank. If the issuer is unable to identify the recipient of the loan because such disclosure would conflict with privacy laws, such as customer confidentiality and data protection laws, of the foreign bank's home jurisdiction, the issuer must provide a legal opinion attesting to that conclusion as an exhibit. In addition, Form 20-F requires the issuer to disclose that (A) an unnamed director, senior management member, or other related party for which disclosure is required by this Item 7 has been the recipient of a loan; (B) the privacy laws of the foreign bank's home jurisdiction prevent the disclosure of the name of this loan recipient; and (C) this loan recipient is unable to waive or has otherwise not waived application of these privacy laws.

The SEC has in recent years emphasized a realistic view of the disclosure requirement regarding related party transactions, focusing on whether arrangements might involve terms or other aspects that might differ from those that might be negotiated with clearly independent parties. It has provided illustrations of the disclosure that might be required in this area, emphasizing that its understanding of "related parties" goes beyond what might be called for under U.S. GAAP to include anyone with whom an issuer has a relationship that "enables the parties to negotiate terms of material transactions that may not be available from other, more clearly independent parties on an arm's-length basis."[12]

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[11] Industry Guide 3 is available at http://www.sec.gov/about/forms/industryguides.pdf.

[12] SEC Release No. 33-8056 (Jan. 22, 2002) (http://www.sec.gov/rules/other/33-8056.htm); FR-61, Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations (Jan. 22, 2002).

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If Form 20-F is being used only as an annual report under the 1934 Act, related party transaction information need only be provided for the period from the beginning of the issuer's last-full financial year up to the latest practicable date.

Interests of Experts and Counsel

Where the issuer is engaged in a securities transaction registered with the SEC, the issuer must disclose whether it employs any named expert or consultant on a contingent basis, whether any such person owns an amount of shares in the issuer or its subsidiaries that is material to such person or whether any such person has a material direct or indirect economic interest in the issuer or any such interest depends on the success of the transaction.

If Form 20-F is being used only as an annual report under the 1934 Act or as a registration statement under the 1934 Act, information relating to the interests of experts and counsel does not need to be provided.

Item 8: Financial Information

Item 8 of Form 20-F (together with Items 17 and 18 discussed later in this chapter) specifies the financial statements that must be included in the document in question (*i.e.*, whether Form 20-F or a 1933 Act registration statement), including the periods to be covered, the age of the financial statements and other information of a financial nature.

Consolidated Financial Statements and Other Financial Information

The document must include audited consolidated financial statements covering the latest three fiscal years and consisting of a balance sheet, income statement, shareholders' equity statement, cash flow statement and related notes and schedules required by the comprehensive body of accounting standards pursuant to which the financial statements are prepared. The financial statements must be audited in accordance with U.S. generally accepted auditing standards ("U.S. GAAS"). In December 2003, the PCAOB adopted Auditing Standard No. 1 ("AS 1"). On May 14, 2004, the SEC approved AS 1, effective for auditors' reports issued or reissued on or after May 24, 2004. AS 1 requires auditors' reports to state compliance with "the standards of the Public Company Accounting Oversight Board (United States)." In addition, AS 1 states that a reference to generally accepted auditing standards in auditors' reports is no longer appropriate or necessary. Since May 24, 2004, U.S. GAAS is understood to mean the PCAOB standards and any applicable SEC rules.

A balance sheet for the earliest year of the three-year period need not be provided if it is not required by the issuer's home jurisdiction. In addition, if an issuer is filing its initial registration statement with its financial statements prepared in accordance with U.S. GAAP, the earliest year of the three-year period may be omitted if that information has not previously been included in a filing made under the 1933 Act or the 1934 Act. Selected financial data presented pursuant to Item 3 of Form 20-F for the full five fiscal years is still required. The audit report must accompany the financial statements, and the auditor must comply with the PCAOB standards and SEC rules for auditor independence. The audit report(s) must cover each of the periods for which these international disclosure standards require audited financial statements. If the auditors have refused to provide a report on the annual accounts or if the report(s) contain

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qualifications or disclaimers, such refusal or such qualifications or disclaimers must be reproduced in full and the reasons given, so the SEC can determine whether or not to accept the financial statements.[13] The issuer should also include an indication of any other information in the document which has been audited by the auditors.

In December 2007, the SEC adopted final rules to accept filings by foreign private issuers of financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP. This rule is applicable to financial statements for financial years ended after November 15, 2007.[14]

Age of Financial Statements

The last year of audited financial statements (which must be audited annual financial statements) may not be older than 15 months[15] at the time of a securities offering (*i.e.*, the time the registration statement is declared effective) or a listing of securities. If the foreign private issuer is making its initial public offering (*i.e.*, the issuer is not public either in the United States or in its home country), the audited financial statements (which may be audited interim financial statements) may not be older than 12 months at the time the relevant document is filed. The foreign private issuer may not update the required audited annual financial statements with any audited interim financial statements for a more recent period. It may, however, update its audited financial statements covering a period of less than one year to satisfy the 12-month requirement.

The effect of the 15-month and 12-month requirements may be to prevent some foreign private issuers from making a securities offering or achieving a U.S. listing at certain times of the year. For example, a foreign private issuer that ordinarily makes its audited calendar-year financial statements available in April of the following year may be prevented from making an SEC-registered public offering after March 31 and until its audited financial statements for the past fiscal year become available. The SEC has stated that it believes that the 15-month requirement is consistent with the requirements in other countries and that it will not present an undue burden on foreign private issuers.

If the foreign private issuer is making its initial public offering (and it is not public in any jurisdiction), where the twelve-month period would therefore apply in addition to the requirement that the audited annual financial statements be no more than 15 months old at the time of effectiveness of a registration statement, the issuer may request the SEC to waive the 12-month requirement if the issuer can adequately represent that it is not required to comply with the 12-month requirement in any other jurisdiction outside the United States and that to do so would be impracticable or involve undue hardship. The issuer should make the waiver request at

[13] The SEC has indicated that the circumstances in which the SEC would accept an audit report containing a disclaimer or qualification are extremely limited. If an issuer plans to submit this type of report, it should contact and discuss the report with the SEC accounting staff well in advance of the filing.

[14] See SEC Release No. 33-8879 (Dec. 21, 2007) (http://www.sec.gov/rules/final/2007/33-8879.pdf).

[15] 18 months in the case of securities offered upon the exercise of outstanding rights granted to securityholders, a dividend or interest reinvestment plan or upon the conversion of outstanding convertible securities or exercise of outstanding transferable warrants.

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the time of filing its initial registration statement or submitting the initial confidential draft when it knows that a waiver will be necessary prior to effectiveness of its registration statement. The SEC staff has stated that they expect the vast majority of IPOs to be subject only to the 15-month rule. The only times that they anticipate audited financial statements will be filed under the 12-month rule are when the issuer must comply with the rule in another jurisdiction, or when those audited financial statements are otherwise readily available. If the 12-month audit is waived in a filed registration statement, the issuer must file this representation as an exhibit to its registration statement.

If Form 20-F or the 1933 Act registration statement is dated more than nine months[16] after the end of the last audited fiscal year, it must contain consolidated interim financial statements, which may be unaudited (in which case that fact should be stated), covering at least the first six months of the financial year. The interim financial statements should include a balance sheet, income statement, cash flow statement, and statement showing either (i) changes in equity other than those arising from capital transactions with owners and distributions to owners or (ii) all changes in equity (including a subtotal of all non-owner items recognized directly in equity). Each of these statements may be in condensed form as long as it contains the major line items from the latest audited financial statements and includes the major components of assets, liabilities and equity (in the case of the balance sheet); income and expenses (in the case of the income statement) and the major subtotals of cash flows (in the case of the cash flow statement). The interim financial statements should include comparative statements for the same period in the prior financial year, except that the requirement for comparative balance sheet information may be satisfied by presenting the year end balance sheet. If not included in the primary financial statements, a note should be provided to analyze the changes in each caption of shareholders' equity presented in the balance sheet. The interim financial statements should include selected note disclosures that will provide an explanation of events and changes that are significant to an understanding of the changes in financial position and performance of the enterprise since the last annual reporting date.

The immediately preceding paragraph does not apply, however, if Form 20-F is being used only as an annual report under the 1934 Act.

If, at the date of the document, the issuer has published interim financial information that covers a more current period than those otherwise required by this Item 8, the more current interim financial information must be included in the document. This requirement covers any publication of financial information that includes, at a minimum, revenue and income information, even if that information is not published as part of a complete set of financial statements. When such more current interim financial information is provided, unless the issuer prepares its annual financial statements in accordance with IFRS as issued by the IASB, the issuer must also (i) describe any ways in which the accounting principles, practices and methods used in preparing such more current interim financial information vary materially from U.S. GAAP, and (ii) quantify any material variations if they are not already quantified in other financial statements included in the document. In addition, interim financial statements prepared

[16] 12 months in the case of securities offered upon the exercise of outstanding rights granted to securityholders, a dividend or interest reinvestment plan or upon the conversion of outstanding convertible securities or exercise of outstanding transferable warrants.

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in compliance with International Accounting Standard No. 34 “Interim Financial Reporting” (“IAS 34”) by a foreign private issuer that prepares its annual financial statements in accordance with IFRS as issued by the IASB are acceptable for Item 8 purposes so long as the issuer explicitly confirms such compliance with IAS 34 in the notes to such interim financial statements. Issuers are encouraged, but not required, to have any interim financial statements in the document reviewed by an independent auditor. If such a review has been performed and is referred to in the document, a copy of the auditor’s interim review report must be included in the document.

Other Financial Information

If export sales are a significant portion of the issuer’s total sales volume, it must provide the total amount of export sales and the percentage and amount of export sales in the total amount of sales volume. It must also provide information on any legal or arbitration proceedings that may have, or that in the recent past may have had, significant effects on the issuer’s financial position or profitability. This includes governmental proceedings pending or known to be contemplated. If Form 20-F is used as an annual report, the issuer must also describe the disposition of any previously reported litigation that occurred during the last fiscal year. The issuer must also describe its policy on dividend distributions.

Significant Changes

The issuer must disclose whether or not any significant change has occurred since the date of the annual or interim financial statements included in the document.

Item 9: The Offer and Listing

Item 9 of Form 20-F is intended to provide information regarding the issuer’s offering or listing of its securities, the plan for distribution of the securities and related matters.

Offer and Listing Details

The issuer must disclose the expected price of the securities to be offered or the method of determining the price and the amount of any expenses to be charged to the purchaser. If there is not an established market for the securities, the document must contain information regarding the manner of determination of the offering price as well as of the exercise price of warrants and the conversion price of convertible securities, including who established the price, who is formally responsible for the determination of the price, the various factors considered in such determination and the parameters or elements used as a basis for establishing the price. If the issuer’s shareholders have pre-emptive purchase rights and where the exercise of the right of pre-emption of shareholders is restricted or withdrawn, the issuer must indicate the basis for the issue price if the issue is for cash, together with the reasons for such restriction or withdrawal and the beneficiaries of such restriction or withdrawal if intended to benefit specific persons.

The immediately preceding paragraph does not apply, however, if Form 20-F is being used only as an annual report under the 1934 Act or as a registration statement under the 1934 Act.

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The document must contain information regarding the price history of the stock to be offered or listed, including the annual high and low market prices for the five most recent full financial years; the high and low market prices for each full financial quarter in the two most recent full financial years and any subsequent period; the high and low market prices for each month for the most recent six months; and for pre-emptive issues, that is, offerings made to the issuer's existing shareholders in order to permit them to exercise their pre-emptive purchase rights to maintain their *pro rata* ownership in the issuer, the market prices for the first trading day in the most recent six months, for the last trading day before the announcement of the offering and (if different) for the latest practicable date prior to publication of the document. Information must be given with respect to the market price in the U.S. market and the principal trading market outside the U.S. market. If significant trading suspensions occurred in the prior three years, they must be disclosed. If the securities are not regularly traded in an organized market, information must be given about any lack of liquidity.

The issuer must disclose the type and class of the securities being offered or listed, indicate whether the shares are registered shares or bearer shares and provide the number of shares to be issued and to be made available to the market for each kind of share. The nominal par or equivalent value should be given on a per share basis and, where applicable, a statement of the minimum offer price. The document must describe the coupons attached, if applicable, and the arrangements for transfer and any restrictions on the free transferability of the shares. If the rights evidenced by the securities being offered or listed are or may be materially limited or qualified by the rights evidenced by any other class of securities or by the provisions of any contract or other documents, the issuer must disclose such limitation or qualification and its effect on the rights evidenced by the securities to be listed or offered. With respect to securities other than common or ordinary shares to be listed or offered, the issuer must describe the rights and any other material terms of such securities.

The immediately preceding paragraph does not apply, however, if Form 20-F is being used only as an annual report under the 1934 Act.

Plan of Distribution

The document must set forth the names and addresses of the lead underwriters and the names of the other underwriters, certain background information on recently-organized underwriters, any material relationship between the issuer and any underwriter or financial adviser, the nature of the underwriting commitment (*e.g.*, whether firm commitment or best efforts) and whether, to the extent known to the issuer, any major shareholders, directors or members of the issuer's management, supervisory or administrative bodies intend to subscribe in the offering, or whether any person intends to subscribe for more than 5% of the offering.

The document must also identify any group of targeted potential investors to whom the securities are being offered and must describe any arrangements for offering tranches to investors in particular countries or for allocating securities to any group of targeted potential investors, such as offerings made to existing shareholders, or securities reserved for sale under so-called "friends and family programs" to directors, officers, present and past employees of the issuer or its subsidiaries, business associates and related persons.

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Overallotment arrangements must also be described, along with arrangements for sales through brokers or dealers, and contemporaneous offerings of securities of the same class. If any securities are to be offered other than through underwriters, the document should indicate the amount and detail the plan of distribution. If the securities are to be offered through the selling efforts of brokers or dealers, the document should describe the plan of distribution and the terms of any agreement or understanding with such entities. If known, the issuer should identify the brokers and or dealers that will participate and the amount to be offered through each. If the securities are to be offered in connection with the writing of exchange-traded call options, the document should describe briefly such transactions. If, simultaneously or almost simultaneously with the creation of shares for which admission to official listing is being sought, shares of the same class are subscribed for or placed privately, or if shares of other classes are created for public or private placing, details must be given of the nature of such operations and of the number and characteristics of the shares to which they relate. Unless otherwise described under Item 10 relating to material contracts, the document should describe the features of the underwriting relationship together with the amount of securities being underwritten by each underwriter in privity of contract with the issuer or selling shareholders. This disclosure also should include a statement as to whether the underwriters are or will be committed to take and to pay for all of the securities if any are taken, or whether it is an agency or the type of "best efforts" arrangement under which the underwriters are required to take and to pay for only such securities as they may sell to the public. If any underwriter or other financial adviser has a material relationship with the issuer, the document should describe the nature and terms of such relationship.

Plan of distribution information need not be included if Form 20-F is being used only as an annual report under the 1934 Act or a registration statement under the 1934 Act.

Markets

The issuer must disclose all stock exchanges and other regulated markets on which the securities to be offered or listed are traded. When an application for admission to any exchange and/or regulated market is being or will be sought, this must be mentioned, without creating the impression that the listing necessarily will be approved. If known, the document should also disclose the dates on which the shares will be listed and dealt in.

Selling Shareholders

The issuer must provide the name and address of any selling shareholders and, the nature of any position, office or other material relationship that the selling shareholder has had within the past three years with the issuer or any of its predecessors or affiliates. The document must include the number and class of securities being offered by each of the selling shareholders, and the percentage of the existing equity capital. It also should specify the amount and percentage of the securities for each particular type of securities beneficially held by the selling shareholders before and immediately after the offering.

This sub-item does not apply, however, if Form 20-F is being used only as an annual report under the 1934 Act or a registration statement under the 1934 Act.

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Dilution

If there is a substantial disparity between the public offering price and the effective cash cost of securities issued during the past five years to directors or senior management or affiliates or that such directors, management members or affiliates have the right to purchase, the document must compare the cash contributions by the public and such other persons. The document must also disclose the amount and percentage of immediate dilution resulting from the offering by disclosing the difference between the offering price per share and the net book value per share for the equivalent class of security, as of the latest balance sheet date.

This sub-item does not apply, however, if Form 20-F is being used only as an annual report under the 1934 Act or a registration statement under the 1934 Act.

Expenses of the Issue

The issuer must disclose the total amount of discounts or commissions to be paid to underwriters or other placement or selling agents, the percentage such total discounts or commissions represent with respect to the total amount of the offering, and the amount of discounts or commissions on a per-share basis. It must also provide a reasonably itemized statement of the major categories of expenses incurred in connection with the offering and a statement as to who will pay such expenses, if other than the issuer. Major categories of expenses include: registration fees, taxes and surcharges, trustees' and transfer agents' fees, printing and engraving costs, legal fees, accounting fees, engineering fees, and any premiums paid to insure directors or officers for liabilities, each in connection with the registration, offer or sale of the securities being registered. If any of the securities are to be offered for the account of a selling shareholder, the document must indicate the portion of expenses to be borne by such shareholder. If the amounts of any items are not known, the issuer may provide estimates and identify them as such.

This sub-item does not apply, however, if Form 20-F is being used only as an annual report under the 1934 Act or registration statements under the 1934 Act.

Item 10: Additional Information

Item 10 of Form 20-F is intended to provide information on certain legal and other matters.

Share Capital

Item 10 requires information on the issuer's authorized and issued share capital, shares issued and paid versus not fully paid, par value per share or that the shares have no par value and a reconciliation of the number of shares outstanding at the beginning and end of the year. The document must disclose if more than 10% of capital has been paid for with assets other than cash within the past five years. If there are shares not representing capital, the number and main characteristics of such shares must be disclosed. The document must indicate the number, book value and face value of shares in the issuer held by or on behalf of the issuer itself or by subsidiaries of the issuer. Where there is authorized but unissued capital or an undertaking to increase the capital, for example, in connection with warrants, convertible obligations or other

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outstanding equity-linked securities, or subscription rights granted, the document should indicate:

- the amount of outstanding equity-linked securities and of such authorized capital or capital increase and, where appropriate, the duration of the authorization;
- the categories of persons having preferential subscription rights for such additional portions of capital; and
- the terms, arrangements and procedures for the share issue corresponding to such portions.

The document should also disclose the persons to whom any capital of the issuer or any of its subsidiaries is under option or agreed conditionally or unconditionally to be put under option, including the title and amount of securities covered by the options; the exercise price; the purchase price, if any; and the expiration date of the options, or an appropriate negative statement. Where options have been granted or agreed to be granted to all the holders of shares or debt securities, or of any class thereof, or to employees under an employees' share scheme, it will be sufficient to disclose that fact without giving names.

The issuer must also provide a history of its share capital for the last three years, identifying the events during such period which have changed the amount of the issued capital and/or the number and classes of shares of which it is composed, together with a description of changes in voting rights attached to the various classes during that time. The issuer will need to provide details regarding the price and terms of any issue, including the particulars of consideration if such consideration was other than cash (or, if there are no such issues, provide an appropriate negative statement to that effect). The issuer must also provide the reason for any reduction of the amount of capital and the ratio of any capital reductions.

Finally, the issuer will need to provide an indication of the resolutions, authorizations and approvals by virtue of which the shares have been or will be created and/or issued, the nature of the issue and amount thereof and the number of shares which have or will be created and/or issued, if predetermined.

Share capital information need not be provided if Form 20-F is being used only as an annual report under the 1934 Act or as a registration statement under the 1934 Act that relates to securities other than common equity.

Memorandum and Articles of Association

The issuer must indicate the register and entry number therein (if applicable), information about its objects and purposes as a company and where this information can be located in its organizational documents, as well as where those organizational documents are located. The issuer must also describe the relative rights and powers under its organizational documents of the issuer's directors and shareholders (by class, if applicable), and, to the extent that these rights and powers differ significantly from the distribution of rights and powers in U.S. corporations, the effect of such differences.

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Material Contracts

Item 10 also requires a summary of each material contract not entered into in the ordinary course of business by the issuer or any of its subsidiaries for the two years immediately preceding publication of the document. The summary of each material contract should include its date, parties, general nature, terms and conditions, and the amount of any consideration passing to or from the issuer or any of its subsidiaries.[17]

Item 19 of Form 20-F, which is described below, sets forth the requirements for filing material contracts as an exhibit to Form 20-F.

Other Information

In addition, Item 10 requires a discussion of home country exchange controls laws (affecting the import or export of capital, remittance of dividends, interest or other payments to non-resident holders of the issuer's securities), home country tax laws (insofar as these may affect shareholders in the United States), a discussion of applicable tax treaties, a discussion of whether the issuer assumes the responsibility for the withholding of tax at the source, a disclosure of dividend restrictions and the date on which the entitlement to dividends arises, if known, and any procedures for non-resident holders to claim dividends, and the identification of paying agents,[18] the names and qualifications of experts whose statements or reports are included in the document,[19] and an identification of the place where documents concerning the issuer that are mentioned in the Form 20-F document may be inspected. Such documents should be translated into English, or a summary in English should be provided.

See *Accessing the U.S. Capital Markets – Securities Products* for a further discussion of disclosure requirements relating to tax matters.

Item 11: Quantitative and Qualitative Disclosures About Market Risk

Item 11 of Form 20-F is intended to clarify the issuer's exposures to market risk associated with its market risk sensitive instruments, such as derivative financial instruments, other financial instruments and derivative commodity instruments. For each category of market risk sensitive instruments, the issuer must distinguish between instruments entered into for "trading purposes," as defined by U.S. GAAP, and instruments entered into for other purposes. The issuer must then make a materiality assessment for each of its market risk exposure categories (including interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market risks, such as equity price risk) within its trading and other than trading portfolios.

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[17] For guidance as to what constitutes a material contract, see the discussion in this chapter below under "—Disclosure Requirements for 'F' Form Issuers—Item 19: Exhibits."

[18] Dividend and paying agent information need not be provided if Form 20-F is being used only as an annual report under the 1934 Act or as a registration statement under the 1934 Act that relates to securities other than common equity.

[19] Expert statement information need not be provided if Form 20-F is being used only as an annual report under the 1934 Act.

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Derivative financial instruments and other financial instruments are each, except as described below, as defined in U.S. GAAP. Derivative financial instruments generally include futures, forwards, swaps, options, and other financial instruments with similar characteristics. Other financial instruments generally include various debt obligations, such as certain trade accounts receivable, investments, loans, structured notes, mortgage-backed securities, trade accounts payable, indexed debt instruments, interest-only and principal-only obligations, deposits, and financial instruments that are not derivative financial instruments and are required by U.S. GAAP to disclose fair value. Derivative commodity instruments include commodity futures, commodity forwards, commodity swaps, commodity options, and other commodity instruments with similar characteristics that are not derivative financial instruments and are permitted by contract or business custom to be settled in cash or with another financial instrument.

For purposes of making the materiality assessment, the issuer must evaluate the materiality of the fair values of its market risk sensitive instruments outstanding as of the end of the latest fiscal year and the materiality of potential near-term losses in future earnings, fair values and cash flows from reasonably possible near-term changes in market rates or prices. ("Near-term" means up to one year from the date of the financial statements.) If either determination is material, the issuer must disclose quantitative and qualitative information about market risk if such market risk for the particular market risk exposure category is material. Except as discussed below, issuers generally should not net fair values unless allowed under U.S. GAAP. For example, the fair value of assets generally should not be netted with the fair value of liabilities.

In making a materiality assessment, issuers should consider the magnitude of past market movements, reasonably possible near-term market movements and potential losses that may arise from leverage, option and multiplier features.

Notwithstanding the foregoing, as a result of the acceptance by the SEC of filings of financial statements of foreign private issuers prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP, a foreign private issuer filing financial statements that comply with IFRS as issued by the IASB, in responding to Item 11 disclosure requirements, need not repeat information contained in its financial statements that comply with IFRS as issued by the IASB and should instead provide disclosure that satisfies the objective of the Item 11 disclosure requirements.

Quantitative Information

The issuer is required to provide, in its reporting currency, quantitative information about market risk as of the end of its latest fiscal year. The issuer must categorize market risk sensitive instruments into (a) instruments entered into for trading purposes and (b) instruments entered into for purposes other than trading purposes. Within each category, the issuer must present separate quantitative information, to the extent material, for each market risk exposure category (*i.e.*, interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market risks, such as equity price risk).

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In presenting the required quantitative information, the issuer may use any of the following three disclosure alternatives:

- A tabular presentation that includes fair values of the issuer's market risk sensitive instruments and information about contract terms sufficient to determine future cash flows from those instruments for at least each of the next five years, categorized by expected maturity dates. Market risk sensitive instruments exposed to rate or price changes in more than one market risk exposure category should be presented in tabular form within each such risk exposure category.

- Sensitivity analysis disclosure that expresses the potential loss in future earnings, fair values or cash flows of market risk sensitive instruments resulting from one or more selected hypothetical changes in interest rates, foreign currency exchange rates, commodity prices, and other relevant market rates or prices over a selected period of time. The hypothetical changes in market rates or prices selected should reflect reasonably possible near-term changes in those rates and prices. Absent economic justification for the selection of a different amount, such near-term changes should not be less than 10% of the period-end market rates or prices. In determining the average, high and low amounts for the sensitivity analysis with respect to any fiscal year during the selected period of time, the issuer should use at least four equal time periods for the fiscal year, such as four quarter-end amounts, 12 month-end amounts, or 52 week-end amounts. The SEC's instructions encourage, but do not require, the issuer to provide quantitative amounts that reflect the aggregate market risk inherent in its two portfolios of market risk sensitive instruments, the for-trading portfolio and for-other-than-trading portfolio, when it uses the sensitivity analysis alternative.

- Value-at-risk disclosure that expresses the potential loss in future earnings, fair values or cash flows of market risk sensitive instruments over a selected period of time, with a selected likelihood of occurrence, from changes in interest rates, foreign currency exchange rates, commodity prices, and other relevant market rates or prices. The SEC's instructions specify that the issuer must select confidence levels that reflect reasonably possible near-term (up to one year from the date of the financial statements) changes in market rates and prices and that, absent economic justification for the selection of different confidence intervals, issuers should use intervals that are 95% or higher. Similar to the sensitivity analysis, when determining the average, high and low amounts for the value-at-risk disclosure with respect to any fiscal year during the selected period of time, the issuer should use at least four equal time periods for the fiscal year, such as four quarter-end amounts, 12 month-end amounts, or 52 week-end amounts. Also, the SEC's instructions encourage, but do not require, the issuer to provide quantitative amounts that reflect the aggregate market risk inherent in its two portfolios of market risk sensitive instruments, those entered into for trading purposes and those entered into for other purposes, when it uses the value-at-risk disclosure alternative.

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Whichever disclosure alternative the issuer chooses, it must include such information about its model, assumptions and parameters as is sufficient for an understanding of the disclosures. The SEC's instructions suggest that such additional information might include the type of model employed, a general description of the modeling technique employed (including how loss is defined by the model), the types of instruments covered by the model and whether other instruments are voluntarily included, and other relevant information (*e.g.*, holding periods, confidence levels, the magnitude and timing of selected hypothetical changes in market rates or prices, the method by which discount rates are determined and key prepayment or reinvestment assumptions).

The issuer must also discuss material limitations that may cause the disclosed information not to reflect fully its net market risk exposures, such as exclusion of certain market risk sensitive instruments, positions and transactions from the disclosure and the inability to make full disclosure of the market risk inherent in instruments with leverage, option, or prepayment features.

Qualitative Information

To the extent material, the issuer should describe its primary market risk exposures and how they are managed.

Primary market risk exposures include interest rate risk, foreign currency exchange rate risk, commodity price risk and other relevant market rate or price risks and, within each of these categories, the particular markets that present the primary risk of loss to the issuer.

The description of how these risks are managed should include, but not be limited to, a discussion of the issuer's objectives, general strategies and instruments (if any) used for this purpose. Information must be presented separately for market risk sensitive instruments entered into for trading purposes and those entered into for other purposes.

Voluntary Disclosures

Issuers are encouraged to go beyond the required disclosure under Item 11 by including instruments, positions and transactions (*e.g.*, commodity positions, derivative commodity instruments not subject to cash settlement, and cash flows from anticipated transactions) as to which disclosure is not required. Issuers who do so and who select the sensitivity analysis or value-at-risk disclosure alternatives will be permitted to present comprehensive market risk disclosures that reflect the combined market risk exposures inherent in both the required and voluntarily selected instruments, positions or transactions.

If the issuer elects to include voluntarily a particular type of instrument, position or transaction in its quantitative disclosures about market risk, it should include all, rather than some, of those instruments, positions or transactions within such disclosures.

Interim Periods

If the document includes interim period financial statements, the issuer must include a discussion and analysis sufficient to enable the reader to assess the sources and effects of

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material changes in the Item 11 information from the end of the preceding fiscal year to the date of the most recent interim balance sheet.

Safe Harbor

The SEC's instructions remind issuers that the statutory "safe harbors" apply to disclosures made under Item 11, all of which are considered to be "forward-looking statements" except for historical facts such as the terms of particular contracts and the number of market risk sensitive instruments held at particular times.

Item 12: Description of Securities Other than Equity Securities

Item 12 of Form 20-F requires information about the securities (other than equity securities, but including American Depositary Shares ("ADSs")) to be disclosed. [20]

Debt Securities

The issuer must provide information about interest, conversions, maturity, redemption, amortization, sinking funds or retirement, the kind and priority of any lien securing the securities (and a brief description of the principal properties subject to such lien), any subordination to other securities or creditors (including the amount of senior indebtedness as of the most recent practicable date and any limitations on the issuance of additional senior indebtedness), information about restrictions on the payment of dividends or the issuance of additional securities, withdrawal of cash deposited against the issuance of additional securities, the incurrence of additional debt, the release or substitution of assets securing the issue, the modification of the terms of the security and similar provisions, the type of event that constitutes a default and the consequences thereof, whether and how the terms of the securities may be modified, any law or decree determining the extent to which the securities may be serviced, the effects of other outstanding securities, the tax effects of any original issue discount, information about the trustee and paying agents, and the currency or currencies in which the securities are payable. The disclosure must include consequences of any failure to pay principal, interest, or any sinking or amortization installment and, if the securities are guaranteed, the name of the guarantor and a brief outline of the guarantee.

If the securities are convertible securities or stock purchase warrants subject to redemption or call, the issuer must describe whether holders will forfeit their right to convert or purchase the securities unless they exercise that right before the specified date in the notice of redemption or call, the expiration or termination date of the warrants, and how the issuer will provide notice of a redemption or call.

[20] See further discussion on ADSs in this chapter below under the heading "—Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 12: Description of Securities Other than Equity Securities—American Depositary Shares" and in *Accessing the U.S. Capital Markets – Securities Products*.

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Warrants and Rights

The issuer must provide information about the securities obtainable upon exercise of the warrants or rights, the period during which the warrants or rights are exercisable, the amount of warrants or rights outstanding, provisions for changes or adjustments in the exercise price, and any other material terms of the warrants or rights.

Other Securities

If the issuer is registering securities other than equity, debt, warrants or rights, briefly describe the rights evidenced by the securities being registered. The description should be comparable in detail to the description an issuer would be required to provide for equity, debt, warrants or rights.

American Depositary Shares

The issuer must provide information about the depositary (including its name and address), the title of the receipts and identify the deposited security, the amount of deposited securities represented by one ADS, procedures for voting, collecting and distributing dividends, transmitting notices, reports and proxy soliciting materials, the sale or exercise of rights, the deposit or sale of securities resulting from dividends, splits or reorganizations, the amendment, extension or termination of the deposit arrangements, any rights of holders of ADSs to inspect the depositary's books, any limitation on the depositary's liability and any restrictions on the right to withdraw or transfer the underlying securities.

The issuer must disclose all fees and charges that a holder of ADSs may have to pay, either directly or indirectly, including fees or charges in connection with (a) depositing or substituting the underlying shares; (b) receiving or distributing dividends; (c) selling or exercising rights; (d) withdrawing an underlying security; and (e) transferring, splitting or grouping ADRs that evidence the ADSs. The document should also indicate the type of services that the depositary will provide to the ADS holders.

Annual Disclosure About ADR Fees and Payments

Beginning with their first fiscal year ending on or after December 15, 2009, an issuer is expected to disclose fees and other charges paid to depositaries in connection with ADR facilities in their annual reports on Form 20-F.[21] In addition, an issuer will be required to disclose payments it has received from a depositary in connection with its ADR facility. These changes apply to registration statements on Form 20-F filed for the deposited securities as well as in the annual reports for sponsored ADR facilities, and were adopted with the thought that ADR holders would benefit from enhanced disclosure in light of depositary fees that are being charged to ADR holders in connection with sponsored ADR facilities. Although fees are disclosed in the

[21] See SEC Release No. 33-8959 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf).

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ADR itself, most ADR holders purchase their ADRs in book-entry form and never see that particular disclosure on the physical certificate.[22]

Item 12 is not applicable if Form 20-F is being used only as an annual report under the 1934 Act, although, as noted above, certain disclosure will be required for fiscal years ending on or after December 15, 2009.

Item 13: Defaults, Dividend Arrearages and Delinquencies

Item 13 of Form 20-F requires disclosure about material defaults on any payment on indebtedness or preferred stock of the issuer or its significant subsidiaries (including a dividend payment on preferred stock) not cured within 30 days. If the amount of indebtedness subject to such default exceeds 5% of total consolidated assets, the issuer must identify such indebtedness and disclose the nature of the default.

Item 14: Material Modifications to Rights of Securityholders and Use of Proceeds

Item 14 of Form 20-F requires disclosure about a material modification to the rights of the holders of the issuer's securities registered with the SEC, including material modifications and qualifications of such rights as a result of the issuance of any other class of securities or the modification of the rights of such other class of securities. The issuer must also disclose any withdrawal or substitution of any material assets securing any class of its SEC-registered securities unless such withdrawal or substitution is pursuant to the terms of an indenture qualified under the 1939 Act. If the trustees or paying agents for any SEC-registered securities have changed during the last financial year, the issuer should also disclose the names and addresses of the new trustees or paying agents.

It also requires an issuer that has made its first SEC-registered public offering to furnish information about that offering, including its use of the proceeds of the offering. The issuer must report its actual use of its net proceeds from the offering in its first Form 20-F annual report and in each subsequent Form 20-F annual report until the issuer has disclosed its application of all its net offering proceeds (unless the offering has been terminated). The reporting of such uses should specify any purposes for which at least 5% of the issuer's total offering proceeds or U.S.$100,000 (whichever is less) has been used. Reasonable estimates are allowed instead of the actual amount of net offering proceeds used. If the use of proceeds as disclosed in Item 14 represents a material change in the use of proceeds described in the prospectus, the issuer should also describe briefly the material change.

Item 15: Controls and Procedures

As a result of Sarbanes-Oxley, Item 15 requires disclosure of the conclusions of the foreign private issuer's principal executive and principal financial officer regarding the

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[22] Most of these fees are already disclosed in the deposit agreement, in the Form F-6 registration statement filed to register the ADRs with the SEC under the 1933 Act, as well as in the registration statement that is filed with the SEC to register the underlying securities under the 1933 Act, but the SEC concluded that these and other ADR fees are significant enough to warrant enhanced transparency to investors on an annual basis.

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effectiveness of the issuer's "disclosure controls and procedures" as of the end of the period covered by the report. "Disclosure controls and procedures" are defined as those controls and other procedures that are designed to ensure that information required to be disclosed under SEC rules is recorded, processed, summarized and reported on a timely basis. The relevant controls and procedures include those that are designed to ensure that information is accumulated and communicated to the issuer's management on a timely basis. In the case of a foreign private issuer, management's conclusions about disclosure controls and procedures must be based on an evaluation process that involves the issuer's principal executive and financial officers.

Item 15 also requires a report of management regarding its responsibility for establishing and maintaining adequate "internal control" over financial reporting for the issuer, including a statement identifying the framework used by management to evaluate the effectiveness of such internal control and management's assessment of the effectiveness of such control.[23] "Internal control" over financial reporting is defined as a process designed by (or under the supervision of) the principal executive and financial officers and effected by the issuer's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes. It includes policies and procedures relating to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the issuer's assets, provide reasonable assurance regarding the authorization and recording of transactions as necessary to permit the preparation of financial statements and provide reasonable assurance regarding prevention or timely detection of unauthorized uses of the issuer's assets. The assessment of management should also disclose and discuss any material weakness in the issuer's internal control over financial reporting identified by management. Management may not conclude that the issuer's internal control over financial reporting is effective if there are one or more material weaknesses in its internal control over financial reporting.

The internal control report of management to be included in the Form 20-F annual report must contain:

- a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the issuer;
- a statement identifying the framework used by management to evaluate the effectiveness of internal control over financial reporting;
- management's assessment of the effectiveness of the internal control over financial reporting as of the end of the issuer's most recent fiscal year, including a statement as to whether internal control over financial reporting is effective and disclosure of any material weakness in the issuer's internal control over financial reporting identified by management; and

[23] Further discussion of "internal control" over financial reporting and management's obligations with respect thereto is contained under the heading "Sarbanes-Oxley—Disclosure and Related Requirements—Disclosure Certification, Controls and Procedures" in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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- a statement that the registered public accounting firm that audited the financial statements included in the Form 10-K, 20-F or 40-F has issued an attestation report on management's assessment of the issuer's internal control over financial reporting.[24]

The issuer's registered public accounting firm must provide an independent opinion on the effectiveness of the issuer's internal control over financial reporting. Where Form 20-F is being used as an annual report under the 1934 Act, the registered public accounting firm's report on the issuer's internal control over financial reporting must be included in the issuer's annual report containing the disclosure required by Item 15. The issuer must also disclose any change in the issuer's control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting. U.S. private issuers are required to report changes in their internal controls over financial reporting on a quarterly basis, rather than on the annual basis required for foreign private issuers.

Due to the complexity involved in compliance, and the time needed by issuers and auditors to be ready to comply, with the Sarbanes-Oxley requirement for management's assessment of the effectiveness of the internal control over financial reporting and the related report of the public accounting firm, the SEC postponed the compliance dates for smaller foreign private issuers. Form 20-F currently requires:

- a foreign private issuer that is an "accelerated filer" but not a "large accelerated filer" to file its auditor's attestation report on internal control over financial reporting with respect to its annual report for fiscal years ending on or after July 15, 2007; and

- a foreign private issuer that is neither a "large accelerated filer" nor an "accelerated filer" to file its auditor's attestation report on internal control over financial reporting with respect to its annual report for fiscal years ending on or after December 15, 2009.

Form 20-F also provides some transitional relief to newly-public issuers so that they need not include the reports of management's assessment regarding their internal control over financial reporting, nor the reports of their registered public accounting firms until they either had been required to file an annual report pursuant to the 1934 Act for the prior fiscal year or had filed an annual report with the SEC for the prior fiscal year.

The SEC has also established a special temporary Item 15T, subject to expiration on June 30, 2010, applicable to those above-mentioned smaller foreign private issuers prior to the arrival of their respective compliance dates. During this interim period, such a foreign private issuer should provide a report of management on its internal control over financial reporting in its Form 20-F annual report, but such management report will not be deemed "filed" for purposes of Section 18 of the 1934 Act or otherwise subject to the liabilities of that section. Also, the issuer

[24] See SEC Release No. 33-8238 (June 5, 2003) (http://www.sec.gov/rules/final/33-8238.htm).

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is not required during this interim period to include the report of its registered public accounting firm regarding internal control over financial reporting.

It should be noted that an issuer is required to maintain evidential materials, including documentation, to provide reasonable support for management's assessment of internal control effectiveness.

Items 15 and 15T do not apply if Form 20-F is being used only as a registration statement under the 1933 Act or as a registration statement under the 1934 Act.

Item 16A: Audit Committee Financial Expert

Responding to another requirement of Sarbanes-Oxley, Item 16A of Form 20-F requires that an issuer disclose whether its board of directors has determined that it has at least one "audit committee financial expert" serving on its audit committee. If so, it must disclose the name of the audit committee financial expert and whether that person is "independent." If not, the issuer must disclose why it does not have such a person on its audit committee. The standard of audit committee financial expert independence is contained in the listing standards applicable to the issuer if it is a listed issuer. If the issuer is not a listed issuer, it must use the definition of audit committee member independence of a U.S. national securities exchange, each as registered pursuant to the 1934 Act and approved by the SEC. The issuer must disclose the standard used in determining such independent status.[25]

Some foreign private issuers have a "two-tier" board of directors in accordance with the legal or listing requirements of their home jurisdictions. For purposes of Item 16A, the term "board of directors" means the supervisory or non-management board. Some foreign private issuers have a board of auditors or statutory auditors either separate from its board of directors or composed of one or more members of the board of directors and one or more members that are not also members of the board of directors, as contemplated in Rule 10A-3(c)(3) under the 1934 Act; in these cases, for purposes of Item 16A, the term "board of directors" means such board of auditors or statutory auditors.

Item 16A does not apply if Form 20-F is being used only as a registration statement under the 1933 Act or as a registration statement under the 1934 Act.

Item 16B: Code of Ethics

Responding to another requirement of Sarbanes-Oxley, Item 16B of Form 20-F requires that an issuer disclose whether it has adopted a code of ethics for its principal executive, financial and accounting officers (and if not, why not). Such a "code of ethics" serves as a written set of standards designed by the issuer to deter wrongdoing. The contents of a "code of ethics" as set forth in Item 16B include standards reasonably designed to deter wrongdoing and to promote:

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[25] For the qualifications an "audit committee financial expert" must have, see the discussion under the heading "Sarbanes-Oxley—Disclosure and Related Requirements—Disclosure of Financial Experts on the Audit Committee" in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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- honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- full, fair, accurate, timely and understandable disclosure in reports and documents that the issuer files with, or submits to, the SEC and in other public communications made by the issuer;
- compliance with applicable governmental laws, rules and regulations;
- prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and
- accountability for adherence to the code.

The code and any amendments or waivers must be filed with the SEC as an exhibit to Form 20-F and posted on the issuer's Internet web site. Only substantive (rather than technical or administrative) amendments to the code need be disclosed. Waivers include explicit approvals by the issuer of a material departure from a provision of the code as well as "implicit waivers" in the form of failures by the issuer to take action within a reasonable period of time regarding a material departure from a provision of the code that has been made known to an executive officer of the issuer.

Item 16B does not apply if Form 20-F is being used only as a registration statement under the 1933 Act or a registration statement under the 1934 Act.

Item 16C: Principal Accountant Fees and Services

A foreign private issuer must provide specified information regarding the fees paid to its principal public accountant, broken down by "audit fees," "audit-related fees," "tax fees" and "all other fees." It must also disclose its audit committee's pre-approval policies and procedures for audit and non-audit services by the independent public accountant, and the percentage of audit-related, tax and other services approved by the audit committee through waivers of any pre-approval. If greater than 50%, the issuer must disclose the percentage of hours expended on the issuer's principal accountant's engagement to audit the issuer's financial statements for the most recent fiscal year that were attributed to work performed by persons not full-time permanent employees of the principal accountant.

Item 16C does not apply if Form 20-F is being used only as a registration statement under the 1933 Act or a registration statement under the 1934 Act.

Item 16D: Exemptions from Listing Standards for Audit Committees

If the foreign private issuer has relied on any of the exemptions in the SEC's rules regarding the independence of members of audit committees (*e.g.*, service on an audit committee by a non-management employee where required by local law), then the issuer must disclose such reliance under Item 16D of Form 20-F and also assess whether such reliance would materially adversely affect the ability of the audit committee to act independently and satisfy its other obligations.

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Item 16D does not apply if Form 20-F is being used only as a registration statement under the 1933 Act or as a registration statement under the 1934 Act.

Item 16E: Purchases of Equity Securities by Issuer and Affiliated Purchasers

An issuer must provide, in tabular format, information with respect to any purchase made by or on behalf of the issuer or any "affiliated purchaser" of any class of the issuer's equity securities registered by the issuer under Section 12 of the 1934 Act, including the total number of shares purchased, the average price paid per share, the total number of shares purchased as part of publicly announced plans or programs and the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs, each on a monthly basis.

Item 16F: Changes in Issuer's Certifying Accountant

Beginning with their first fiscal year ending on or after December 15, 2009, foreign private issuers are expected to report certain information with respect to any changes in their certifying accountant under this new Item 16F. Among other things, the required disclosure includes information about "opinion shopping" (the search for an auditor who is willing to support a proposed accounting treatment that is designed to help a company achieve its reporting objective despite the fact that the treatment could frustrate reliable reporting standards). Foreign private issuers that are listed on the NYSE are already required to notify the public about a change in their auditors furnished under cover of a Form 6-K periodic report, albeit not with the same substantive disclosure requirements as are currently required by Form 8-K for U.S. issuers. The SEC requires foreign private issuers to include disclosure about changes in their certifying accountants in their annual reports on Form 20-F, as well as in their registration statements filed on Forms 20-F, F-1, F-3 and F-4.[26]

Item 16-F requires a foreign private issuer, among other things, to disclose whether an independent accountant that was previously engaged as the principal accountant to audit the issuer's financials statements, or those of a significant subsidiary on which the accountant expressed reliance in its report, has resigned, declined to stand for re-election, or was dismissed. Item 16-F also requires a foreign private issuer to disclose any disagreements with the former accountant or reportable events that occurred within the issuer's latest two fiscal years and any interim period preceding any change of accountant.

Further, to the extent that during the issuer's latest two fiscal years or any subsequent interim period, a new independent accountant has been engaged by the issuer to audit its financial statements, Item 16F requires the issuer to identify the newly-engaged accountant and indicate the date of engagement. In addition, if the issuer (or someone on its behalf) consulted the newly-engaged accountant with respect to (i) the application of a specified transaction or the type of audit opinion that might be rendered on the issuer's financial statements, and either a written report was provided to the issuer or oral advice was provided that was an important factor considered by the issuer in reaching a decision as to the accounting, auditing or financial reporting issue or (ii) any matter that was either the subject of a disagreement or a reportable event under Item 16F, then the issuer must identify the issues that were the subject of

[26] See supra footnote 21.

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consultation, briefly describe the views of the newly-engaged accountant (and if written views were received by the issuer, file them as an exhibit), state whether the former accountant was engaged as to any such issues (and, if so, provide a summary of the former accountant's views) and request the newly-engaged accountant to review the required disclosure before it is filed.[27] The issuer shall also provide its former accountants with a copy of the disclosure it is making in this regard, and request the former accountant furnish the issuer with a letter addressed to the SEC stating whether it agrees with the statements made by the issuer, and, if not, stating the respects in which it does not agree. The issuer shall file the former accountant's letter as an exhibit.

Item 16F(b) solicits disclosure about the fiscal year in which the change of accountant took place as well as the subsequent fiscal year with regard to whether or not the issuer had any material transactions similar to those which led to the disagreement with the former accountant and whether such transactions were accounted for or disclosed in a manner different from that which the former accountant would have concluded was required. If this is answered in the affirmative, Item 16F(b) requires the issuer to disclose the existence and nature of the disagreement or reportable event, and also to disclose the effect on the financial statements if the method that would have been required by the former accountant had been followed.

The term "disagreements" as used in Item 16F is broadly interpreted to include any difference of opinion concerning any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure which (if not resolved to the satisfaction of the former accountant) would have caused it to make reference to the subject matter of the disagreement in connection with its report. It does not, however, include initial differences of opinion based on incomplete facts or preliminary information that were later resolved to the former accountant's satisfaction by additional relevant facts or information obtained, provided that the issuer and the accountant do not continue to have a difference of opinion with such additional facts or information.

The term "reportable events" as used in Item 16F includes each of the following kinds of events (even though the issuer and the former accountant did not express a difference of opinion regarding the event) that occurred within the issuer's two most recent fiscal years and any subsequent interim period preceding the former accountant's resignation, declination to stand for re-election, or dismissal:

- the accountant's having advised the issuer that the internal controls necessary for the issuer to develop reliable financial statements do not exist;
- the accountant's having advised the issuer that information has come to the accountant's attention that has led it to no longer be able to rely on management's representations, or that has made it unwilling to be associated with the financial statements prepared by management;

[27] The newly-engaged accountant should be provided an opportunity to furnish the issuer with a letter addressed to the SEC containing any new information, clarification of the issuer's expressions of its views or the respects in which it does not agree with the statements made by the issuer. The issuer shall file any such letter as an exhibit.

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- the accountant's having advised the issuer of the need to expand significantly the scope of its audit, or that information has come to the accountant's attention that, if further investigated, may: (i) materially impact the fairness or reliability of a previously issued audit report, the underlying financial statements, or the financial statements issued or to be issued covering the fiscal period(s) subsequent to the date of the most recent financial statements covered by an audit report (including information that may prevent it from rendering an unqualified audit report on those financial statements), or (ii) cause it to be unwilling to rely on management's representations or be associated with the issuer's financial statements; and due to the accountant's resignation (as a result of audit scope limitations or otherwise) or dismissal, or for any other reason, the accountant did not so expand the scope of its audit or conduct such further investigation; or

- the accountant's having advised the issuer that information has come to the accountant's attention that, it has concluded, materially impacts the fairness or reliability of a previously issued audit report, the underlying financial statements, or the financial statements issued or to be issued covering the fiscal period(s) subsequent to the date of the most recent financial statements covered by an audit report (including information that, unless resolved to the accountant's satisfaction, would prevent it from rendering an unqualified audit report on those financial statements) and due to the accountant's resignation, dismissal or declination to stand for re-election, or for any other reason, the issue has not been resolved to the accountant's satisfaction prior to its resignation, dismissal or declination to stand for re-election.

The SEC has acknowledged that this disclosure requirement may require a foreign private issuer to disclose more information about its former auditors than may be required by its home country law, but it is thought that permitting foreign private issuers to prepare and provide the disclosure in their annual reports may reduce the burden of reporting this information.

Item 16F applies if Form 20-F is being used for annual reports under the 1934 Act, registration statements under the 1933 Act or registration statements under the 1934 Act, but, in each case, only for fiscal years ending on or after December 15, 2009.

Item 16G: Corporate Governance

Beginning with their first fiscal year ending on or after December 15, 2008, foreign private issuers that are listed on a U.S. exchange are required to provide a concise summary in their annual reports of the significant ways in which the foreign private issuer's corporate governance practices differ from the corporate governance practices followed by U.S. companies under the relevant exchange's listing standards under this new Item 16G.[28]

This item has been added as the SEC recognizes that foreign private issuers are subject to different legal and regulatory requirements in their home jurisdictions and, as a result, often follow different corporate governance practices from U.S. companies. Many U.S. exchanges

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[28] See supra footnote 21.

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currently exempt listed foreign private issuers from a number of their corporate governance requirements, and instead require these issuers to disclose the significant ways in which their corporate governance practices differ from those followed by U.S. issuers under the relevant exchange's listing standards. The U.S. exchanges typically allow the listed foreign private issuers to provide this information either in their annual report or on their company web site. Item 16G does not have a specified format as the SEC does not want to encourage a tick-the-box approach as to the required disclosure and expects that the disclosure provided in response to Item 16G will be similar, if not the same, as the disclosure that many foreign private issuers currently provide in response to the corporate governance disclosure requirements of the exchange on which their securities are listed.

Like the NYSE, the SEC does not require any foreign private issuer to provide more than a brief and general discussion under Item 16G. It is not anticipating a detailed, item-by-item analysis.

Item 16G does not apply if Form 20-F is being used only as a registration statement under the 1933 Act or as a registration statement under the 1934 Act.

Item 17: Financial Statements

A foreign private issuer's 1933 Act registration statement and each Form 20-F generally must include audited balance sheets as of the end of each of the two most recent fiscal years and audited statements of income and cash flow for each of the three most recent fiscal years. Item 8 of Form 20-F contains additional requirements for the financial information disclosure by foreign private issuers in such documents.

The financial statements must contain information substantially similar to financial statements that comply with U.S. GAAP and with the SEC's Regulation S-X. They may be prepared according to U.S. GAAP, prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP[29] or prepared in accordance with another comprehensive body of accounting principles and reconciled to U.S. GAAP.

If a foreign private issuer chooses to use financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP, the foreign private issuer must declare in the notes to its financial statements that such statements are in compliance with IFRS as issued by the IASB and provide an unqualified auditor's report indicating such compliance. Item 17 also contains a temporary accommodation for issuers incorporated in member states of the European Union ("EU") that have previously filed financial statements with the SEC compiled in accordance with IFRS as issued by the EU, which contain a carve-out to the International Accounting Standard No. 39 "Financial Instruments: Recognition and Measurement" ("IAS 39"). Such an EU issuer may continue to file such financial statements for its first two financial years that end after November 15, 2007 without reconciling to U.S. GAAP if its financial statements, aside from IAS 39, comply with IFRS as issued by the IASB and the issuer provides an audited reconciliation to IFRS as issued by the IASB. All financial statements of such an EU issuer for prior fiscal years must continue to be reconciled to U.S. GAAP, and its

[29] See supra footnote 14.

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financial statements for subsequent fiscal years must also include reconciliations to U.S. GAAP unless such financial statements comply fully with IFRS as issued by the IASB.

Financial statements prepared according to a comprehensive body of accounting principals other than U.S. GAAP or IFRS as issued by the IASB may be filed as part of Form 20-F if the following information is disclosed:

- an indication, in the accountant's report or in a reasonably prominent head note before the financial statements, of the comprehensive body of accounting principles used to prepare the financial statements;
- a discussion of the material variations in the accounting principles, practices and methods used in preparing the financial statements from the principles, practices and methods generally accepted in the United States and in Regulation S-X;
- a reconciliation of such material variations, in a tabular format, insofar as they affect net income (including net income per share, if materially different) for each year and each interim period for which an income statement is presented (reconciliation of the net income of the earliest year of the three years presented may be omitted if that information has not previously been included in an SEC filing);
- a reconciliation of such material variations insofar as they affect line items in each balance sheet presented; and
- a reconciliation of such material variations insofar as they affect funds or cash flows. (As an alternative, the issuer may provide a statement of cash flows prepared in accordance with IAS No. 7 "Cash Flow Statements," as amended in October 1992).

The SEC has provided relief for reconciliations with respect to financial statements prepared in accordance with a comprehensive body of accounting principles other than U.S. GAAP and IFRS as issued by the IASB, including the following:

- Reconciliations relating to the effects of price level changes need not be provided if financial statements prepared in accordance with the issuer's home country accounting principles comprehensively include the effects of price level changes using the historical cost/constant currency or current cost approach. The financial statements should describe the basis of presentation and disclose that such effects of price level changes have not been included in the reconciliation.
- Reconciliations relating to the effects of the different method of accounting for financial statements stated in a currency of a hyperinflationary economy need not be provided if the financial statements prepared in accordance with the issuer's home country accounting principles translate amounts in a currency of a hyperinflationary economy (an economy with cumulative inflation of approximately 100% or more over the most recent three-year period) into the issuer's reporting currency in accordance with IAS No. 21 "The Effects of

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Changes in Foreign Exchange Rates," as amended in 1993, using the historical cost/constant currency approach.

- Reconciliations relating to financial statements of a business acquired or to be acquired by a foreign private issuer need not be provided if the issuer's investment in, and its share of the assets and income of, the business in question each do not exceed 30% of the issuer's assets or pre-tax income from continuing operations. Reconciliations also need not be provided for the financial statements of a business acquired or to be acquired, regardless of its size, if the foreign private issuer prepares its financial statements pursuant to IFRS as issued by the IASB that are furnished pursuant to Rule 3-05 of Regulation S-X.

- Reconciliations need not be provided for financial statements of a less-than-majority-owned investee if the issuer's investment in, and share of income of, the investee each do not exceed 30% of the issuer's assets or pre-tax income from continuing operations. Reconciliations also need not be provided for the financial statements of an investee, regardless of its size, if the issuer prepares its financial statements pursuant to IFRS as issued by the IASB that are furnished pursuant to Rule 3-09 of Regulation S-X.

- Foreign private issuers that prepare financial statements pursuant to their home country accounting principles that allow proportionate consolidation for investments in joint ventures that would be accounted for under the equity method pursuant to U.S. GAAP may omit such differences in classification in reconciliations to U.S. GAAP under Item 17 so long as the joint venture is an operating entity with its significant financial operating policies jointly controlled by all parties having an equity interest in the entity by contractual arrangement.

Previously, Instruction 3 of Item 17 had allowed a foreign private issuer's financial statements to be considered compliant with Item 17 even if it did not conform to U.S. GAAP insofar as segment reporting is concerned, provided that the issuer had provided the operating segment and geographic market information called for by Item 4 of Form 20-F. In 2008, the SEC approved a rule change to remove the then Instruction 3 to Item 17 and to eliminate most of the omissions available to foreign private issuers relating to segment reporting from their financial statements pursuant to Item 17. As a result, foreign private issuers are now required to comply with Item 18 requirements (in lieu of Item 17) for their financial statements and related information beginning with their first fiscal year ending on or after December 15, 2009.[30]

Form 20-F registration statements or annual reports filed solely under the 1934 Act covering any fiscal year ending before December 15, 2011 may continue to contain the financial statements and related information specified in Item 17. The SEC, however, encourages such foreign private issuers to provide their financial statements and related information specified in Item 18 in lieu of Item 17. Foreign private issuers will be required to comply with Form 18

[30] See supra footnote 21.

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requirements for such filings beginning with their first fiscal year ending on or after December 15, 2011.[31]

Item 17 will still be available for Canadian MJDS filers and for the financial statements of non-registrants that are required to be included in a foreign or U.S. issuer's registration statement or its 1934 Act report, but eliminated for all others.

Item 18: Financial Statements

Item 18 of Form 20-F requires the inclusion of all financial statements required by Item 17 and, in addition, the inclusion of all other information required by U.S. GAAP and the SEC's Regulation S-X. Like Item 17, foreign private issuers may instead choose to prepare and present their financial statements pursuant to IFRS as issued by the IASB without reconciliation to U.S. GAAP, permitted as a result of the SEC rule change in January 2008. As with Item 17, where a foreign private issuer elects not to use U.S. GAAP or IFRS as issued by the IASB, it must reconcile to U.S. GAAP.

The principal difference between Item 17 and Item 18 is that Item 18 requires the inclusion, as discussed in Appendix B (*Disclosures About Segments of an Enterprise and Related Information*) of this volume, of operating segment information prepared in accordance with U.S. accounting standard SFAS 131.

Compliance with Item 18 is necessary if Form 20-F is used to support a U.S. registered public offering. Foreign private issuers required to provide a U.S. GAAP reconciliation must do so pursuant to Item 18, except for third-party financial statements required in Form 20-F which can continue to be prepared pursuant to Item 17.[32]

We suggest that any accounting questions be cleared with the staff of the SEC prior to filing a report or a registration statement. The SEC has in the past shown some flexibility with foreign private issuers, particularly bank holding companies, and has required less than full compliance with some of the financial disclosure requirements where it was demonstrated that historical compliance was impractical and systems were in place that would assure future compliance.

As with Item 17, Item 18 also contains a temporary accommodation for EU issuers that have previously filed financial statements with the SEC compiled in accordance with IFRS as issued by the EU, which, as noted above, contain a carve-out to IAS 39. Such an EU issuer may continue to file such financial statements for its first two financial years that end after November 15, 2007 without reconciling to U.S. GAAP, if its financial statements otherwise comply with

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[31] Id.

[32] Id. As adopted by the SEC, in addition to the continued availability of Item 17 for financial statements of non-registrants required to be included in an issuer's registration statement, annual report or other 1934 Act report, such as significant acquired businesses under Rule 3-05 of Regulation S-X, significant equity method investees under Rule 3-09 of Regulation S-X, entities whose securities are pledged as collateral under Rule 3-16 of Regulation S-X, and exempt guarantors under Rule 3-10(i) of Regulation S-X, Item 17 will also continue to be available to Canadian MJDS filers in light of the special recognition accorded to MJDS filings.

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IFRS as issued by the IASB and the issuer provides an audited reconciliation to IFRS as issued by the IASB. All financial statements of such an EU issuer for prior fiscal years must continue to be reconciled to U.S. GAAP, and all its financial statements for subsequent fiscal years must also include reconciliations to U.S. GAAP unless such financial statements comply fully with IFRS as issued by the IASB.

Item 19: Exhibits

Form 20-F requires the filing of various exhibits. These include:

- the issuer's organizational documents (including voting trust agreements) and copies of all instruments that define the rights of holders of its securities and a copy of any indenture under which the securities are being issued;
- a list (if the SEC so requests) of material non-U.S. patents for inventions not covered by a U.S. patent;
- a list of all or "significant" subsidiaries;
- computations relating to earnings per share, the ratio of earnings to fixed charges and any statement of hardship under Item 8 relating to the age of the issuer's financial statements;
- every material contract that is to be performed on or after that date of filing and that was entered into not more than two years before the filing date. Contracts do not have to be filed if they are entered into in the ordinary course of the issuer's business, that is, contracts of the type that ordinarily accompany the kind of business the issuer and its subsidiaries conduct, unless they fall within one or more of the following categories and are not immaterial in amount or significance:

  (a) any contract with directors, officers, promoters, voting trustees, major shareholders of the issuer, except for contracts involving only the purchase or sale of current assets with a determinable market price and purchased or sold at such price;

  (b) any contract upon which the business of the issuer and its subsidiaries are substantially dependent, such as continuing contracts to sell the major part of their products or services or to purchase the major part of their requirement of goods, services or raw materials, or any franchise or license or other agreement to use a patent, formula, trade secret, process or trade name if their business depends to a material extent on that patent, formula, trade secret, process or trade name;

  (c) any contract for the acquisition or sale of any property, plant or equipment if the consideration exceeds 15% of the issuer's fixed assets on a consolidated basis;

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(d) any material lease under which the issuer or its subsidiaries hold part of the property described in Form 20-F; or

(e) any management contract or compensatory plan, contract or arrangements participated by the issuer's directors or members of its administrative, supervisory or management bodies;

- any code of ethics, or its amendment, as required to be disclosed under Item 16B, if the issuer intends to satisfy its Item 16B disclosure requirements through an exhibit filing;
- the legal opinion required under Item 7 attesting to the fact that the foreign bank issuer is not allowed to identify the recipient of a loan because such disclosure would conflict with privacy laws of the foreign bank's home jurisdiction; and
- certifications as required by Sarbanes-Oxley (see the discussion in this chapter below under the heading "—Disclosure Requirements for 'F' Form Issuers—Signature and Certifications" below).

Rules issued by the SEC in January 2009 will require U.S. and foreign large accelerated filers that use U.S. GAAP and have a worldwide public common equity float above U.S.$5 billion to file interactive data files as an exhibit to Form 20-F beginning with annual reports filed on Form 20-F for fiscal years ending on or after June 15, 2009.[33] Similar requirements for other issuers using U.S. GAAP and IFRS as issued by the IASB will be phased in over the next three years.

Exhibits previously filed with the SEC or a U.S. exchange may be incorporated into Form 20-F by reference. If any previously filed exhibits have been amended or modified, the issuer must file copies of the amendment or modification or copies of the entire exhibit as amended or modified.

If any required exhibit is in a foreign language, the issuer must provide either an English translation or an English summary of the foreign language document. The issuer may also submit a copy of the unabridged foreign language document along with the English translation or summary.

Signature and Certifications

Form 20-F must be signed on behalf of the issuer by any duly authorized officer. Two separate provisions of Sarbanes-Oxley require the principal executive and financial officers of each reporting company to personally certify the accuracy of periodic reports filed with the SEC.

Sarbanes-Oxley Section 906 amended the U.S. federal criminal code to require certifications of all periodic reports containing financial statements filed with the SEC. In the

[33] For further information on interactive data filing requirements, see the discussion under the heading "Extensible Business Reporting Language ('XBRL')" in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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case of foreign private issuers, the Sarbanes-Oxley Section 906 certification requirements are generally regarded as applying only to Form 20-F. The certification may be a single certification by both officers. It must state that the report fully complies with the statutory requirements of the 1934 Act and that the information in the report "fairly presents, in all material respects, the financial condition and results of operations of the issuer." Although the SEC has only limited power to change or interpret the Sarbanes-Oxley Section 906 certification requirement, it has acted to require that the Section 906 certification be "furnished" to (rather than "filed" with) the SEC as an exhibit to Form 20-F.[34]

Sarbanes-Oxley Section 302 required the SEC to adopt rules to require the principal executive and financial officers of each issuer filing annual or quarterly reports to make separate certifications regarding these reports. As implemented by the SEC, the Sarbanes-Oxley Section 302 certifications are to be "filed" with the SEC (rather than "furnished") as exhibits to the related report. Since foreign private issuers are required to furnish their interim financial statements to the SEC under the cover of Form 6-K, only their Form 20-F annual reports will require such Sarbanes-Oxley Section 302 certifications as exhibits. The current content of the required certifications (which must be "exactly" as specified by the SEC) may be summarized as follows:

- the signer has personally reviewed the report;
- based on the signer's knowledge, the report does not contain an untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which the statements were made, not misleading with respect to the period covered by the report;
- based on the signer's knowledge, the financial statements and other financial information in the report fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of and for the periods presented in the report;
- the signer and the other certifying officer are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer and have:

  (a) designed such disclosure controls and procedures or caused them to be designed under their supervision to ensure that material information is made known to the certifiers;

  (b) designed such internal control over financial reporting or caused it to be designed under their supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of

[34] Documents that are "furnished" to, rather than "filed" with the SEC would not be automatically incorporated by reference in a foreign private issuer's Form F-3 registration statement. They also entail different liabilities under the U.S. securities laws, as discussed in Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume.

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financial statements for external purposes in accordance with generally accepted accounting principles;

(c) evaluated the effectiveness of such disclosure controls and procedures and presented the signer's conclusions about such effectiveness; and

(d) disclosed any change in internal control over financial reporting that occurred during the period covered by the report that has materially affected or is reasonably likely to materially affect the issuer's internal control over financial reporting;

- the signer and the other certifying officer have disclosed to the issuer's auditors and audit committee all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information and any fraud (whether or not material) involving management or other employees with a significant role in the issuer's internal control over financial reporting.

SEC Accommodation for First-Time Application of IFRS

The SEC amended Form 20-F to provide a one-time accommodation for foreign private issuers that prepare their audited financial statements for the first time under IFRS. This accommodation is available to foreign private issuers who have adopted IFRS as issued by the IASB for the first time by an explicit and unreserved statement of compliance with such IFRS and the audited financial statements for their most recent financial year as required by Item 8 are prepared in accordance with IFRS as issued by the IASB. The accommodation to any first-time IFRS filer includes:

- the selected historical financial data required under Item 3 must be based on financial statements for the two most recent financial years prepared in accordance with IFRS as issued by the IASB, together with selected historical financial data in accordance with U.S. GAAP for the five most recent financial years (unless the omission of U.S. GAAP information for any of the earliest years of the five-year period is otherwise permitted pursuant to Item 3);

- the audited financial statements for the two most recent financial years presented in accordance with IFRS as issued by the IASB, rather than three years otherwise required by Item 8, may be without reconciliation to U.S. GAAP, unless the issuer has published audited financial statements prepared in accordance with IFRS as issued by the IASB for the three latest financial years, in which case the issuer must include all three years of audited IFRS financial statements in its SEC filings;

- the interim financial statements required under Item 8 may be satisfied in any one of the following three ways: (i) audited financial statements for the three latest financial years and unaudited interim financial statements for the current and comparable prior year period, prepared in accordance with the body of accounting

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principles previously used in preparing its financial statements ("Previous GAAP") and reconciled to U.S. GAAP as required by Item 17 or 18, as applicable; (ii) audited financial statements for the two latest financial years and unaudited interim financial statements for the current and comparable prior year period, prepared in accordance with IFRS as issued by the IASB; or (iii) audited financial statements for the latest three financial years prepared in accordance with the Previous GAAP and unaudited interim financial statements for the current and comparable prior year period prepared in accordance with IFRS as issued by the IASB. together with condensed financial information prepared in accordance with U.S. GAAP for the most recent financial year and the current and comparable prior year interim period; and

- quantitative and qualitative disclosures about market risk under Item 11 must be presented on the basis of IFRS as issued by the IASB.

The SEC allows an eligible first-time IFRS filer to elect to include or incorporate by reference financial data prepared in accordance with the issuer's Previous GAAP subject to the following conditions:

- such inclusion (including any reference to such financial data in this requirement) or incorporation by reference must be accompanied by a prominent disclosure of the different accounting standards underlying such information and the non-comparable nature of such financial information;

- such presentation or incorporation by reference is limited to selected historical financial data prepared in accordance with Previous GAAP for the first four of the latest five financial years, but not including the most recent financial year;

- such presentation or incorporation by reference is limited to operating and financial review and prospects information under Item 5 that focuses on the financial statements for the first two of the latest three financial years prepared in accordance with Previous GAAP, but not including the most recent financial year and with no discussion or reference to the reconciliation to U.S. GAAP or financial statements prepared in accordance with IFRS;

- such inclusion or incorporation by reference is limited to comparative financial statements prepared in accordance with Previous GAAP that cover the first two of the latest three financial years, but not including the most recent financial year; and

- none of the inclusion or incorporation by reference of such Previous GAAP financial information may be presented side-by-side with IFRS financial information.

OFFER-SPECIFIC INFORMATION REQUIRED TO BE INCLUDED IN PROSPECTUS

As discussed above, a prospectus in a Form F-3 registration statement may incorporate by reference information from the foreign private issuer's Form 20-F annual report and Form 6-K

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interim reports. We describe below the items of Form F-3 that require additional disclosure regarding a particular securities offering registered on Form F-3 under the 1933 Act (which are similar to the additional items required by Form F-1), as well as Form F-3's incorporation by reference provisions.[35]

Item 1: Forepart of Registration Statement and Outside Front Cover Page of Prospectus

The outside front cover page of a prospectus for most securities offerings is standardized. The style of the cover page normally is determined by the investment bank retained as the lead underwriter or the lead selling agent. It must be limited to one page and contain the following information in plain English:

- the English version or translation of the name of the foreign private issuer;
- the title and amount of securities offered and a brief description of the securities, including, in the case of debt securities and preferred stock, information about the interest or dividend rate. In the case of continuous or delayed offerings, such as medium-term note programs, much of this information is omitted from the cover page of the prospectus and included on a pricing supplement that is prepared at the time of sale and attached to the prospectus;
- information about the public offering price, underwriting or selling agents' discounts and commissions and net proceeds to the foreign private issuer;[36]
- the market in which the securities will trade and the trading symbol for the securities;
- if any of the securities to be registered are to be offered for the account of securityholders, a statement to that effect and information about the net proceeds to the selling securityholders;
- a standardized legend required by the SEC and state securities commissioners;
- if risk factors or similar considerations are disclosed in the prospectus, a legend referring readers to the appropriate page number of the prospectus;

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[35] It should also be noted that 1933 Act regulations require that issuers registering securities on Form F-8, F-9 or F-10, or registering securities and filing periodic reports on Form 40-F, among others, file a Form F-X with the SEC appointing an agent for service of process in the United States. Also, pursuant to Rule 489 under the 1933 Act, non-U.S. banks and insurance companies that publicly offer securities in the United States are required to file with the SEC a Form F-N appointing for the benefit of investors an agent for service of process in the United States.

[36] As discussed further under the heading "Offering Documents" in Chapter 1 (*The U.S. Offering Process*) of this volume, preliminary prospectus used to market an offering normally omits much of the pricing and share information, although a preliminary prospectus for an initial public equity offering by a foreign private issuer must contain a good faith estimate of the maximum offering price range and maximum amount of securities to be offered.

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- name(s) of the lead or managing underwriter(s) and identification of the nature of the underwriting arrangements;
- the date of the prospectus; and
- in the case of a preliminary prospectus that is used before the effective date of the registration statement, a legend indicating that the preliminary prospectus is subject to amendment or completion.

Item 2: Inside Front and Outside Back Cover Pages of Prospectus

Either the inside front or the outside back cover of the prospectus must contain certain standardized disclosure relating to dealer prospectus delivery obligations (if applicable) and a reasonably detailed table of contents.

Item 3: Summary Information, Risk Factors and Ratio of Earnings to Fixed Charges

Summary Information

A brief summary in plain English of the information contained in the prospectus is required in the front part of the prospectus when the length or complexity of the prospectus makes a summary useful. The summary should contain a brief description of the foreign private issuer and the offering, including, if they are not already provided on the cover page, the issuer's address and telephone number. For marketing purposes, the investment bank that acts as the lead underwriter or the lead selling agent may want to use a summary even if the prospectus is not particularly lengthy or complex.

Risk Factors

Where appropriate, the issuer should provide under the caption "Risk Factors" a concise and logically organized discussion of the most significant factors that make the offering speculative or risky. The discussion should immediately follow the cover page of the prospectus or the summary. Risk factors include not only matters concerning the business and financial condition of the foreign private issuer, but also such matters (to the extent applicable) as the absence of an operating history, the absence of profitable operations and, particularly in the case of a common equity offering, the absence of a prior market for the foreign private issuer's securities. Additional factors may include foreign exchange restrictions or other political or governmental factors.

Ratio of Earnings to Fixed Charges

If debt securities are being registered, the prospectus must disclose a ratio of earnings to fixed charges. If preferred equity securities are being offered, the prospectus must disclose the foreign private issuer's ratio of combined fixed charges and preference dividends to earnings. The ratio should be presented for each of the last five fiscal years (or for the life of the foreign private issuer or its predecessors, if less) and for the latest interim period for which financial statements are presented. If the issuer will use the proceeds from the sale of debt or preference securities to repay any of its outstanding debt or to retire other securities and the change in the

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ratio would be 10% or greater, the issuer also must include a *pro forma* ratio showing the application of the proceeds. If a foreign private issuer reconciles its financial statements to U.S. GAAP, the foreign private issuer must disclose the ratio on the basis of its primary financial statements in the prospectus as well as (if materially different) on the basis of the reconciliation to U.S. GAAP. If summary information is provided, the ratio information should be shown as part of the summarized financial data.

Fixed charges include interest expensed and capitalized, amortized premiums, discounts and capitalized expenses related to indebtedness, estimated interest within rental expense, and preference security dividend requirements of consolidated subsidiaries. Preference security dividend means the amount of pre-tax earnings that is required to pay the dividends on outstanding preference securities. Earnings represent the sum of (a) pre-tax income from continuing operations before adjustment for minority interests in consolidated subsidiaries or income or loss from equity investees, (b) fixed charges, (c) amortization of capitalized interest, (d) distributed income of equity investees, and (e) the issuer's share of pre-tax losses of equity investees (for which charges arising from guarantees should be included in fixed charges), subtracted by (x) interest capitalized, (y) preference security dividend requirements of consolidated subsidiaries, and (z) minority interest in pre-tax income of subsidiaries that have not incurred fixed charges.

If the ratio indicates less than one-to-one coverage, the issuer is required to disclose the dollar amount of the deficiency.

A foreign private issuer should file an exhibit to its Form F-3 registration statement to show the figures used to calculate the ratios.

Item 4: Information about the Offering

Form F-3 refers to Item 2 (Offer Statistics and Expected Timetable), Item 3.B (Capitalization and Indebtedness), Item 3.C (Reasons for the Offer and Use of Proceeds), Item 7.C (Interests of Experts and Counsel), Item 9 (The Offer and Listing), Item 10 (Additional Information) and Item 12 (Description of Securities Other than Equity Securities) of Form 20-F for disclosure requirements with respect to a foreign private issuer and its securities offering. Any information included in a report incorporated by reference into the prospectus need not be repeated in the prospectus.

Item 5: Material Changes

Form F-3 requires a description of all material changes in the issuer's affairs that have occurred since the end of the latest fiscal year for which certified financial statements are included in this registration statement in accordance with Item 6 and that have not been described in a report on Form 6-K.

Form F-3 also requires the prospectus to include, if not included in documents incorporated by reference into the prospectus, information about material acquisitions or dispositions and material financial restatements to reflect a change in accounting principles or a correction of an error, as well as additional financial statements or information necessary to comply with the requirements of Item 8.A of Form 20-F.

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Item 6: Incorporation of Certain Information by Reference

Form F-3 incorporates by reference the issuer's latest Form 20-F, Form 40-F, Form 10-K or Form 10 filed pursuant to the 1934 Act, as well as all subsequent annual reports filed by the issuer on Form 20-F, Form 40-F or Form 10-K, and all subsequent filings on Form 10-Q and 8-K, prior to the termination of the offering. If capital stock is to be registered and securities of the same class are registered under Section 12 of the 1934 Act, the description of such class of securities which is contained in a registration statement filed under the 1934 Act also must be incorporated by reference. The issuer may incorporate by reference any Form 6-K; if the issuer intends to incorporate any Form 6-K subsequently submitted to the SEC, the prospectus must state that the issuer may incorporate such Forms 6-K by identifying in such Forms that they are being incorporated by reference into the F-3. If capital stock is to be registered and securities of the same class are registered under Section 12 of the 1934 Act, the description of such class of securities which is contained in a registration statement filed under the 1934 Act also must be incorporated by reference. The prospectus must state that the issuer will provide, upon request, copies of any information incorporated by reference.

The prospectus must also identify the reports and other information the issuer files with the SEC and indicate that these are available at the SEC's main office in Washington, D.C. If the issuer is an electronic filer, the prospectus must state that the SEC maintains a web site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC and state the address of that site. Issuers are encouraged to give their own web site address, if available.

Item 7: Disclosure of SEC Position on Indemnification for 1933 Act Liabilities

Form F-3 requires the prospectus to include a brief description of indemnification provisions relating to directors, officers and controlling persons of the issuer against liabilities arising under the 1933 Act, together with a statement in substantially the following form:

> Insofar as indemnification for liabilities arising under the 1933 Act may be permitted to directors, officers or persons controlling the issuer pursuant to the foregoing indemnification provisions, the issuer has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the 1933 Act and is therefore unenforceable.

Item 8: Indemnification of Directors and Officers

Form F-3 requires that in Part II of the registration statement a foreign private issuer disclose the general effect of any statute, corporate charter, such as articles of association or by-laws, contract or other arrangement, pursuant to which any controlling person, director or officer of the issuer is insured or indemnified in any manner against liability it may incur in such capacity.

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Item 9: Exhibits

Form F-3 requires the filing of various exhibits. These include (as applicable):

- underwriting agreement in connection with the sale of the registered securities;
- any plan of acquisition, reorganization, arrangement, liquidation or succession;
- any instruments defining the rights of securityholders, including indentures;
- opinions regarding legality and tax matters;
- letter from the issuer's auditors regarding unaudited interim financial information;
- consents of experts and counsel;
- powers of attorney;
- statements of eligibility of the trustee;
- invitation for competitive bids; and
- any additional exhibits.

Form F-3 also requires a foreign private issuer to file financial statement schedules as exhibits to the extent such financial statement schedules are required by Regulation S-X and Item 4 of Form F-3. In January 2009, the SEC issued new rules that will require the filing of interactive financial data files as an exhibit to Form F-3.[37]

Item 10: Undertakings

Form F-3 requires inclusion of various undertakings by the foreign private issuer prescribed by the SEC, based upon the type of offering being registered.

DISCLOSURE REGARDING NON-GAAP FINANCIAL MEASURES[38]

Pursuant to Sarbanes-Oxley Section 401(b), the SEC adopted Regulation G and Item 10(e) of Regulation S-K. Regulation G applies to public disclosure by any issuer that is required to file reports under Section 13(a) or 15(d) of the 1934 Act containing non-GAAP financial measures (as defined below). Item 10(e) of Regulation S-K, which applies to issuers that file reports on Forms 10-K and 20-F (but not Form 40-F), contains requirements that are stricter than those of Regulation G. SEC rules require quantitative reconciliation to GAAP of non-GAAP financial measures in an issuer's oral or written public statements, press releases and reports filed with the SEC, including annual and interim reports and registration statements filed under the 1933 Act.

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[37] See supra footnote 33.

[38] Sarbanes-Oxley Section 401(b); Regulation G; Regulation S-K Item 10(e); Form 20-F Gen'l Inst. C.(e).

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If non-GAAP financial measures are included in an issuer's annual report, the issuer's management must disclose why the non-GAAP financial measures may be useful to investors and the purposes for which management uses such non-GAAP financial measures.

A "non-GAAP financial measure" is a financial measure that is not prepared in accordance with the accounting principles applicable to a comparable financial measure under an issuer's "home country" GAAP. The definition does not include financial measures specifically required by GAAP, SEC rules or other applicable regulation.

The rules do not apply to public disclosure of a non-GAAP financial measure not made in an annual report filed with the SEC on Form 10-K, 20-F or 40-F if:

- the issuer's securities are listed on a non-U.S. stock exchange or quoted on a non-U.S. inter-dealer quotation system;
- the non-GAAP financial measure is not derived from or based on measures calculated and presented in accordance with U.S. GAAP; and
- the disclosure, even if made in the United States, is also made outside the United States, or is included in a written communication that is released outside the United States.[39]

This exclusion will apply notwithstanding the existence of one or more of the following circumstances:

- a written communication released in the United States as well as outside the United States, so long as the communication is released in the United States contemporaneously with or after the release outside of the United States and is not otherwise targeted at persons located in the United States;
- non-U.S. journalists, U.S. journalists or other third parties have access to the information;

[39] Regulation G appears on its face to apply to Form 40-F disclosure, absent the availability of the exemption for foreign private issuers provided by Section 100(c) of Regulation G. However, SEC Release No. 33-8176 (Jan. 22, 2003) (http://www.sec.gov/rules/final/33-8176.htm) (the "Reg. G Adopting Release") at II.B.1.b. states that Form 40-F filers are not subject to the requirements of Regulation G or Item 10(e) of Regulation S-K. See also question 32 of the June 13, 2003 FAQ Regarding the Use of Non-GAAP Financial Measures at www.sec.gov/divisions/corpfin/faqs/nongaapfaq.htm. However, any public disclosure by a Canadian issuer not covered by the Section 100(c) exclusion and not included in a Form 40-F is subject to Regulation G. See the Reg. G Adopting Release at n.40. Accordingly, Canadian issuers should consult their counsel regarding the use of non-GAAP financial measures in public disclosures. In addition, Canadian Securities Administrators Staff Notice 52-306 (Nov. 21, 2003) advises that Canadian issuers reconcile non-GAAP financial measures to GAAP and explain why the non-GAAP financial measure provides useful information to investors, among other requirements. Although it should also be noted that Canada is expected to adopt IFRS as their basis of accounting, or to permit companies to use IFRS as issued by IASB as their basis of accounting in the next few years.

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- the information appears on one or more web sites maintained by the issuer, so long as the web sites, taken together, are not available exclusively to, or targeted at, persons located in the United States; or
- following the disclosure or release of the information outside the United States, the information is included in a submission by the issuer to the SEC made under cover of Form 6-K.

Unless the following non-GAAP measures are required or expressly permitted under the issuer's home country GAAP and are included in the annual reports or financial statements it uses in its home country, the following are prohibited in an issuer's Form 10-K or 20-F annual report filed with the SEC:

- excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than the measures EBIT and EBITDA;
- adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when (1) the nature of the charge or gain is such that it is reasonably likely to recur within two years, or (2) there was a similar charge or gain within the prior two years;
- presenting non-GAAP financial measures on the face of an issuer's financial statements prepared in accordance with GAAP or in the accompanying notes;
- presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X; and
- using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

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CHAPTER 5

SHELF REGISTRATION

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GENERAL

A 1933 Act shelf registration statement covers securities that are not to be sold in a single discrete offering immediately upon effectiveness, but rather are intended to be sold in a number of offerings over a period of time or on a continuous basis.

Shelf registrations are governed by Rule 415 under the 1933 Act. Rule 415 permits issuers to register securities in advance of their offering, placing them "on the shelf" for immediate takedown without any further action by the SEC, thereby dramatically reducing the time to execute an offering. Shelf registrations have resulted in standardization of basic documentation, "bought deals" and greater product flexibility to satisfy windows of issuer and investor demand. Since Securities Offering Reform became effective on December 1, 2005, WKSIs have automatic shelf registration statement effectiveness.

Securities Offering Reform established four categories of issuers – WKSIs, seasoned issuers, unseasoned 1934 Act reporting issuers and non-reporting issuers. Two other categories of issuers – ineligible issuers and voluntary filers – also must be taken into account to determine what registration requirements and limitations apply to an issuer.

SECURITIES COVERED BY RULE 415

Rule 415 permits registration of the following on a shelf registration statement:

(i) securities to be offered or sold by selling securityholders other than the issuer, or a parent or subsidiary of the issuer (this provision permits issuers to offer shelf registration rights to securityholders that purchased their securities in a private placement or otherwise hold restricted securities);

(ii) securities offered and sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan;

(iii) securities to be issued upon the exercise of outstanding options, warrants or rights;

(iv) securities which are issued upon conversion of other outstanding securities;

(v) securities pledged as collateral;

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(vi) securities registered on Form F-6 (*i.e.*, ADRs);

(vii) mortgage-related securities, including such securities as mortgage-backed debt and mortgage participation or pass-through certificates;

(viii) securities to be issued in connection with business combination transactions;

(ix) securities the offering of which will be commenced promptly, will be made on a continuous basis and may continue for a period in excess of 30 days from the date of initial effectiveness (this provision provides one option for shelf registration of medium-term notes);

(x) securities registered or qualified to be registered on Form S-3 or F-3, as the case may be,[1] which are to be offered and sold on an immediate, continuous or delayed basis by or on behalf of an issuer, or a parent or subsidiary of the issuer (this provision provides the most flexible option for primary offerings, including offerings of medium-term notes); and

(xi) shares of common stock which are offered and sold on a delayed or continuous basis by or on behalf of a registered closed-end management investment company or business development company that makes periodic repurchase offers under Rule 23c-3 of the 1940 Act.

Clause (x) of Rule 415 is the provision that most issuers use to register securities because, by allowing incorporation by reference of future 1934 Act filings, as well as prior filings, and permitting delayed offerings, Forms S-3 and F-3 provide the most updating and product flexibility. Issuers that are not eligible to use Form S-3 or F-3 may nevertheless register shelf securities, such as medium-term notes, pursuant to clause (ix). Clause (ix) is less flexible than clause (x) inasmuch as it permits continuous offerings (such as medium-term note programs) but not delayed offerings. However, if shelf securities are registered on Form S-1 or F-1 (which permits incorporation by reference of prior 1934 Act filings after the issuer has filed an annual report required under Section 13(a) or 15(d), but no forward incorporation by reference of subsequently filed documents), a post-effective amendment must be filed with the SEC annually and a new prospectus prepared each time the issuer files its annual and periodic reports under the 1934 Act. Chapter 14 (*Foreign Governmental Issuers*) of this volume discusses delayed or continuous offerings by foreign governmental issuers.

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[1] Investment grade asset-backed securities offerings are eligible to use Form S-3 without any 1934 Act reporting history requirements, thus making Rule 415 shelf registration available for such offerings. See SEC Release No. 33-8518 (Jan. 7, 2005) (http://www.sec.gov/rules/final/33-8518.htm). Form S-3 allows issuers to use short-form registration for all investment grade, asset-backed securities, regardless of the size of the particular issuer's public float, provided the securities meet the Form S-3 standard and any issuer of asset-backed securities involving the same class of asset-backed securities previously established by the depositor or any affiliate made timely 1934 Act filings for the last 12 calendar months. The investment grade rating must exist at the time of sale to the public, not at the time of effectiveness of the registration statement. See SEC Release No. 33-7053 (Apr. 19, 1994) (hyperlink unavailable).

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SHELF REGISTRATION PROCEDURES

Automatic Shelf Registration Statements

WKSIs have the most registration procedure benefits, including automatic registration statements and pay-as-you-go registration fee arrangements. Larger, more mature issuers, including both WKSIs and seasoned issuers, also benefit from procedures for shelf registration statements that permit the omission of certain information as of the effective date and remove certain limitations on the quantity of securities registered for delayed sale.

WKSIs may file "automatic shelf registration statements." This means that they are effective upon filing and not subject to pre-effective review by the staff of the SEC. Taken together with the SEC's communications rules that permit WKSIs (but not underwriters on their behalf) to make offerings of securities before the filing of a registration statement, the automatic shelf registration statement rules permit WKSIs to file the registration statement at the time of sale. Additional filing requirements apply at the time sales are made under the shelf. An automatic shelf registration statement may cover both primary and secondary offerings.

WKSI status is measured as of the filing date and is subject to reevaluation at the time the registration statement is updated for purposes of Section 10(a)(3) of the 1933 Act, which is the date the annual report on Form 10-K or 20-F is filed. A WKSI holding the status solely on the basis of debt or preferred stock issuances would be limited to the sale of non-convertible debt or preferred securities unless its common equity securities held by unaffiliated persons had a market value of at least U.S.$75 million. Certain subsidiaries of WKSIs may be included on their parent's automatic shelf registration statements. Forms S-3 and F-3 are the only forms of registration statement allowing the use of the automatic shelf technique.

Contents of Automatic Shelf Registration Statements

The automatic shelf registration statement need include only the information required by Rules 430A and 430B under the 1933 Act. With incorporation by reference from 1934 Act periodic reports of most prescribed prospectus disclosure items, the prospectus forming part of the automatic shelf registration could merely identify the WKSI and the types of its securities (without specifying an amount) to be sold and incorporate by reference its recent and future 1934 Act filings. An automatic shelf registration statement need not specify whether it covers a primary or secondary offering. While an automatic shelf registration statement could consist only of the facing sheet (identifying the form of registration, the issuer, and the types of securities included), a single-page prospectus including the disclosures just described, a signature page and any required exhibits, most automatic shelf registration statements continue to follow the pre-Securities Offering Reform practice and include a description of each type and class of securities expected to be offered under the shelf. This is done so as to limit the additional information that needs to be prepared and delivered to purchasers at the time of sale, as discussed in Chapter 4 (*Disclosure Requirements*) of this volume.

Transactional and other disclosures otherwise required must be provided at the time of sale through (i) a Rule 424(b) prospectus that is deemed to be a part of the registration statement, (ii) a 1934 Act filing incorporated by reference, (iii) a free writing prospectus or (iv) a

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post-effective amendment to the registration statement. A filing supplying the information omitted in reliance on Rule 430B will be deemed to be a new effective date of the registration statement, a matter of significance for liability issues, including the statute of limitations.

Among the types of securities that have been included in the more complete universal registration statements are:

- Debt securities: senior and subordinated, convertible into equity securities of the issuer, exchangeable for securities of another issuer, fixed and variable interest rates and principal amount at maturity, interest and/or principal payable in various currencies, interest gross-up provisions for non-U.S. offerings, zero-coupon securities[2] and warrants to purchase debt securities.

- Equity securities: common stock, preferred stock (including depositary receipts), warrants to purchase equity securities, and warrants with a value at maturity tied to a specified securities index, currency or other benchmark.

Fees for Automatic Shelf Registration Statements

A WKSI filing an automatic shelf registration statement has the option to pay the SEC registration fee for the entire amount of securities it expects eventually to sell under the registration statement or to pay as the securities are sold, which the SEC calls pay-as-you-go registration fees. Both methods may be used at once. For example, a WKSI may elect to prepay fees for some future offerings while deferring fees for others. Because registration fees for shelf offerings can be significant, the option to defer payment is attractive. For continuous offering programs, such as medium-term note facilities, issuers may want to consider use of the lock-box account offered by the SEC.[3]

When prepayments are made, the fee table in the registration statement need only state the amount of the fee, calculated on the value of all securities proposed to be sold, and the classes of securities covered by the registration statement. No allocation of the fee among the included classes or specification of the amount of each class proposed to be sold is required.

If a WKSI defers fees for an automatic shelf registration statement, the fee table must identify the classes of securities covered by the registration statement and note reliance on Rules 456(b) and Rule 457(r), the enabling rules for pay-as-you-go fees. Rule 456(b) specifies additional procedures for deferred fees. Deferred fees must be paid not later than the date the prospectus relating to the securities is required to be filed under Rule 424(b), calculated on the basis of the rates in effect as of such date. Good-faith failures to pay a fee will be deemed to have been timely if paid within four days of the original due date. At the time of the deferred payment, the issuer must update the fee table either in a Rule 424(b) prospectus supplement filing or in a post-effective amendment to the automatic shelf registration statement.

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[2] If zero coupon securities are included, a footnote to the fee table on the cover page of the registration statement should be added to indicate that securities will be issued with significant original issue discount.

[3] Fees paid through the use of a lock-box account will be calculated at the time the money is withdrawn from the account to make the payment, not at the time the money is deposited in the account.

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Post-Effective Amendments

A WKSI can add securities to an automatic shelf registration statement by means of a post-effective amendment, an action not available to non-WKSI issuers. In addition to its own securities, a WKSI may add the securities of a qualifying majority-owned subsidiary, whether or not the subsidiary had previously been a registrant under the registration statement. Such post-effective amendments will become effective on filing.

Other Shelf Registration Procedures

Registration of Unlimited Quantities of Securities

There is no limit on the amount of securities that can be registered by WKSIs and seasoned issuers. In fact, they are not required to specify any amount of securities that may be issued under the shelf registration statement. For delayed primary offerings (*i.e.*, offerings by the issuer under Rule 415(a)(1)(viii) and (ix)), other issuers are limited to the amount of securities the issuer reasonably believes would be sold in the succeeding two years. This limitation also applies to acquisition shelf registration statements and certain continuous offerings, such as best-efforts offerings for unseasoned issuers. The expiration of the two-year period, however, will not terminate the registration of any securities that remain unsold.[4]

Maximum Three-Year Life for Shelf Registration Statements

Shelf registration statements for WKSIs, seasoned issuers, mortgage-backed securities, certain continuous offerings and delayed primary offerings are subject to a three-year limitation. In general, to be permitted to make further sales, the issuer will be required to file a new shelf registration statement on or before the third anniversary of the effective date of the older shelf registration statement. Automatic registration statements become effective on filing, so there should be no interruption in market access for WKSIs. To provide some assurance to other issuers that market access will continue in the period during which their new registration statements may be reviewed by the SEC staff, sales of securities under old shelf registration statements other than the automatic shelf registration will be permitted for an additional six months. SEC registration fees from any securities unsold under registration statements subject to the three-year rule can be applied to the new registration statements.[5]

Certain Shelf Registration Contents

Registration statements for mortgage-backed securities and for delayed primary offerings are required to include only limited disclosures at the time of filing.

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4 The Regulation S-K Item 512 undertaking to de-register securities is generally interpreted to be applicable only if the registrant has no intention to issue the securities under any circumstances.

5 The SEC has published guidance regarding the three-year limitation for shelf registration statements and the conditional procedure permitting sales for up to six additional months. See http://www.sec.gov/divisions/corpfin/guidance/415a5guidance6.htm.

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At-the-Market Offerings

At-the-market offerings in any amount are possible without the services of an underwriter under Securities Offering Reform.[6] The only condition is that the issuer be eligible to make a primary offering on Form S-3 or F-3 at the time the registration statement is filed or updated to satisfy Section 10(a)(3).

Immediate Offerings upon Effectiveness

Securities Offering Reform eliminated the so-called "convenience shelf" problem by amending Rule 415 to authorize an immediate takedown after effectiveness. Prior to Securities Offering Reform, the SEC staff's position was that an immediate takedown was not permitted without the use of a pricing amendment or the procedures associated with Rule 430A.

Identification of Selling Securityholders

Generally, the view of the SEC staff is that selling securityholders must be identified at the time of effectiveness of the registration statement covering a secondary offering of their securities or, if the sellers are unknown, by means of a post-effective amendment prior to sale by the previously unnamed persons. For registration statements on Form S-3 or F-3, however, issuers may supply the names of selling securityholders after effectiveness in a prospectus filed under Rule 424(b), in a 1934 Act report incorporated by reference, or in a post-effective amendment. The use of the Rule 424 filing will be the recommended procedure in almost all cases.

Issuers ineligible to register primary offerings on Form S-3 or F-3 must identify selling securityholders at the time of effectiveness of a registration statement covering a secondary offering of securities or, if the sellers are unknown, by means of a post-effective amendment prior to sale by the previously unnamed persons. Because these post-effective amendments will not be automatically effective, there may be a delay in their use.

Incorporation by Reference by Unseasoned Issuers

Forms S-1 and F-1 permit incorporation by reference of prior 1934 Act reports by reporting companies ineligible to use Form S-3 or F-3. An issuer that has been reporting under the 1934 Act for at least twelve months and that has filed its annual report on Form 10-K or 20-F for its most recent fiscal year may incorporate by reference most of the business and financial information required within the prospectus from its periodic reports. The incorporation by reference is permitted only for historical reports. Unlike Form S-3 or F-3, future periodic reports will not be incorporated by reference as they are filed.

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[6] Rule 415 under the 1933 Act defines an "at-the-market offering" of securities as one made "into an existing trading market for outstanding shares of the same class at other than a fixed price."

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Documentation

The documentation required for a shelf registration varies depending upon the type of security involved. However, the process of documenting the registration, offering and sale of shelf securities is generally the same regardless of which type of security is involved.

At the time the securities are registered under a 1933 Act registration statement, the basic documents are filed with the SEC. The base prospectus, which typically permits broad variations on the securities that can be issued, is finalized at the time of effectiveness. In the case of debt or mortgage-backed securities, an open-ended indenture that permits numerous types of debt or mortgage-backed securities is qualified under the 1939 Act. In the case of trust preferred securities, a base trust declaration that contemplates various terms is qualified under the 1939 Act.[7] In the case of preferred stock, a form of charter amendment or board of director certificate of designation required to establish the basic terms of the preferred stock is normally included as part of the filing package. In other cases, such as registration of rights and warrants, the documents creating the registered rights or warrants also are normally filed with the 1933 Act registration statement. The form of underwriting agreement or distribution agreement is finalized and included as part of the filing package.

The documentation process for Rule 415 shelf registrations allows issuers to quickly access the U.S. capital markets. For example, when a financing opportunity arises, the issuer will already have on hand the registered securities and pre-negotiated underwriting arrangements and, in the case of debt securities and trust preferred securities, pre-negotiated indenture and trustee arrangements. The underwriting agreement or a brief terms agreement in the form previously filed with the SEC is signed. The terms of the new securities and the underwriting arrangements are set forth in a prospectus supplement that is conveyed to investors at or prior to the time of sale, together with the base prospectus, and the securities are issued pursuant to pre-established procedures with the underwriters or selling agents and, in the case of debt securities, the trustee. Although the prospectus supplements and certain related documents are filed with the SEC at the time of a "take-down" of securities "off the shelf," the SEC does not ordinarily review these filings.[8]

SHELF UPDATING PROCEDURES

In order to issue securities registered on a shelf registration statement, an issuer must keep current the information about itself that is included or incorporated by reference in the prospectus. This is required by the undertakings that the issuer must make to the SEC when it registers securities in accordance with Rule 415 under the 1933 Act and Rule 3-12 of Regulation S-X or, in the case of foreign private issuers, Item 8.A of Form 20-F. Rule 3-12 of Regulation

[7] All documents required to be qualified under the 1939 Act must be filed or incorporated by reference as exhibits to the registration statement and so qualified prior to effectiveness of the registration statement or by means of a post-effective amendment.

[8] In connection with many shelf registration programs, the SEC has indicated that it will review prospectus supplements that relate to "novel or unique" securities. Therefore, in connection with such securities or other product areas that raise questions about the application of the 1933 Act, it may be prudent to consult with the SEC in advance of an offering to ensure that it has no objections prior to issuing the securities off the shelf.

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S-X and Item 8.A of Form 20-F govern the age of financial statements that foreign private issuers filing 1933 Act registration statements on the "F" Forms are required to include or incorporate by reference in any prospectus used to sell securities in the U.S. capital markets.[9]

Rule 415 Undertakings

Item 512(a) of Regulation S-K requires that if securities are being registered pursuant to Rule 415 under the 1933 Act, the issuer must include in the 1933 Act registration statement undertakings that, among other things, require the issuer (other than a registrant on Form S-3, S-8 or F-3) to file, during any period in which offers are being made, a post-effective amendment:[10]

(1) to include any prospectus required by Section 10(a)(3) of the 1933 Act (which provides that any prospectus used more than nine months after the effective date of a 1933 Act registration statement must contain information as of a date not more than 16 months prior to its use);

(2) to reflect in the prospectus any facts or events arising after the effective date of the 1933 Act registration statement (or the most recent post-effective amendment) that, individually or in the aggregate, represent a "fundamental change" in the information set forth therein; and

(3) to include any material information with respect to the plan of distribution not disclosed in the 1933 Act registration statement or any material change in such information.

In the case of registration statements on Form S-3 or F-3, these undertakings are generally satisfied by including the required information in a 1934 Act report that automatically is incorporated by reference in the 1933 Act registration statement or in a prospectus supplement.

Item 512(a) of Regulation S-K also requires an agreement by the issuer that information in any prospectus supplement is deemed part of and included in the registration statement and that new effective dates as to the issuer and underwriter will occur in respect of each prospectus related to most shelf takedowns.

Item 8 of Form 20-F

As discussed in Chapter 4 (*Disclosure Requirements*) of this volume, in order for an offering to be registered under the 1933 Act, the financial statements included or incorporated by reference in the prospectus used to sell the securities must be within specified time periods. A foreign private issuer can facilitate uninterrupted access to the U.S. capital markets by providing

9 For further information on the requirements regarding the age of financial statements and related issues, see the discussion under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 8: Financial Information" in Chapter 4 (*Disclosure Requirements*) of this volume.

10 Post-effective amendments are subject to SEC review and, unlike prospectus supplements, must be declared effective by the SEC before the prospectus may be used in confirming sales.

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(1) consolidated financial statements, audited by an independent auditor, comprised of a balance sheet, income statement, shareholders' equity statement, cash flow statement, and related notes and schedules and (2) an audit report that covers each of the periods for which audited financial statements are required. A balance sheet for the earliest year of the three-year period need not be provided if it is not required by the issuer's home jurisdiction. Additionally, the last year of audited financial statements may not be older than 15 months at the time of the offering or listing and, if the document is dated more than nine months after the end of the last audited financial year, it should contain consolidated interim financial statements, which may be unaudited, covering at least the first six months of the financial year.[11]

DUE DILIGENCE

The due diligence performed by investment banks and their counsel for a 1933 Act-registered offering has adapted to the continuous or delayed offering aspects of shelf registrations. At the time an issuer registers securities on a 1933 Act shelf registration statement, interview due diligence sessions and document due diligence sessions are conducted in much the same fashion as a non-shelf registration.[12] Following shelf registration, due diligence is done on an "update" basis.

Updating interview and document due diligence when an issuer publishes its annual and interim financial statements is the preferred approach for issuers that want to ensure their shelf registrations are available on short notice. Generally, unless there are significant problems or developments in the issuer's business, interview and document due diligence for continuously offered securities such as medium-term notes are only updated when new financial statements are published. In between these sessions, the selling agents rely on their prior due diligence efforts and the knowledge that their banking and research personnel have about the issuer. The interview due diligence sessions are either meetings or conference calls with the selling agents and their counsel. In the case of a debt shelf that permits the issuance of securities other than medium-term notes, it is customary for the issuer to invite prospective managing underwriters and their counsel to the periodic update meetings and to update the due diligence by conference call prior to the time of each take down.[13]

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[11] See Chapter 4 (*Disclosure Requirements*) of this volume for a further discussion of the financial statement requirements for a foreign private issuer.

[12] See Chapter 1 (*The U.S. Offering Process*) of this volume for a further discussion of due diligence.

[13] For a discussion from the underwriter's point of view of due diligence techniques in shelf takedowns and medium-term note offerings, see the Committee on Federal Regulation of Securities' report entitled Report of Task Force on Sellers' Due Diligence and Similar Defenses Under the Federal Securities Laws (48 BUS. LAW. 1185 (1993).

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CHAPTER 6

LISTING ON U.S. SECURITIES EXCHANGES

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GENERAL

U.S. issuers and foreign private issuers may list their equity and other types of securities, such as debt, equity-linked debt and preferred securities, on U.S. securities exchanges, but foreign private issuers generally opt to list their ordinary or common equity securities in the form of ADRs. An ADR is a negotiable certificate issued by a U.S. bank or depository representing a specified number of shares of a foreign stock that is traded on a U.S. exchange. ADRs are denominated in U.S. dollars, and the underlying security is held by a U.S. financial institution outside the United States.

The reasons that foreign private issuers typically opt to list securities in the form of ADRs, rather than as non-ADR securities traded in their home countries, are outside the scope of this chapter. However, these reasons generally include (from the standpoint of the issuer) facilitating entry into the U.S. market by the foreign issuer without investors having to acquire those shares in a cross-border transaction and possibly enabling the issuer to obtain a better valuation for its share price than it would if the investors were obligated to buy the shares through a cross-border transaction; and (from the standpoint of the investor) providing a more convenient way to access shares of the issuer, a more liquid market in which to buy and sell these securities (ADRs price and pay dividends in U.S. dollars and are traded like the securities of U.S. companies) and a more cost-efficient way to access the securities of the foreign issuer (ADRs avoid custody fees and dividends on them can offer more attractive foreign exchange rates). In addition, trades that settle in the United States very rarely fail to be delivered, a problem that can be common in emerging markets.

An exemption from 1934 Act registration under Section 12(g) of the 1934 Act allows a foreign private issuer to have its securities traded in the U.S. over-the-counter markets, typically for the purpose of establishing an unlisted ADR facility. Previously, in order to establish and maintain the exemption, an issuer was required to make an application and submit to the SEC a list of its non-U.S. disclosure requirements and copies of its home country disclosure documents (meaning those produced in accordance with the requirements of its home country's regulator) that were published since the beginning of its last fiscal year and on a continuous basis for as long as its ADRs remain outstanding. Effectively, this requirement meant that the Section 12(g) exemption from registration was limited to ADR facilities (discussed below) established by the issuer itself or by a depositary with the consent and assistance of the issuer, establishing what is referred to as a "sponsored" ADR facility. "Depositaries" for ADR facilities are banks organized in the United States that provide all the security transfer and agency services in connection with the ADR facility.

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Under recent amendments to Rule 12g3-2(b) under the 1934 Act, the SEC eliminated the written application and paper submission requirement that the foreign private issuer seeking this exemption from registration submit to the SEC its home country disclosure documents.[1] The revised Rule mandates that these foreign private issuers post specified non-U.S. disclosure documents in English on their web sites or publish them through an electronic information delivery system in the issuer's primary market. One of the practical effects of these amendments is to remove the limitation on use of the exemption to issuers and sponsored depositaries and open it to use by depositories without the consent or even advance knowledge of the issuer.

The form used to register ADRs with the SEC is Form F-6, which can be filed either by an issuer or by a depositary. Where Form F-6 is filed by a depositary to register ADRs not sponsored by the issuer, the amendments permit the filing of the Form F-6 to be based on a representation by the depositary that it has a reasonable, good-faith belief that the issuer has complied with the new Rule 12g3-2(b) electronic publication condition.[2]

There are three levels of ADR facilities by which to do this:

- "Level One": a facility that permits the non-U.S. issuer's ADRs to trade in the private or over-the-counter markets;
- "Level Two": a facility that permits the non-U.S. issuer to list its ADRs on a U.S. national securities exchange; and
- "Level Three": a facility established by the non-U.S. issuer to list its ADRs in connection with a U.S. public offering thereof.

Compared to Level One facilities, Level Two and Level Three facilities generally reach wider markets of investors and promote more active trading in the ADRs. Level Two and Level Three facilities provide the U.S. markets with the types of information required for a U.S. public offering, and Level Three facilities are established to undertake a U.S. public offering.

We have set forth below certain considerations and procedures relating to listing ADRs on the NYSE, the NYSE Arca, the NYSE Alternext US[3] or NASDAQ, followed by a summary description of the requirements applicable to listing certain other types of securities on the NYSE, the NYSE Arca and the NYSE Alternext US. As discussed in this chapter below, NASDAQ consists of three different markets.

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1 See SEC Release No. 34-58465 (Sept. 5, 2008) (http://www.sec.gov/rules/final/2008/34-58465.pdf). See also the discussion under the heading "Information Reporting under Rule 12g3-2(b) for Foreign Private Issuers" in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume for a further discussion of Rule 12g3-2(b) and the recent amendments.

2 Id.

3 Formerly known as the American Stock Exchange, or AMEX. Following the acquisition of the AMEX by NYSE Euronext on October 1, 2008, the AMEX was renamed NYSE Alternext US LLC. The NYSE Alternext US has indicated it will continue to engage in the business of operating a national securities exchange registered under Section 6 of the 1934 Act.

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At the time of publication of this volume, the rules of the NYSE and the NYSE Alternext US currently contemplate that ADRs listed on those exchanges will be sponsored by the issuer of the underlying securities. While NASDAQ presently does not have a rule requiring sponsorship of ADRs, as a practical matter an ADR facility must be sponsored before it will be accepted for listing by NASDAQ.[4] It is conceivable that one or more of these exchanges will consider amending its rules to permit the listing of unsponsored ADRs, which are presently limited to trading in the over-the-counter market.

As a general rule, to qualify for listing on a U.S. national securities exchange, securities must be registered with the SEC under the 1934 Act. Registration under the 1934 Act must be made on Form 10, in the case of securities of a U.S. issuer, or Form 20-F, in the case of securities of a foreign private issuer or ADRs representing such securities, unless the issuer is already filing reports under the 1934 Act or the registration simultaneously accompanies a 1933 Act-registered public offering, in which case Form 8-A may be used.[5] Once an issuer has registered securities under the 1934 Act, it will have to comply with certain periodic reporting requirements. These requirements include, at a minimum, filing with the SEC quarterly reports on Form 10-Q, periodic reports on Form 8-K and annual reports on Form 10-K, in the case of a U.S. issuer, and annual reports on Form 20-F, in the case of a foreign private issuer.[6]

Form 10-K or 20-F, which must be prepared and signed by the issuer, requires general information as to the business, properties, capitalization, legal proceedings, and management of the issuer, and, if the securities are represented by ADRs, information concerning the applicable depositary bank and the deposit agreement; however, it does not require all of the detailed information required to be submitted by a U.S. issuer.

LISTING ON THE NYSE AND THE NYSE ARCA

NYSE Euronext operates three exchanges in the United States: the NYSE, the NYSE Arca (a fully electronic exchange that has lower minimum listing standards than the NYSE) and the NYSE Alternext US, formerly known as the AMEX. A discussion regarding listing on this exchange is in this chapter below under "—Listing on the NYSE Alternext US."

A U.S. issuer must qualify for listing on the NYSE under the NYSE's domestic listing standards (the "NYSE Domestic Listing Standards"). A non-U.S. issuer may elect to qualify for listing under either the NYSE Domestic Listing Standards or under the Alternate Listing Standards for non-U.S. issuers (the "NYSE Alternative Listing Standards"). The NYSE Domestic Listing Standards address distribution of securities within the United States, while the NYSE Alternative Listing Standards address worldwide distribution of a non-U.S. issuer's securities. Non-U.S. issuers that do not meet the U.S. public share distribution requirements of the NYSE Domestic Listing Standards may seek listing on the NYSE pursuant to the NYSE

4 Certain ADRs that were unsponsored when first admitted to trading on the NYSE or AMEX (as predecessors of the NYSE Alternext US) or accepted for quotation on NASDAQ prior to establishment of these requirements have been permitted to retain their listing or quotation privileges.

5 These and other SEC forms are available at http://www.sec.gov/about/forms/secforms.htm.

6 See Chapter 3 (*The Securities Registration and Reporting Process*) and Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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Alternative Listing Standards. The latter require that a broad, liquid market for the issuer's shares exist in its home country.

To qualify for listing on the NYSE Arca, both U.S issuers and non-U.S. issuers must meet the same listing standards, which are lower minimum listing standards than those applicable to the NYSE.

NYSE Listing Process

The first step in the application process for listing on the NYSE is to contact the NYSE to request a confidential review of eligibility. Only after the NYSE has provided the issuer with a letter notifying it of its eligibility clearance and conditions of listing should the issuer submit a listing application to the NYSE. In connection with the submission of the listing application, the issuer must also file a registration statement on Form 10, 20-F or 8-A registering the common or ordinary equity securities under the 1934 Act and, in the case of a foreign private issuer, a registration statement on Form F-6 registering (*e.g.*, the ADRs under the 1933 Act).[7] The data should be set forth in the listing application in narrative form and supplemented by financial statements as required. The narrative should provide a summary description of the issuer's business and its securities. The issuer should also attach any information required as discussed in this chapter below.

An issuer interested in listing on the NYSE Arca must submit to the NYSE Arca a listing application and the information required as described below. Issuers that meet the NYSE Arca's listing standards are not automatically approved and the listing approval of a given issuer is at the sole discretion of the NYSE Arca. During the eligibility review process, the NYSE Arca will review the issuer's compliance with the applicable financial and corporate governance requirements, as well as biographies of the members of the issuer's board of directors and board committees. The NYSE Arca will also examine the following:

(1) the issuer's financial condition, accounting practices, ability to service existing obligations, financing and expense ratio;

(2) nature and scope of the issuer's operations, demonstrated ability to develop new products or services and future plans;

(3) purpose of offering and use of proceeds (if applicable), product development, marketing, licensing and working capital;

(4) composition of the issuer's assets, reserves, royalties and intangible assets;

(5) management's experience and reputation;

(6) government policies;

(7) competition and industry condition; and

(8) credit ratings.

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[7] Customarily, it would be the ADR depositary bank's responsibility to prepare the Form F-6.

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The NYSE Arca will also conduct a merit review that considers the issuer's overall compliance with all listing criteria, the issuer's response to the exchange's "comment" letters and also comments from the SEC on the issuer's registration statement. The NYSE Arca may also initiate dialog with state administrators in certain states where the issuer seeks to register stock for sale to the public.

NYSE Listing Fees

The fees payable to the NYSE or the NYSE Arca consist of an initial listing fee and an annual listing maintenance fee.

Initial Listing Fees. On the NYSE, the initial listing fee, which is subject to a minimum of U.S.$150,000 and a maximum of U.S.$250,000, is calculated in the following manner using the NYSE current fee schedule:[8] (A) an "original fee" of U.S.$37,500 plus (B) U.S.$0.0048 per share for the first 75 million shares or, in the case of a non-U.S. issuer, shares represented by the ADRs, plus (C) U.S.$0.00375 per share for the next 225 million shares or, in the case of a non-U.S. issuer, shares represented by the ADRs, plus (D) U.S.$0.0019 per share for any shares over 300 million.[9]

On the NYSE Arca, the initial listing fee is, subject to a maximum of U.S.$250,000 total initial listing fee and annual fee payable by an issuer per year, U.S.$100,000 for a listing of fewer than 30 million shares; U.S.$125,000 for a listing of 30 million to 50 million shares; and U.S.$150,000 for the listing of more than 50 million shares. The initial listing fee applies to both U.S. issuers and non-U.S. issuers, provided that, for U.S. issuers, the initial listing fee is determined based on the aggregate total shares outstanding at the time of listing, whereas for non-U.S. issuers, the initial listing fee is determined based on the total shares issued and outstanding in the United States. The initial listing fee is waived for issuers that transfer their listing from the NYSE to the NYSE Arca and for issuers that list upon emergence from bankruptcy, or whose primary class of common shares is registered under the 1934 Act but not listed on a national securities exchange.

Annual Fees. Annual listing fees are required on a calendar-year basis to maintain the listing. A U.S. issuer's annual fees are based on the number of all issued and outstanding shares as of December 31 of the previous year, whereas a non-U.S. issuer's annual fees are based on a four-quarter average of the number of ADRs issued in the U.S. and are equal to the greater of the minimum fee or the fee calculated on a per share basis. The NYSE divides equity securities into five classes and each class has a different minimum fee and fee per share. A portion of the annual fee in respect of the first calendar year of the listing, prorated for portion of the calendar year remaining after the initial listing, is due upon the initial listing.

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8 The NYSE has a cap of U.S.$500,000 for total fees (initial and annual listing fees) payable in one year.

9 For example, if a non-U.S. issuer seeks to list ADRs representing 125 million shares, the fee would be the maximum of U.S.$250,000, because the calculated amount of U.S.$585,000 exceeds the maximum initial listing fee. The calculated amount would be the sum of: (A) U.S.$37,500 for the original fee; plus (B) U.S.$360,000 for the first 75 million shares, calculated at the rate of U.S.$0.0048 per share; plus (C) U.S.$187,500 for the next 50 million shares, calculated at the rate of U.S.$0.00375 per share.

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On the NYSE Arca, the annual fee is, subject to a maximum of U.S.$250,000 total initial listing fee and annual fee payable by an issuer per year, calculated as follows: (i) U.S.$30,000 for up to 10 million shares; (ii) U.S.$30,000 plus U.S.$0.000375 per share above 10 million for 10,000,001 to 100 million shares; and (iii) U.S.$85,000 for more than 100 million shares. The annual fee is payable in January of each calendar year. The annual fee for the first year of a listing will be pro-rated based on days listed in that calendar year. The annual fees apply to both U.S. issuers and non-U.S. issuers. For non-U.S. issuers, the annual fee will be calculated based on a four-quarter average of the securities issued and outstanding in the United States during the preceding year.

NYSE Listing Standards

As noted above, the NYSE offers two sets of standards, the NYSE Domestic Listing Standards and the NYSE Alternative Listing Standards, under which issuers may qualify for listing. U.S. issuers must qualify for listing on the NYSE under the NYSE Domestic Standards, whereas non-U.S. issuers may qualify for listing on the NYSE under either the NYSE Domestic Standards or the NYSE Alternative Listing Standards. Both standards include distribution and financial criteria and an issuer must satisfy both criteria within that particular standard.

NYSE Domestic Listing Standards.[10] In order to list equity securities on the NYSE under the NYSE Domestic Listing Standards, an issuer must meet the following distribution requirement:

(i) it must have (A) at least 400 shareholders in the United States each of which owns 100 or more shares of the issuer's stock (or ADRs representing such number of shares); (B) at least 2,200 shareholders in the United States and a U.S. average monthly trading volume of at least 100,000 shares (or ADRs representing such number of shares) for the most recent six months; or (C) at least 500 shareholders in the United States and a U.S. average monthly trading volume of at least one million shares (or ADRs representing such number of shares) for the most recent 12 months; and

(ii) it must also have at least 1.1 million publicly-held shares (or ADRs representing such number of shares) in the United States with an aggregate market value in excess of U.S.$100 million (U.S.$60 million in the case of issuers that list at the time of their IPO, as a result of a spin-off or under the NYSE's affiliated company standard).

The issuer must also meet one of the following financial standards:

(a) its pre-tax income must total at least U.S.$10 million in the aggregate for the latest three fiscal years, each of which must be profitable, with at least U.S.$2 million for each of the two most recent fiscal years; or

[10] Issuers organized under the laws of Canada, Mexico and the United States (collectively, "North America") may satisfy the minimum holder and trading volume requirements of the NYSE's domestic initial listing standards by reference to holders and trading volume in all of North America. With respect to ADRs, volume in the ordinary shares will be adjusted to be on an ADR-equivalent basis.

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(b) it must have at least U.S.$500 million of worldwide market capitalization, with at least U.S.$100 million in revenues in the most recent twelve-month period and aggregate cash flow of U.S.$25 million for the last three years, all of which must be profitable;[11] or

(c) it must have at least U.S.$750 million in worldwide market capitalization and at least U.S.$75 million of revenues during the most recent fiscal year; or

(d) it must have at least U.S.$500 million in worldwide market capitalization, have been operating for at least 12 months, and have a parent or an affiliated company that is listed and is in good standing, and the parent or affiliated listed company must retain control of the entity or be under common control with the entity.

NYSE Alternative Listing Standards. In order to list equity securities on the NYSE under the NYSE Alternative Listing Standards, a non-U.S. issuer must have at least 5,000 shareholders worldwide who each own 100 or more shares of the issuer's stock. The issuer also must have at least 2.5 million publicly-held shares worldwide with a market value in excess of U.S.$100 million or, in the case of issuers listing under the financial criteria described in (d) below, U.S.$60 million.

The non-U.S. issuer must also meet one of the following financial criteria:

(a) its pre-tax income must equal at least U.S.$100 million in the aggregate for the last three fiscal years together with a minimum of U.S.$25 million in each of the most recent two fiscal years; or

(b) it must have not less than U.S.$500 million of worldwide market capitalization and U.S.$100 million of revenues in the most recent twelve-month period and at least U.S.$100 million of aggregate cash flow for the last three fiscal years, where each of the two most recent years is reported at a minimum of U.S.$25 million;[12] or

(c) it must have at least U.S.$750 million in total worldwide market capitalization with at least U.S.$75 million in revenues for the most recent fiscal year; or

(d) it must have at least U.S.$500 million in total worldwide market capitalization, have at least 12 months of operating history, and have a parent or affiliated company listed on the NYSE that is in good standing, and the parent or the affiliated listed company must retain control of the issuing entity or is under common control of the entity.

Representatives of the NYSE have advised that the NYSE is prepared to be flexible in applying these numerical requirements to non-U.S. issuers.

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[11] Cash flow represents net income adjusted to (a) reconcile such amounts to cash provided by operating activities and (b) exclude changes in operating assets and liabilities.

[12] Id.

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NYSE Arca Initial Listing Standards. In order to list equity securities on the NYSE Arca, an issuer must have, at the time of initial listing:

(i) at least 1.1 million publicly-held shares;

(ii) an initial public offering price per share of U.S.$5 or more (if the issuer is listing in conjunction with an initial public offering) or a closing price per share of U.S.$5 or more (currently traded issuers must meet this requirement on the basis of a 90-day average of the closing price of its common stock prior to applying for listing and cannot fall below U.S.$1 per share during the 90-day period before applying for listing;

(iii) a minimum of 400 shareholders who each own 100 or more shares of the issuer's stock;

(iv) a market value of publicly-held shares of at least U.S.$45 million;

(v) at least U.S.$150 million in total market capitalization (currently-traded issuers must meet this requirement on the basis of a 90-day average of the closing price of their common stock prior to applying for listing).

The issuer must also meet two of the following four financial conditions:

(a) it must have total assets of at least U.S.$75 million;

(b) it must have at least U.S.$50 million in revenues for the most recent fiscal year;

(c) it must have shareholders' equity of at least U.S.$50 million; or

(d) its pre-tax income must be positive for the latest fiscal year.

Information Required. In order to conduct a confidential eligibility review, the NYSE requires a U.S. issuer to provide it with the following information:

(1) certified copy of the corporate charter and by-laws;

(2) specimens of certificates representing securities traded or to be traded;

(3) the issuer's annual reports to shareholders for the last five years, including two copies of the latest report;

(4) the latest available prospectus covering an offering under the 1933 Act and latest Form 10-K filed with the SEC;

(5) the proxy statement for the most recent annual general meeting;

(6) a distribution schedule for the issuer's securities on the NYSE's form; and

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(7) supplementary data required by the NYSE in order to determine the character of the share distribution and the number of publicly-held shares.[13]

In order to conduct a confidential eligibility review, the NYSE requires a non-U.S. issuer to provide it with the following information:

(1) certified copy of the corporate charter and by-laws (translated into English);

(2) specimens of certificates representing securities traded or to be traded in the United States, along with a copy of any deposit agreement, if applicable;

(3) the issuer's annual reports to shareholders for the last five years, including two copies of the latest report;[14]

(4) the latest available prospectus covering an offering under the 1933 Act and latest annual filings with the SEC, if any;[15]

(5) the proxy statement or equivalent material made available to shareholders of the issuer for the most recent annual general meeting (translated into English);

(6) worldwide and U.S. distribution schedules for the issuer's securities; and

(7) supplementary data required by the NYSE in order to determine the character of the share distribution and the number of publicly-held shares, both worldwide and in the United States;[16]

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[13] This information should include the names of the 10 largest shareholders, including beneficial owners if known; the identities of NYSE member organizations holding 1,000 or more shares; the price range and trading volume of the issuer's securities in NASDAQ or other registered stock exchanges during each of the last two years; summary, by principal groups, of stock owned or controlled by the issuer's directors, officers, their immediate families or 10% holders; descriptions with respect to shares held under investment letters; an estimate of the number of non-officer employees owning shares of the issuer and the total shares held; shares of the issuer held in profit sharing, savings, pension or similar plans or trusts for the benefit of the issuer's employees; and a description of the basis on which employee's participation is allocated or vested and the circumstances under which employees may receive the issuer's shares, and provision for 'pass through' of voting rights to employees or other methods of voting shares of the issuer.

[14] If no English version is available, the non-U.S. issuer must provide translations for the last three years.

[15] If no documents have been filed with the SEC, the non-U.S. issuer must provide a copy of the most recent document utilized in connection with an offering of securities to the public or to its existing shareholders, as well as any filings made with any regulatory authority.

[16] This information should include the names of the 10 largest shareholders; the identities of NYSE member organizations holding 1,000 or more shares or other units; a list of the stock exchanges or other markets upon which the non-U.S. issuer's securities are currently traded, as well as the price range and trading volume of those securities over the past five years; descriptions with respect to any stock owned or known to be controlled by the non-U.S. issuer's directors, officers, their immediate families or 10% holders; descriptions with respect to any type of restrictions relating to the non-U.S. issuer's shares; an estimate of share ownership by non-officer employees; and shares of the non-U.S. issuer held in profit sharing, savings, pension or similar plans for the benefit of the non-U.S. issuer's employees.

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(8) if the issuer has any partially-owned subsidiaries, it must provide detailed ownership information (whether public or private) as to the shares it does not own (as well as any share ownership by directors or officers therein);

(9) a list of the issuer's principal bankers and a statement disclosing holdings of more than 5% of the issuer's stock by any of such bankers;

(10) the identity of any regulatory agency that regulates the issuer or any portion of its operations and a description of such regulations, including the impact of such regulations on taxation, accounting, foreign exchange controls and other areas;

(11) the names, titles and principal occupations of the issuer's directors and principal officers;

(12) the total number of employees and general status of labor relations; and

(13) a description of any pending material litigation along with an opinion as to its potential impact on the issuer's operations.

Because of the widespread use of bearer securities outside the United States, some non-U.S. issuers may have difficulty establishing that they have the number of shareholders on a worldwide basis required to satisfy the NYSE Alternative Listing Standards. In such cases, sponsorship by a NYSE member firm with respect to the liquidity and depth of the market for the issuer's shares may substitute for documentation concerning the number of shareholders. In any case, the NYSE staff must be satisfied that a broad and independent market exists for the non-U.S. issuer's shares. For a non-U.S. issuer with minimal U.S. distribution, the primary non-U.S. market must provide sufficient liquidity against which arbitrage transactions in the United States can be effected.

In order to conduct an eligibility review, the NYSE Arca requires an issuer to provide it with the following information:

(1) if the listing is for initial public offerings:

 (a) the issuer's latest registration statement and exhibits; and

 (b) the SEC's comments and responses.

(2) if the listing is not for initial public offerings:

 (a) the issuer's latest Form 10-K and 10-Q filings with the SEC;

 (b) the issuer's latest proxy statement and latest prospectus;

 (c) the past six-months' trading history of the securities; and

 (d) evidence of approval by the NYSE, NYSE Alternext US or NASDAQ.

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(3) opinion of counsel as to issuer's compliance with certain corporate governance requirements;

(4) articles of incorporation and by-laws of the issuer;

(5) registrar/transfer agent agreement; and

(6) specimens of certificates representing the securities.

If the listing is for an initial public offering, the NYSE Arca will also require an issuer to submit, after trading has started, a distribution schedule that identifies the issuer's beneficial holders.

Corporate Governance Requirements. In addition to the minimum numerical standards for listing, each of the NYSE and the NYSE Arca has established its respective policies and requirements concerning interim earnings reporting and certain corporate governance practices, such as structure and composition of the board of directors, shareholder approval, quorum requirements for shareholders meetings and related requirements. These policies and practices may not necessarily be consistent with the laws or practices of the jurisdictions in which a non-U.S. issuer is organized.

The SEC has approved rules on corporate governance for the NYSE, which were filed by the Exchange in response to passage of Sarbanes-Oxley. The corporate governance standards are set out in Section 303A of the NYSE Listed Company Manual ("Section 303A") and require a listed issuer to:

- have a majority of independent directors;[17]
- have regularly scheduled executive sessions in which non-management directors meet without management participation;
- have a nominating/corporate governance committee composed entirely of independent directors;[17]
- have a compensation committee composed entirely of independent directors;[17]
- have an audit committee that has at least three members, satisfies the requirements of Rule 10A-3 under the 1934 Act, and consists solely of independent directors who have the requisite financial experience and expertise;
- provide shareholders the opportunity to vote on all equity-compensation plans and material revisions thereto, with certain limited exemptions;[18]

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17 The following issuers are exempted from such requirement: (i) an issuer of which more than 50% of the voting power is held by an individual, a group or another company, (ii) limited partnerships and (iii) companies in bankruptcy proceedings.

18 Shareholder approval is not required for employment inducement awards, certain grants, plans and amendments in the context of mergers and acquisitions, and certain specific types of plans, as described in Section 303A of the NYSE Listed Company Manual. However, these exempt grants, plans and

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- adopt and disclose corporate governance guidelines;
- adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers;
- provide to the NYSE each year a certification by the issuer's CEO that he or she is not aware of any violation by the issuer of NYSE corporate governance listing standards, which certification can be qualified to the extent necessary;
- promptly notify the NYSE in writing after any executive officer becomes aware of non-compliance with any applicable provision of Section 303A;
- submit an executed written affirmation annually to the NYSE and an interim written affirmation each time a change occurs to the board or any of the committees subject to Section 303A; and
- have and maintain a publicly accessible web site.

For the purposes of Section 303A, a director does not qualify as independent unless the board of directors of the issuer has made an affirmative determination that such director has no material relationship with the issuer, either directly or as a partner, shareholder or officer of an organization that has a relationship with the issuer. Furthermore, a director does not qualify as independent under Section 303A if:

(1) such director is, or has been within the last three years, an employee of the issuer, or an immediate family member is, or has been within the last three years, an executive officer of the issuer;

(2) such director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than U.S.$120,000 in direct compensation from the issuer, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service);

(3) (A) such director or an immediate family member is a current partner of a firm that is the issuer's internal or external auditor; (B) such director is a current employee of such a firm; (C) such director has an immediate family member who is a current employee of such a firm and personally works on the issuer's audit; or (D) the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such a firm and personally worked on the issuer's audit within that time;

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amendments may be made only with the approval of the issuer's independent compensation committee or the approval of a majority of the independent directors. Issuers must also notify NYSE in writing when they use one of these exemptions.

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(4) such director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the issuer's present executive officers at the same time serves or served on the compensation committee of such other company; or

(5) such director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the issuer for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of U.S.$1 million, or 2% of such other company's consolidated gross revenues.

An issuer that is a closed-end or open-end management investment company registered under the 1940 Act is not required to comply with all the NYSE corporate governance standards, but is required to (i) have an audit committee, (ii) promptly notify the NYSE in writing after any executive officer becomes aware of any non-compliance with the applicable corporate governance standards and (iii) submit an executed written affirmation annually to the NYSE and an interim written affirmation each time a change occurs to the board or audit committees. In addition, an issuer that is a closed-end investment company is also required to provide to the NYSE each year a certification by the issuer's CEO that he or she is not aware of any violation by the issuer of the applicable NYSE corporate governance standards, which certification can be qualified to the extent necessary.

Section 303A allows listed companies that are foreign private issuers to follow home country practice in lieu of the new requirements, except that such issuers would be required to:

(1) have an audit committee that satisfies the requirements of Rule 10A-3 under the 1934 Act;[19]

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[19] Note that Rule 10A-3(c)(3) under the 1934 Act also provides exemptions to certain audit committee requirements for listed foreign private issuers. Pursuant to Rule 10A-3(c)(3) under the 1934 Act, a foreign private issuer does not need to comply with any of the requirements of Rule 10A-3(b)(1) (independence of audit committee members), (b)(2) (direct responsibility of audit committee over registered public accounting firm), (b)(3) (establishment of procedures for complaints), (b)(4) (authority to engage advisers) or (b)(5) (appropriate funding) if it can meet the following requirements:

(1) the issuer has a board of auditors or similar body, or has statutory auditors, established and selected pursuant to home country legal or listing provisions that expressly require or permit such a board or similar body;

(2) the board or body, or statutory auditors, is required under home country legal or listing requirements to be either (i) separate from the board of directors or (ii) composed of one or more directors and one or more non-directors;

(3) the board or body, or statutory auditors, is not elected by the issuer's management and no executive officer is a member of such board or body, or statutory auditors;

(4) home country legal or listing provisions set forth or provide for standards for the independence of such board or body, or statutory auditors, from the issuer or its management;

(5) pursuant to any applicable home country legal or listing requirements or the issuer's governing documents, such board or body, or statutory auditors, is responsible, to the extent permitted by law, for the appointment, retention and oversight of the work of any registered public accounting

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(2) provide the NYSE with a certification by the CEO of the issuer that he or she is not aware of any violation by the issuer of NYSE corporate governance listing standards, which certification can be qualified to the extent necessary;

(3) promptly notify the NYSE in writing after any executive officer becomes aware of non-compliance with any applicable provision of Section 303A;

(4) submit an executed written affirmation annually to the NYSE and an interim written affirmation each time a change occurs to the board or any of the committees subject to Section 303A; and

(5) provide a brief general summary of the significant ways in which its governance practices differ from those of domestic listed companies as required by the NYSE listing standards.

With respect to the last requirement, foreign private issuers may provide this disclosure either on their web site (provided that it is in English and accessible from the United States) and/or their annual reports as distributed to shareholders in the United States. If the disclosure is made available only on a web site, the annual report is required to state this and provide the web site address at which the information may be obtained.

Any non-U.S. issuers that are not foreign private issuers (as defined in Rule 3b-4 under the 1934 Act) cannot rely on the exemption provided in Section 303A. Instead, such issuers must follow the NYSE requirements that are applicable to domestic listed issuers.[20]

Issuers with securities listed on the NYSE Arca must comply with the corporate governance and disclosure policies established by the NYSE Arca. With a few exceptions,[21] the

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firm engaged (including the resolution of disagreements between the management and the auditor regarding financial reporting, to the extent permitted by law) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer; and

(6) the audit committee requirements of Rules 10A-3(b)(3), (b)(4) and (b)(5) apply to such board or body, or statutory auditors, to the extent permitted by law.

If a foreign private issuer relies on one of the exemptions, it must disclose in an annual report its reliance on the exemption and its assessment of whether, and if so, how, such reliance will materially adversely affect the ability of its audit committee to act independently and to satisfy other requirements of Rule 10A-3. For purposes of Rule 10A-3, the term "board of directors" means the supervisory non-management board if the foreign private issuer has a two-tier board system.

Rules 10A-3(b)(1)(iv)(C), (D) and (E) under the 1934 Act also provide exemptions from the "no fee" requirement and the prohibition on affiliates of the issuer or any subsidiary thereof for audit committee members of listed foreign private issuers.

See also Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

[20] In response to a query from Sidley Austin, the NYSE confirmed that even if a non-U.S. issuer chooses to comply fully with all the requirements in Section 303A of the NYSE Listed Company Manual (*i.e.*, not relying on the available exemption to follow home country practice), the non-U.S. issuer needs to comply with Section 303A.11, disclosing any significant ways in which its corporate governance practices differ from those followed by domestic issuers under the NYSE standards.

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corporate governance and disclosure policies established by the NYSE Arca are generally the same for U.S. issuers and foreign private issuers. The NYSE Arca requires foreign private issuers to have audit committees that satisfy the requirements of Rule 10A-3 under the 1934 Act,[22] and to disclose any significant ways in which their governance differs from those of domestic listed companies required by the NYSE Arca listing standards. Foreign private issuers may provide such disclosure either on their web site (provided that it is in English and accessible from the United States) and/or their annual reports as distributed to shareholders in the United States. If the disclosure is made available only on a web site, the annual report is required to state this and provide the web site address at which the information may be obtained.

Rights Offerings. The NYSE sets forth certain requirements with respect to short-term rights offerings related to listed securities. Due to the potential complexity of rights offerings, the NYSE recommends that issuers confer with NYSE representatives well in advance of the offering date to discuss compliance with these requirements. Rule 801 under the 1933 Act exempts from the provisions of Section 5 of the 1933 Act rights offerings in respect of equity securities made on a *pro rata* basis to existing securityholders of the same class, including holders of ADRs evidencing those securities as long as the conditions specified in the Rule are met.[23]

Mergers, Acquisitions and Other Business Combinations. The NYSE requires shareholder approval as a prerequisite to listing securities in connection with:

(1) the issuing of securities for equity compensation plans;

(2) the issuance of common stock or securities convertible into or exercisable for common stock to a director, officer or substantial securityholder of an issuer (a "Related Party"), a subsidiary, affiliate or other closely-related person of a Related Party or any company or entity in which a Related Party has a substantial direct or indirect interest if the number of shares of common stock to be issued or the number of shares of common stock into which the securities may be convertible or exercisable exceeds either 1% of the number of shares of common stock or 1% of the voting power outstanding before the issuance;[24]

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21 Certain provisions of the NYSE Arca's rules on corporate governance and disclosure policies are not applicable to foreign private issuers, *e.g.,* (i) Rule 5.3(b) of the NYSE Arca sets out the minimum number of independent directors for the board of directors of a U.S. issuer; (ii) Rule 5.3(k) of the NYSE Arca requires that a U.S. issuer must have a majority of independent directors on its board of directors. The NYSE Arca's rules do not provide for similar requirements for foreign private issuers.

22 A foreign private issuer with securities listed on NYSE Arca is therefore also eligible for the exemption from compliance with Rule 10A-3(b)(1), (2), (3), (4) and (5) under the 1934 Act if it meets the requirements set out in footnote 20 above.

23 See SEC Release No. 33-7759 (Oct. 22, 1999) (http://www.sec.gov/rules/final/33-7759.htm).

24 If a Related Party is classified as such solely because such person is a substantial securityholder and a sale of stock is for cash at a price at least as great as each of the book and market value of the issuer's common stock, then shareholder approval is not required. However, this exception becomes inapplicable if the number of shares of common stock to be issued or the number of shares of common stock into which the

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(3) where the present or potential issuance of common equity or securities convertible into common equity, in any one transaction or a series of related transactions, other than a public offering for cash or a *bona fide* private financing,[25] could result in (1) an increase in voting power of 20% or more or (2) an increase in the amount of outstanding common equity of 20% or more; or

(4) the issuance that will result in a change of control of the issuer.[26]

The NYSE Arca requires shareholder approval as a prerequisite to the issuance of securities in the following situations:

(1) the issuing of securities for equity compensation plans;

(2) the issuance that will result in a change of control of the issuer;

(3) in connection with the acquisition of the shares or assets of another company:

(A) if any director, officer or substantial securityholder of the issuer has a 5% or more interest (or such persons collectively have a 10% or more interest), directly or indirectly, in the company or assets to be acquired or in the consideration to be paid in the transaction or series of related transactions, and the present or potential issuance of common equity or securities convertible into common equity could result in an increase in voting power or in the amount of outstanding common equity of 5% or more; or

(B) where the present or potential issuance of common equity or securities convertible into common equity, other than a public offering for cash, could result in (i) an increase in voting power of 20% or more or (ii) an increase in the amount of outstanding common equity of 20% or more;

(4) in connection with a transaction other than a public offering:

(A) the sale or issuance by the issuer of common equity or securities convertible into common equity at a price less than the greater of book or market value, which together with sales by officers, directors or principal shareholders of the issuer equals 20% or more of outstanding common equity, or 20% or more of outstanding voting power; or

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securities may be convertible or exercisable exceeds either 5% of the number of outstanding shares of common stock or 5% of the voting power outstanding before the issuance.

[25] A *bona fide* private financing involves a sale of: (i) common stock, for cash, at a price at least as great as each of the book and market value of the issuer's common stock or (ii) securities convertible into or exercisable for common stock, for cash, if the conversion or exercise price is at least as great as each of the book and market value of the issuer's common stock.

[26] With respect to stock option or purchase plans, the NYSE does not require shareholder approval by a foreign private issuer. Rather, the NYSE will allow foreign private issuers to use home country practice for such plans.

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(B) the sale or issuance by the issuer of common equity or securities convertible into common equity equal to 20% or more of outstanding equity or outstanding voting power for less than the greater of book or market value of the issuer's common stock.

NYSE Continued Listing Requirements

Listed issuers must continue to comply with certain ongoing requirements of the NYSE in order to maintain the securities listing on the NYSE. The NYSE will consider delisting a listed security under the following circumstances:[27]

(1) the extent of public distribution or the aggregate market value of the security has declined below certain levels;[28]

(2) the issuer's operating assets have been, or are to be, substantially reduced such as by sale, lease, spin off, discontinuance, destruction, condemnation, abandonment, seizure or expropriation, or the issuer has ceased to be an operating company or has discontinued a substantial portion of its operations for any reason whatsoever, whether or not this results from actions by the issuer, related parties, or persons unrelated to the issuer;

(3) the issuer's intention to file under any of the sections of applicable bankruptcy law has been announced or a filing has been made, or liquidation has been announced and the issuer is committed to proceed;

(4) the issuer's registration or exemption from registration pursuant to the 1934 Act is no longer effective for any reason; or

(5) advice has been received, and deemed by the NYSE to be authoritative, that the security is without value.

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[27] Certain other events may also cause an issuer's securities to be delisted, including the following: (1) the issuer, its transfer agent or registrar violates any of the listing or other agreements with the NYSE; (2) the entire class, issue or series of listed securities is repaid, redeemed or retired; (3) the issuer's interest coverage of debt securities becomes inadequate or its operations are not properly financed; (4) the issuer fails to make timely, adequate and accurate disclosure of information to its shareholders and the investing public; (5) the issuer fails to observe sound accounting practices; (6) the issuer participates in other conduct not in keeping with sound public policy; (7) the financial condition or operating results of the issuer are unsatisfactory; (8) the selling price or volume of trading with respect to listed securities of the issuer is abnormally low; (9) the issuer makes unwarranted use of its funds for the repurchase of its equity securities; (10) the issuer's audit committee is not maintained in accordance with Rule 10A-3 under the 1934 Act; or (11) any other event or condition that makes further dealings or listing of the securities on the NYSE inadvisable or unwarranted in the opinion of the NYSE.

[28] The NYSE recently announced its intention temporarily to lower from U.S.$25 million to U.S.$15 million the required floor for average global market capitalization over a consecutive 30 trading-day period. This change is expected to remain in effect through April 22, 2009 (and may be extended thereafter) (http://www.nyse.com/press/1232709549311.html).

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Listed issuers must continue to comply with certain requirements of the NYSE Arca in order to maintain the securities listing on the NYSE Arca. The NYSE Arca will consider delisting a listed security in circumstances substantially similar to those discussed in this chapter above under which the NYSE will consider delisting a listed security. Additional information on the NYSE Arca initial and continuing listing standards, fees, and other matters relating to listing securities on the NYSE Arca can be found in the NYSE Arca Equities Rules, which are available online at http://wallstreet.cch.com/PCX/PCXE.

LISTING ON THE NYSE ALTERNEXT US

Like the NYSE, the NYSE Alternext US has established certain numerical guidelines, outlined below, which will be considered in evaluating listing eligibility. In addition to these criteria, in making listing determinations the NYSE Alternext US considers other factors, including the nature of an issuer's business, the market for its products, the reputation of its management, its historical record and pattern of growth, its financial integrity, its demonstrated earnings power and its future outlook.

NYSE Alternext US Listing Process

In accordance with the NYSE Alternext US listing procedures, an issuer must submit a listing application that meets certain initial listing standards (the "NYSE Alternext US Initial Listing Standards"). For an issuer that commenced its listing process prior to an SEC Order released December 3, 2008, if the issuer's NYSE Alternext US Initial Listing Standards application is denied, then the issuer may appeal the NYSE Alternext US decision to the NYSE Alternext US listing Qualifications Panel by satisfying one of two minimum numerical alternative listing standards (the "Alternative Listing Standards").[29] For issuers commencing the listing process after December 3, 2008, a new confidential pre-application eligibility review process has been added and only the NYSE Alternext US Initial Listing Standards apply; the Alternative Listing Standards have been eliminated for any post-December 3, 2008 applicants.[30] Issuers that initially listed under the Alternative Listing Standards will remain listed and will not be affected by the change.

Usually, shares of non-U.S. issuers are listed on the NYSE Alternext US as ADRs. The listing of the ordinary shares will be considered, however, when: (a) the certificates evidencing such shares are printed in English and are in registered form; (b) the certificates are interchangeable and can be delivered and transferred in The City of New York as well as the issuer's home country; and (c) arrangements for distributing dividends and other rights and benefits to holders in the United States are equivalent to those provided by the use of ADRs.

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[29] See SEC Release No. 34-59050 (Dec. 3, 2008) (http://www.sec.gov/rules/sro/amex/2008/34-59050.pdf).

[30] However, because they continue to apply to pre-December 3, 2008 applicants, discussion of the Alternative Listing Standards has been retained in this volume.

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Additional information on NYSE Alternext US listing standards, fees, and other matters relating to listing securities on the NYSE Alternext US can be found in the AMEX Company Guide, which is available online at http://wallstreet.cch.com/AMEX/CompanyGuide.[31]

NYSE Alternext US Listing Fees

Entry Fees. The fees for an issuer, other than a non-U.S. issuer listed on a foreign stock exchange, listing shares or ADRs on the NYSE Alternext US will include: a one-time processing fee of U.S.$5,000 for an issuer that does not have a stock or warrant issue listed on the NYSE Alternext US; a fee of U.S.$40,000 for the listing of fewer than 5 million shares or ADRs; a fee of U.S.$50,000 for the listing of 5 million to 10 million shares or ADRs; a fee of U.S.$55,500 for the listing of 10,000,001 to 15 million shares or ADRs; and a fee of U.S.$65,000 for the listing of more than 15 million shares or ADRs. In the case of a non-U.S. issuer listed on a foreign stock exchange the original listing fee, including the one-time processing fee of U.S.$5,000, will be U.S.$40,000. For example, if a non-U.S. issuer not listed on a foreign stock exchange wants to list 10 million ADRs on the NYSE Alternext US, the fee would be U.S.$50,000 plus a one-time fee of U.S.$5,000, totaling U.S.$55,000. The initial listing fee and the U.S.$5,000 processing fee are waived for an issuer that transfers from a national securities exchange to list exclusively on the NYSE Alternext US or that is already listed on a national securities exchange.

Annual Fees. Listing of additional shares or ADRs subsequent to an original listing carries fees of U.S.$0.02 per share or ADR with a minimum fee of U.S.$2,000 and a maximum fee of U.S.$45,000 per application, with a U.S.$60,000 maximum total fee for additional listings. Annual fees range from a minimum fee of U.S.$27,500 to a maximum fee of U.S.$34,000 based on the number of shares outstanding. Upon the original listing, an issuer must also pay a prorated portion of the annual fee, based upon the portion of the calendar year remaining after the listing.

NYSE Alternext US Listing Standards

NYSE Alternext US Initial Listing Standards. In order to list equity securities on the NYSE Alternext US under the NYSE Alternext US Initial Listing Standards, an issuer must have a minimum public distribution of:

(a) 500,000 publicly-held shares in the United States and a minimum of 800 U.S. public shareholders;

(b) one million publicly-held shares in the United States and a minimum of 400 U.S. public shareholders;

(c) 500,000 publicly-held shares in the United States and a minimum of 400 U.S. public shareholders and average daily trading volume of 2,000 shares or more for the six months preceding the date of the application; or

[31] Despite the rebranding of AMEX as the NYSE Alternext US, at the time of publication of this volume, the Guide was still labelled the "AMEX Company Guide" and was still located at the web site address provided above.

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(d) in the case of a non-U.S. issuer only, one million publicly-held shares worldwide having an aggregate market value of U.S.$3 million together with a minimum of 800 round-lot public shareholders worldwide.

With the exception of the minimum public distribution described in alternative (d), an issuer must also satisfy one of the following standards:

(i) stockholders' equity of at least U.S.$4 million, pre-tax income of at least U.S.$750,000 in its last fiscal year or in two of its last three fiscal years and an aggregate market value of publicly-held shares of U.S.$3 million with a minimum market price of U.S.$3.00 per share;

(ii) stockholders' equity of at least U.S.$4 million, at least two years of operation and an aggregate market value of publicly-held shares of U.S.$15 million with a minimum market price of U.S.$3.00 per share;

(iii) stockholders' equity of at least U.S.$4 million, market capitalization of U.S.$50 million and an aggregate market value of publicly-held shares of U.S.$15 million with a minimum market price of U.S.$2.00 per share; or

(iv) market capitalization of U.S.$75 million, or total assets and total revenue of U.S.$75 million each in its last fiscal year, or in two of its last three fiscal years, and an aggregate market value of publicly-held shares of U.S.$20 million with a minimum market price of U.S.$3.00 per share.

NYSE Alternext US Alternative Listing Standards.[32] In order to list equity securities on the NYSE Alternext US under the NYSE Alternext US Alternative Listing Standards, an issuer must satisfy one of two minimum numerical standards. Under the first alternative, the issuer must have:

(a) stockholders' equity of at least U.S.$3 million;

(b) pre-tax income of at least U.S.$500,000 in its last fiscal year, or in two of its last three fiscal years;

(c) an aggregate market value of publicly-held shares of U.S.$2 million;

(d) a minimum share price of U.S.$2.00 per share; and

(e) a minimum public distribution of 400,000 publicly-held shares and 600 public shareholders, or 800,000 publicly-held shares and 300 public shareholders.

Under the second alternative, the issuer must have:

(a) stockholders' equity of at least U.S.$3 million;

[32] See supra footnotes 29, 30.

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(b) an aggregate market value of publicly-held shares of U.S.$10 million;

(c) a minimum share price of U.S.$2.00 per share;

(d) a minimum public distribution of 400,000 publicly-held shares and 600 public shareholders, or 800,000 publicly-held shares and 300 public shareholders; and

(e) at least two years of operation.

Information Required by the NYSE Alternext US. In order to conduct an eligibility review, the NYSE Alternext US requires a U.S. issuer to provide it with the following information:

(1) the listing application;

(2) a copy of:

(a) the latest Form 10-K report, Form 10-Q report(s) and Form 8-K report(s) for periods subsequent to the latest Form 10-K (or comparable periodic reports filed with the appropriate regulatory agency of the issuer pursuant to the 1934 Act), and the latest proxy statement for the annual meeting of stockholders; or

(b) a prospectus declared effective by the SEC which contains the latest audited financial statements of the issuer, Form 10-Q report(s) and Form 8-K report(s) (or comparable periodic reports filed with the appropriate regulatory agency of the issuer pursuant to the 1934 Act), for periods subsequent to the effective date of the prospectus, and latest available proxy statement for the meeting of stockholders;

(3) a copy of the latest annual report distributed to stockholders;

(4) a copy of such other information, documents or materials as may be deemed appropriate by the NYSE Alternext US for inclusion in the issuer's listing application;

(5) the issuer's financial statements may be submitted to the NYSE Alternext US's consulting accountants for review as to compliance with the NYSE Alternext US requirements and generally accepted accounting principles; and

(6) any additional information or documentation, public or non-public, the NYSE Alternext US may deem necessary to make a determination regarding a security's initial listing eligibility, including, but not limited to, any material provided to or received from the SEC or other appropriate regulatory authority.

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In order to conduct an eligibility review, the NYSE Alternext US requires a non-U.S. issuer to provide it with the following information:

(1) a formal request for listing;

(2) any general information concerning the issuer and the legal status of the shares and the ADRs to be listed;[33]

(3) a copy of the issuer's most recent filings with the SEC;

(4) a copy of the issuer's latest proxy statement or information statement covering the most recent annual shareholder meeting;

(5) a statement concerning any recent material developments or events not otherwise disclosed;

(6) a summary of the principal provisions of the Deposit Agreement if ADRs are to be traded;

(7) the names of the exchanges upon which the securities are traded, whether they are officially listed or admitted to dealings, and a tabulation indicating the current quotation of the securities and recent price range, along with the terms of settlement for transactions in the securities or ADRs on such exchanges;

(8) any restrictions on ownership of, or rights normally attaching to, the ADRs or the underlying shares;

(9) a description of any laws or restrictions as to the export or import of capital, including the foreign exchange controls affecting the security to be listed, and a statement of the current official rate of exchange of the currency of the issuer's home country;

(10) all taxes to which, under existing laws of the issuer's home country, the holders of ADRs and underlying securities are subject (any non-U.S. withholding taxes on dividends subject to credit against U.S. income tax under reciprocal tax treaties must be described);

(11) a statement of any fees that may be charged to anyone holding or dealing in the securities by the issuer, depositary bank, or transfer agent, other than those ordinarily applying in the case of domestic securities; and

(12) a statement describing the circumstances of any defaults on any obligations of the issuer within the last ten years.

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[33] If the non-U.S. issuer's shares are currently registered under the 1934 Act, the listing application would also include a copy of the most recent annual report on Form 20-F and copies of any subsequent Form 6-K interim reports filed with the SEC. If the non-U.S. issuer's shares are not registered under the 1934 Act, the filing would include a copy of the Form 20-F registration statement.

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Exhibits. Certain exhibits must be filed in support of the original application, including the NYSE Alternext US Listing Agreement, a copy of the deposit agreement, a specimen certificate representing the securities or ADRs, various material contracts and corporate documents, an opinion of counsel and, in the case of an application to list ADRs, a copy of the deposit agreement. These requirements are substantially similar to those of the NYSE.

Corporate Governance Requirements. In addition to the minimum numerical standards for listing, the NYSE Alternext US has established policies and requirements concerning certain corporate governance practices, such as conflicts of interest, structure and composition of the board of directors, shareholder approval, quorum requirements for shareholder meetings, and other related requirements. These policies and practices are not necessarily consistent with the laws or practices of a non-U.S. issuer's home country. The NYSE Alternext US has adopted enhanced corporate governance rules substantially identical to those of the NYSE in this regard and the SEC approved such rules on December 1, 2003.

The corporate governance standards are set out in Part 8 of the AMEX Company Guide ("Part 8") which provides, among other things, that:

- the issuer must have a majority of independent directors;[34]
- the issuer must not appoint or permit an NYSE Alternext US employee or floor member to serve on its board of directors;
- the independent directors must meet on a regular basis and at least annually in executive session without the presence of non-independent directors and management;
- the issuer must have an audit committee that has at least three members (or at least two members, in the case of a small business issuer), satisfies the requirements of Rule 10A-3 under the 1934 Act, and consists of members who have the requisite financial experience and expertise;
- board of director nominations must be either selected, or recommended for the board's selection, by either a nominating committee comprised solely of independent directors or by a majority of the independent directors;[35]
- compensation of the chief executive officer of the issuer must be determined, or recommended to the board for determination, either by a compensation committee

[34] The following issuers are exempted from such requirement: (i) an issuer of which more than 50% of the voting power is held by an individual, a group or another company; (ii) limited partnerships; and (iii) companies in bankruptcy proceedings. An issuer that satisfies the definition of smaller reporting company under Regulation S-K are only required to maintain a board of directors comprised of at least 50% independent directors.

[35] The following issuers are exempted from such requirement: (i) an issuer of which more than 50% of the voting power is held by an individual, a group or another company; (ii) limited partnerships; and (iii) companies in bankruptcy proceedings.

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comprised of independent directors or by a majority of the independent directors;[36]

- approval of shareholders is required with respect to stock option and equity compensation plans and material revisions thereto, with certain limited exemptions;[37]

- the issuer must adopt and make publicly available a code of conduct and ethics, applicable to all directors, officers and employees, which also complies with the definition of a "code of ethics" as set forth in Item 406 of Regulation S-K;

- the issuer must promptly notify the NYSE Alternext US after any executive officer becomes aware of non-compliance with any applicable provision of Part 8;

For the purposes of Part 8, an independent director means a person other than an executive officer or employee of the issuer in respect of whom the board of directors of the issuer has made an affirmative determination that such director does not have a relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Furthermore, the following persons may not be deemed as independent:

(1) a director who is, or during the past three years was, employed by the issuer, other than prior employment as an interim executive officer for a period of not longer than one year;

(2) a director who accepted or has an immediate family member who accepted compensation from the issuer in excess of U.S.$120,000 during any twelve-month period within the last three years, other than (i) compensation for board or board committee service, (ii) compensation to an immediate family member who is an employee (other than an executive officer) of the company, (iii) compensation for former service as an interim executive officer for a period of not longer than one year or (iv) benefits under a tax-qualified retirement plan, or non-discretionary compensation;

(3) a director who is an immediate family member of an individual who is, or at any time during the past three years was, employed by the issuer as an executive officer;

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36 The following issuers are exempted from such requirement: (i) an issuer of which more than 50% of the voting power is held by an individual, a group or another company; (ii) limited partnerships; and (iii) companies in bankruptcy proceedings.

37 Shareholder approval is not required for (i) employment inducement awards; (ii) certain tax-qualified, non-discriminatory employee benefit plans or parallel nonqualified plans; (iii) plans and arrangements relating to mergers and acquisitions; and (iv) warrants or rights issued generally to all securityholders of the issuer or stock purchase plans available on equal terms to all securityholders of the issuer. However, the exempt grants, plans and amendments in clauses (i) and (ii) above may be made only with the approval of the issuer's independent compensation committee or the approval of a majority of the independent directors. Issuers must also notify the NYSE Alternext US in writing when they use any of the exemptions in clauses (i) through (iv).

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(4) a director who is, or has an immediate family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the issuer made, or from which the issuer received, payments (other than those arising solely from investments in the issuer's securities or payments under non-discretionary charitable contribution matching programs) that exceed the greater of (i) 5% of the organization's consolidated gross revenues for that year, or (ii) U.S.$200,000, in any of the most recent three fiscal years;

(5) a director who is, or has an immediate family member who is, employed as an executive officer of another entity where at any time during the most recent three fiscal years any of the issuer's executive officers serve on the compensation committee of such other entity; or

(6) a director who is, or has an immediate family member who is, a current partner of the issuer's outside auditor, or was a partner or employee of the issuer's outside auditor who worked on the issuer's audit at any time during any of the past three years.

A director who is not independent under the NYSE Alternext US's definition, but who satisfies the requirements of Rule 10A-3 under the 1934 Act, and is not a current officer or employee or an immediate family member of such officer or employee, may still be appointed to the audit committee for a non-chairperson position for no more than two consecutive years, if the board of the issuer determines, under exceptional and limited circumstances, that such director's membership on the committee is required by the best interests of the issuer and its shareholders, and the issuer discloses, in the proxy statement for its next shareholders' meeting, the nature of the relationship and the reason for the determination.

An issuer that is a closed-end or open-end management investment company registered under the 1940 Act is not required to comply with all the NYSE Alternext US corporate governance standards, but is required to (i) have an audit committee and (ii) not appoint or permit an NYSE Alternext US employee or floor member to serve on its board of directors.

Section 110 of the AMEX Company Guide provides that, in evaluating whether a non-U.S. issuer is eligible for listing, the NYSE Alternext US will consider the laws, customs and practices of the applicant's home country, to the extent not contrary to the federal securities laws (including but not limited to Rule 10A-3 under the 1934 Act[38]), with respect to: (i) the election and composition of the issuer's board of directors; (ii) the issuance of quarterly earnings statements; (iii) shareholder approval requirements; and (iv) quorum requirements for shareholder meetings. If a non-U.S. issuer wishes to seek relief under these provisions, the issuer must provide written certification from independent local counsel that non-compliance with the provisions is not prohibited by home country law. A non-U.S. issuer also must provide disclosure in English of any significant ways in which its corporate governance practices differ from those followed by domestic issuers under the NYSE Alternext US's standards. This disclosure may be provided either on the issuer's web site and/or in its annual report as

[38] The NYSE Alternext US will not grant to any non-U.S. issuer relief from the audit committee requirements under Rule 10A-3 under the 1934 Act.

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distributed to shareholders in the United States. If the disclosure is only available on the web site, the issuer's annual report must so state and provide the web site address at which the information may be obtained.

In addition, a non-U.S. issuer is required to: (i) furnish to shareholders in the United States an English language version of its annual financial statements and all other materials regularly provided to other shareholders and (ii) publish, at least semi-annually, an English language version of its interim financial statements. The NYSE Alternext US will permit non-U.S. issuers to follow home country practices regarding the distribution of annual reports to shareholders if, at a minimum, shareholders (i) are provided at least summary annual reports, including summary financial information and (ii) have the ability, upon request, to receive a complete annual report and the financial information contained in the summary annual report is reconciled to U.S. GAAP to the extent such reconciliation would be required in the full annual report.

NYSE Alternext US Continued Listing Requirements

In considering whether a security warrants continued listing, the NYSE Alternext US will evaluate numerous factors, such as the degree of investor interest in the issuer, its prospects for growth, the reputation of its management, the degree of commercial acceptance of its products, and whether its securities have suitable characteristics for auction market trading. Any developments which substantially reduce the size of the issuer, the nature and scope of its operations, the value or amount of its securities available for the market, or the number of holders of its securities may subject the issuer to continued listing review by the NYSE Alternext US. The NYSE Alternext US will consider the suspension of trading in, or removal from listing of, any security when, in the opinion of the NYSE Alternext US:

(1) the financial condition and/or operating results of the issuer appear to be unsatisfactory;

(2) it appears that the extent of public distribution or the aggregate market value of the security has become so reduced that further dealings on the NYSE Alternext US are inadvisable;

(3) the issuer has sold or otherwise disposed of its principal operating assets, or has ceased to be an operating company;

(4) the issuer has failed to comply with its listing agreements with the NYSE Alternext US; or

(5) any other event occurs which makes further dealings on the NYSE Alternext US unwarranted.

LISTING ON THE NASDAQ MARKETS

To list securities on any of the three NASDAQ markets, an issuer must meet the minimum qualifications and other requirements, file an application, sign a listing and listing fee agreement, and pay the initial and continuing listings fees, in each case applicable to that

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NASDAQ market. As a preliminary matter, the securities to be so listed must be registered under Section 12(b) of the 1934 Act before being listed on any NASDAQ market. Note that this registration under the 1934 Act is required even though the applicant may have previously registered an offering of the securities under the 1933 Act.

FINRA, which administers NASDAQ through its subsidiary, the NASDAQ Stock Market, Inc., has established certain guidelines, outlined below, that are considered in evaluating quotation eligibility for issuers on its three markets: the NASDAQ Capital Market (formerly the Nasdaq SmallCap Market); the NASDAQ Global Market (formerly the NASDAQ National Market); and the more recently established NASDAQ Global Select Market. Compared to the NASDAQ Capital Market, the NASDAQ Global Market has higher minimum initial listing standards and requires more trading information about the listed securities to be made publicly available. While the NASDAQ Global Select Market maintains the same continued listing requirements as the NASDAQ Global Market, the Global Select Market claims to have the highest initial financial and liquidity listing qualifications of any securities market in the world.

NASDAQ Listing Process

Application for a NASDAQ market listing is made on the applicable form provided by FINRA and signed by a corporate officer of the issuer. FINRA may require the issuer to submit any information that is relevant to a determination of designation as a NASDAQ-listed security.

An issuer may seek a preliminary listing eligibility review by NASDAQ to determine whether it meets the numerical listing requirements and to address specific concerns regarding corporate governance requirements.[39]

NASDAQ Listing Fees

Entry Fees. For U.S. issuers, the entry fee is based on the aggregate number of shares to be listed at the time of initial listing, regardless of class, plus a one-time, non-refundable application fee of U.S.$5,000. For non-U.S. issuers, the entry fee is based upon the aggregate number of shares represented by the ADRs to be issued and outstanding in the United States at the time of initial listing, plus a one-time, non-refundable application fee of U.S.$5,000. On the NASDAQ Capital Market, the entry fee is U.S.$50,000 for up to 15 million shares, and U.S.$75,000 for listings over 15 million shares. On the NASDAQ Global Market and the NASDAQ Global Select Market, the entry fee is U.S.$100,000 for up to 30 million shares; U.S.$125,000 for 30 million to 50 million shares; and U.S.$150,000 for listing any quantity over 50 million shares. Issuers already listed on NASDAQ must follow the same application procedures to list a new class of securities.

Certain filings are exempt from entry fees. There is no application or entry fee for an issuer transferring its listing from the NASDAQ Capital Market to the NASDAQ Global Market if it was listed on the NASDAQ Capital Market prior to January 1, 2007, or if it was listed after January 1, 2007 but did not qualify for the NASDAQ Global Market at the time of its initial

[39] Issuers interested in a preliminary review should contact NASDAQ at the office of the Senior Vice President, New Listings and Capital Markets.

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listing. Any other issuer must pay the entry fees, but not the application fees, for the NASDAQ Global Market, less the fees paid for listing on the NASDAQ Capital Market. The same is true for an issuer transferring its listing from the NASDAQ Capital Market to the NASDAQ Global Select Market. Furthermore, there is no application or entry fee for securities that are transferred from a national securities exchange to list exclusively on the NASDAQ Stock Market. Where an issuer listed on another securities exchange is acquired by an unlisted company, and in connection with such acquisition, the unlisted company lists exclusively on NASDAQ, this listing is also exempt. Lastly, there is no charge for securities of an issuer that has a dual listing on the NYSE and a NASDAQ market.

Annual Fees. Annual fees are based on the issuer's total shares outstanding for all classes of stock listed, as reported in the issuer's latest filing on record with NASDAQ. For non-U.S. issuers, total shares outstanding include only those shares issued and outstanding in the United States. On the NASDAQ Capital Market, the annual fee for securities other than ADRs is U.S.$27,500. On the NASDAQ Global Market and the NASDAQ Global Select Market, the annual fee for securities other than ADRs is U.S.$30,000 for up to 10 million shares; U.S.$35,000 for 10 to 25 million shares; U.S.$37,500 for 25 to 50 million shares; U.S.$45,000 for 50 to 75 million shares; U.S.$65,500 for 75 to 100 million shares; U.S.$85,000 for 100 to 150 million shares; and U.S.$95,000 for any number over 150 million shares.

Annual fees for ADRs are based on the aggregate number of all classes of ADRs listed. On the NASDAQ Capital Market, the annual fee is U.S.$17,500 for up to 10 million shares represented by the ADRs and U.S.$21,000 for listings over 10 million shares. On the NASDAQ Global Market and the Global Select Market, the annual fee is U.S.$21,225 for up to 10 million shares represented by the ADRs; U.S.$26,500 for 10 to 25 million shares; U.S.$29,820 for 25 to 50 million shares; and U.S.$30,000 for any number over 50 million shares.

Listing Additional Shares. Issuers must pay a fee in connection with the issuance of additional shares, or in the case of ADRs, the issuance of additional shares underlying the ADRs. For U.S. issuers, there is no fee for the issuance of up to 49,999 additional shares per quarter, and a fee equal to the greater of U.S.$5,000 or U.S.$0.01 per share for the issuance of 50,000 or more additional shares per quarter, subject to an annual fee cap of U.S.$65,000. For non-U.S. issuers, the fee is U.S.$5,000 for any additional shares listed on an annual basis; however, there is no fee for issuances of up to 49,999 additional shares per year. This fee is consistent for all three of the NASDAQ markets. The fee is assessed annually based on the issuer's total shares outstanding as reported on its periodic reports filed with the SEC. In the event that the issuer has not timely made required filings with the SEC, the issuer must instead provide NASDAQ with the change in its total shares outstanding and the fee will be calculated based on that change. If this number differs from the delinquent periodic report later filed with the SEC, NASDAQ will reconcile the change by adjusting the issuer's bill.

Issuers that list securities on the NYSE, designate their securities as NASDAQ Global securities, and maintain such listing and designation after listing on a NASDAQ market are not required to pay a fee for issuing additional shares.

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NASDAQ Listing Standards

NASDAQ Initial Listing Standards. Issuers must meet liquidity and financial requirements specific to the NASDAQ market on which listing is sought. With respect to ADRs, NASDAQ will look to the underlying security when determining whether it qualifies for initial or continued listing. For example, in calculating the market value of listed securities, NASDAQ will include the value of all ordinary securities listed on the issuer's home market, not just the value of the ADRs.

To qualify an initial listing on the NASDAQ Capital Market, an issuer must have at least one million publicly-held shares (excluding shares held by any officers, directors, or 10% shareholders), 300 round lot shareholders (a "round lot" means 100 shares), three market makers, and a minimum U.S.$4 bid price. Additionally, the issuer must meet all of the criteria in at least one of three standards: (i) stockholders' equity of U.S.$5 million, a U.S.$15 million market value of publicly-held shares ("MVPHS"), and an operating history of two years; (ii) stockholders' equity of U.S.$4 million, a U.S.$15 million MVPHS, and a U.S.$50 million market value for listed securities (NASDAQ or other national securities exchange); or (iii) stockholders' equity of U.S.$4 million, a U.S.$5 million MVPHS, and net income from continuing operations of at least U.S.$750,000 in the last fiscal year, or in two of the last three fiscal years.

To qualify an initial listing on the NASDAQ Global Market, an issuer must have at least 1.1 million publicly-held shares (excluding shares held by any officers, directors, or 10% shareholders), 400 round lot shareholders, and a U.S.$5 bid price. Additionally, the issuer must meet all of the criteria in at least one of three standards: (i) stockholders' equity of U.S.$15 million, income of U.S.$1 million from continuing operations before income taxes in the latest fiscal year or in two of the last three fiscal years, three market makers, and an U.S.$8 million MVPHS; (ii) stockholders' equity of U.S.$30 million, an U.S.$18 million MVPHS, three market makers, and an operating history of two years; or (iii) a U.S.$75 million market value of listed securities or U.S.$75 million in total assets and U.S.$75 million in total revenue, a U.S.$20 million MVPHS, and four market makers.

To qualify for the NASDAQ Global Select Market, a new issuer, that is, an issuer that is neither a seasoned issuer nor an affiliated issuer as discussed in this chapter below, must have: (i) a minimum of 550 total shareholders and average monthly trading volume over the previous 12 months of at least 1,100,000 shares per month; (ii) a minimum of 2,200 total shareholders; or (iii) a minimum of 450 round lot shareholders. Seasoned issuers with currently trading common stock or other equivalents must have (i) either 450 round lot beneficial shareholders, 2,200 beneficial shareholders, or 550 beneficial shareholders and an average monthly trading volume of U.S.$1.1 million over the past twelve months; and (ii) a U.S.$100 million MVPHS, or a U.S.$100 million MVPHS and U.S.$110 million in shareholders' equity.[40] Affiliated issuers

[40] NASDAQ considers an issuer to be a "seasoned issuer" if it has been listed on a market for at least two years; and in the case of spin-offs, the operating history of the spin-off will be considered.

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must meet the same criteria as seasoned issuers but are only required to have a U.S.$70 million MVPHS.[41]

Whichever of these standards applies, any issuer that is newly listed on the NASDAQ is required to have a minimum U.S.$5 bid price to list on the NASDAQ Global Select Market.

A new issuer must also meet certain financial requirements to qualify for the NASDAQ Global Select Market. New issuers must meet one of three standards: (i) aggregate pre-tax earnings of at least U.S.$11 million over the prior three years, with positive pre-tax earnings in each such year and at least U.S.$2.2 million of pre-tax earnings in each of the prior two years; (ii) aggregate cash flow of at least U.S.$27.5 million over the prior three years, with positive cash flow in each such year, an aggregate market capitalization of at least U.S.$550 million over the prior 12 months and total revenue of at least U.S.$110 million in the previous year; or (iii) total revenue of at least U.S.$90 million in the previous year and an average market capitalization of at least U.S.$850 million over the prior 12 months.

A closed-end management investment company must meet different liquidity requirements. It must have (i) at least 1,250,000 publicly-held shares and (ii) either 450 beneficial round lot shareholders, 2,200 beneficial shareholders, or 550 beneficial shareholders and an average monthly trading volume of 1.1 million over the past twelve months. A fund group must also have an MVPHS of U.S.$35 million for each fund, a total MVPHS of U.S.$220 million for the group and an average of U.S.$50 million MVPHS for all funds in the group. Closed-end funds not part of a group must have an MVPHS of U.S.$70 million for each fund. A business development company must have a U.S.$70 million MVPHS for each fund and a market value of U.S.$80 million for listed securities.

NASDAQ Continuing Listing Standards. On the NASDAQ Capital Market, issuers must maintain at least 500,000 publicly-held shares, a U.S.$1 million MVPHS, a U.S.$1 bid price, at least 300 public holders for common stock and 100 public holders for preferred stock and secondary classes of common stock, two market makers and at least one of the following: (i) U.S.$2.5 million in shareholders' equity, (ii) a market value of U.S.$35 million for listed securities (securities listed on NASDAQ or other national securities exchanges), or (iii) U.S.$500,000 of net income from continuing operations in the last fiscal year, or in two of the last three fiscal years.[42]

There are two standards by which issuers can continue to list on the NASDAQ Global Market and the NASDAQ Global Select Market. Under the first standard, issuers must have

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[41] NASDAQ considers an issuer to be an "affiliated issuer" if it is affiliated with another company listed on The NASDAQ Global Select Market, where such affiliation exists if such other company, directly or indirectly though one or more intermediaries, controls, is controlled by, or is under common control of the issuer. For this purpose, control means having the ability to exercise significant influence – the ability to exercise significant influence will be presumed to exist where the parent or affiliated company directly or indirectly owns 20% or more of the other company's voting securities, and also can be indicated by representation on the board of directors, participation in policy making processes, material intercompany transactions, interchange of managerial personnel, or technological dependency.

[42] Note that NASDAQ defines publicly-held shares as total shares outstanding, less any shares held by officers, directors or beneficial owners of 10% of more.

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U.S.$10 million in shareholders' equity, 750,000 publicly-held shares, a U.S.$5 million MVPHS, a U.S.$1 bid price, 400 total shareholders for common stock and equivalent and 100 public shareholders for preferred stock and secondary classes of common stock and two market makers. Under the second standard, issuers must have either a market value of U.S.$50 million for listed securities, or U.S.$50 million in total assets and U.S.$50 million in total revenue; 1.1 million publicly-held shares, a U.S.$15 million MVPHS, a U.S.$1 bid price, 400 total shareholders for common stock and equivalent and 100 public shareholders for preferred stock and secondary classes of common stock and four market makers.

Disclosure/Regulatory Activities. An issuer must promptly disclose any material news to the public in the United States through any Regulation FD compliant method (or combination of methods).[43] Material news is defined as information that may affect the value of its securities or influence investors' decisions. Material news may include the following categories:

- Financial-related disclosures, including quarterly or yearly earnings, earnings restatements, pre-announcements or "guidance;"
- Corporate reorganizations and acquisitions, including mergers, tender offers, asset transactions and bankruptcies or receiverships;
- New products or discoveries, or developments regarding customers or suppliers (*e.g.*, significant developments in clinical or customer trials and receipt or cancellation of a material contract or order);
- Senior management changes or changes in control;
- Resignation or termination of independent auditors or withdrawal of a previously issued audit report;
- Events regarding the issuer's securities (*e.g.*, defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of securityholders or public or private sales of additional securities);
- Significant legal or regulatory developments; and
- Any event requiring the filing of a Form 8-K or Form 6-K.

The issuer must also notify NASDAQ MarketWatch prior to the release of such information to in order to permit MarketWatch to assess the news announcement for materiality and, in certain circumstances, implement temporary trading halts to allow for even dissemination of the material news. Issuers can disclose material news to MarketWatch through the Electronic

[43] These methods include broadly disseminating a press release, furnishing to or filing a Form 8-K or Form 6-K with the SEC, and conference calls, press conferences and webcasts so long as the public is provided adequate notice (generally through a press release) and granted access. See also SEC Release No. 34-58288 (Aug. 1, 2008) (http://www.sec.gov/rules/interp/2008/34-58288.pdf) for further guidance as to disclosure dissemination.

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Disclosure submission system only.[44] Effective September 4, 2007, NASDAQ no longer accepts material news disclosures by fax or telephone except in emergency situations. Notification should be provided at least ten minutes before the release of the information to the public.

Issuers are also required to notify NASDAQ when taking certain actions. Issuer actions requiring notification include the following:

- Listing of additional shares;
- Forward stock splits and stock dividends;
- Reverse stock splits;
- Cash dividend and distribution notices;
- Change in the number of shares outstanding;
- Change in the issuer name;
- Change in the trading symbol;
- Change in title or security or par value;
- Change in transfer agent or registrar;
- Substitution listing events;
- Change in state of incorporation or issuer place of organization; and
- Mergers, tender offers, and redemptions/extensions of derivative securities.

In most cases, issuers must fill out the appropriate notification form and may be required to provide additional supporting documentation.

Continuing Reporting Requirements. An issuer that registers securities under the 1933 Act or the 1934 Act must file an annual report on Form 10-K or Form 20-F. Foreign issuers must fill out Form 20-F as an annual report within six months after the end of each fiscal year. The content is substantially the same as when filed as a registration statement, with a few additional disclosures and special certifications. The issuer must disclose the conclusions of its CEO and CFO about the effectiveness of its disclosure controls and procedures. Issuers must also include an "internal control report" on the effectiveness of its internal controls and procedures as of the end of the most recent fiscal year, to which the issuer's external auditors are required to attest. The report must include the following: (i) whether or not the issuer's audit committee includes an "audit committee financial expert;" (ii) whether or not it has adopted a code of ethics; (iii) specialized information about the fees paid to and services provided by the principal auditor; (iv) certifications made through exhibits by the issuer's CEO and CFO

[44] The MarketWatch Electronic Disclosure submission system is available through http://www.nasdaq.net.

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concerning various matters specified under Sarbanes-Oxley; (v) a statement of certification from both the CEO and CFO stating that the annual report complies with the applicable 1934 Act requirements and that the information contained in the annual report fairly presents the issuers' financial condition and results of operations;[45] and (vi) whether or not there were significant changes in its internal controls or related factors subsequent to the evaluation.

Periodic Reporting Requirements. NASDAQ listed companies are required to file with NASDAQ three copies of all reports and other documents filed or required to be filed with the SEC. Filing through the SEC IDEA system fulfills this requirement. Additionally, Section 16 filings, Schedules 13-D and 13-G, and Form 144 filings related to NASDAQ-listed securities must also be filed. These filings may also be made through the SEC's IDEA system.

Corporate Governance. In addition to the minimum numerical standards for inclusion, FINRA has established policies and requirements concerning interim earnings reporting and certain corporate governance practices, such as the structure and composition of the board of directors, shareholder approval, quorum requirements for shareholder meetings, and other related requirements. On November 4, 2003, the SEC approved the NASDAQ Stock Market, Inc.'s corporate governance proposals that were filed with the SEC in response to the passage of Sarbanes-Oxley. Rules 4350 and 4351 of NASD Manual[46] ("NASDAQ Governance Rules") set forth corporate governance rules for issuers listed on NASDAQ.

The NASDAQ Governance Rules provides, among other things, that:

- the issuer must have a majority of independent directors;[47]
- the independent directors must have regularly scheduled meetings at which only independent directors are present;
- compensation of the chief executive officer and all other executive officers must be determined, or recommended to the board for determination, either by a compensation committee comprised solely of independent directors or by a majority of the independent directors;[46]
- director nominees must either be selected, or recommended for the board's selection, by either a nominations committee comprised solely of independent directors or by a majority of the independent directors;[46]
- the issuer must have an audit committee that has at least three members, satisfies the requirements of Rule 10A-3 under the 1934 Act, and consists solely of independent directors who have the requisite financial experience and expertise;

[45] Certification of the issuer's financial condition and results of operations can subject the officer to criminal penalties if knowingly made falsely.

[46] Although the NASD is now referred to as FINRA, we continue to refer to the applicable guidance as the "NASD Manual."

[47] An issuer of which more than 50% of the voting power is held by an individual, a group or another company is exempted from such requirement.

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- the issuer's audit committee or another independent body of the board of directors shall conduct appropriate review and oversight of all related party transactions for potential conflict of interest situations on an ongoing basis;

- approval of shareholders is required with respect to (i) stock option and equity compensation plans and material revisions thereto, with certain limited exemptions,[48] (ii) issuance of securities resulting in a change of control; (iii) acquisitions where the issuance of securities equals 20% or more of the pre-transaction outstanding shares, or 5% or more of the pre-transaction outstanding shares when a related party has a 5% or greater interest in the acquisition target; or (iv) private placements where the issuance (together with sales by officers, directors, or substantial shareholders, if any) equals 20% or more of the pre-transaction outstanding shares at a price less than the greater of book or market value;

- the issuer must provide NASDAQ with prompt notification after an executive officer becomes aware of any material non-compliance by the issuer of the NASDAQ Governance Rules; and

- the issuer must adopt and make publicly available a code of conduct and ethics, applicable to all directors, officers and employees, which complies with the definition of a "code of ethics" as set forth in Item 406 of Regulation S-K.

For the purposes of the NASDAQ Governance Rules, an independent director means a person other than an executive officer or employee of the issuer or any other individual having a relationship which, in the opinion of the issuer's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Furthermore, the following persons may not be considered as independent:

(1) a director who is, or during the past three years was, employed by the issuer;

(2) a director who accepted or has an immediate family member who accepted compensation from the issuer in excess of U.S.$120,000 during any twelve-month period within the last three years, other than (i) compensation for board or board committee service, (ii) compensation to an immediate family member who is an employee (other than an executive officer) of the issuer, or (iii) benefits under a tax-qualified retirement plan, or non-discretionary compensation;

48 Shareholder approval is not required for (i) employment inducement awards; (ii) certain tax-qualified, non-discriminatory employee benefit plans or parallel nonqualified plans; (iii) plans and arrangements relating to mergers and acquisitions; and (iv) warrants or rights issued generally to all securityholders of the issuer or stock purchase plans available on equal terms to all securityholders of the issuer. However, the exempt grants, plans and amendments in clauses (i) and (ii) above may be made only with the approval of the issuer's independent compensation committee or the approval of a majority of the independent directors.

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(3) a director who is an immediate family member of an individual who is, or at any time during the past three years was, employed by the issuer as an executive officer;

(4) a director who is, or has an immediate family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the issuer made, or from which the issuer received, payments for property or services (other than those arising solely from investments in the issuer's securities or payments under non-discretionary charitable contribution matching programs) that exceed the greater of (i) 5% of the organization's consolidated gross revenues for that year, or (ii) U.S.$200,000, in any of the most recent three fiscal years;

(5) a director who is, or has an immediate family member who is, employed as an executive officer of another entity where at any time during the past three fiscal years any of the issuer's executive officers serve on the compensation committee of such other entity; or

(6) a director who is, or has an immediate family member who is, a current partner of the issuer's outside auditor, or was a partner or employee of the issuer's outside auditor who worked on the issuer's audit at any time during any of the past three years.

A director who is not independent under NASDAQ's definition may still be appointed to the nominating, compensation and audit committees for no longer than two years, if the board of the issuer determines, under exceptional and limited circumstances, that such director's membership on the committee is required by the best interests of the issuer and its shareholders (and, in the case of an appointment to the audit committee, such director is not a current officer or employee or an immediate family member of such officer or employee), and the issuer discloses, in the proxy statement for its next shareholders' meeting, the nature of the relationship and the reason for the determination.

An issuer that is an investment company registered under the 1940 Act is required to comply with NASDAQ Governance Rules but is exempt from the requirements of (i) a majority of independent directors; (ii) regularly scheduled meetings of independent directors; (iii) determination of executive compensation by a compensation committee or a majority of independent directors; (iv) selection and recommendation of director nominees by nominating committee or a majority of independent directors; and (v) adoption of a code of conduct and ethics.

The policies and practices required by the NASDAQ Governance Rules may not necessarily be consistent with the laws or practices of a non-U.S. issuer's home country. Thus, while these requirements generally apply to non-U.S. issuers, NASDAQ Governance Rule 4350(a) provides an exemption to non-U.S. issuers that follow certain home country governance practices.

To qualify for an exemption, an issuer must provide NASDAQ with a letter from outside counsel in the issuer's home country, certifying that the issuer's practices are not prohibited by

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home country law. This letter is required only once, either at the time of initial listing, or prior to the time the issuer first adopts a non-conforming practice. Furthermore, the issuer must disclose each requirement under NASDAQ Governance Rule 4350 that it does not follow and the alternative home country practice it does follow in its annual reports filed with the SEC. Likewise, a non-U.S. issuer making its initial public offering or its first U.S. listing on a NASDAQ market must make the same disclosures in its registration statement.

All non-U.S. issuers are required to comply with the audit committee requirements of Rule 10A-3 under the 1934 Act, under which an issuer must have an audit committee comprised solely of directors who are independent and directly responsible for the issuer's relationship with an outside auditor. Furthermore, the committee is required, among other things, to have procedures for handling account-related complaints. All non-U.S. issuers must also continue to comply with the listing agreement requirement under NASDAQ Governance Rule 4350(j), the requirement to promptly notify NASDAQ of material non-compliance under NASDAQ Governance Rule 4350(m), and the requirement to disclose receipt of a going concern opinion from an auditor under NASDAQ Governance Rule 4350(b)(1)(B).

Non-U.S. issuers that are not "foreign private issuers"[49] cannot rely on exemptions pursuant to NASDAQ Governance Rule 4350(a). Instead, such issuers must comply with the NASDAQ Governance Rules requirements applicable to domestic issuers.

Although issuers must generally meet all listing requirements at the time of listing, a grace period of up to one year from the first trade date may be granted to issuers completing initial public offerings to secure their independent directors and/or establish audit, compensation, and nominating committees, which meet NASDAQ's requirements.

Suspension or Termination of Inclusion. NASDAQ will delist an issuer in certain circumstances, following NASDAQ's determination that the issuer no longer meets the requirements for continued listing, and after the issuer has received notice of that determination and has had an opportunity to appeal. NASDAQ will provide public notice of its final determination to remove a security from listing by issuing a press release and posting notice on its web site. This public notice will be disseminated no fewer than ten days before the delisting becomes effective and will remain posted until the delisting is effective. Following such public notification, NASDAQ will file an application on Form 25 with the SEC to delist the security, and will promptly provide a copy of that Form 25 to the issuer. The Form 25, and the delisting of the security, will become effective ten days after it is filed, unless the SEC chooses to postpones such delisting. An issuer of a security the listing of which has been suspended is required, prior to re-listing, to comply with all requirements for continued listing. An issuer of a security the listing of which has been terminated is required, prior to re-listing, to comply with the requirements for initial listing.

[49] See Rule 3(b)-4 under the 1934 Act and Rule 405 under the 1933 Act for definition of "foreign private issuer" and *An Overview of U.S. Securities Regulators and Laws* in this volume for a further discussion in relation thereto.

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LISTING CERTAIN OTHER SECURITIES

An issuer may also wish to list other types of its securities on an exchange in the United States. The following summarizes the applicable requirements of the NYSE, the NYSE Arca and the NYSE Alternext US.

Listing Debt Securities on the NYSE

In order for debt securities to be listed on the NYSE, the debt issue of an issuer must have an aggregate market value or principal amount of no less than U.S.$5 million. Debt securities that are convertible into equity securities may be listed only if the underlying equity securities are subject to real-time last sale reporting in the United States. In the case of a convertible debt issue by a U.S. issuer, the NYSE also requires the convertible debt issue to have an aggregate market value or principal amount of no less than U.S.$10,000,000.

In addition, the NYSE will require that one of the following conditions be satisfied:

(1) the issuer of the debt security has equity securities listed on the NYSE;

(2) an issuer of equity securities listed on the NYSE directly or indirectly owns a majority interest in, or is under common control with, the issuer of the debt securities;

(3) an issuer of equity securities listed on the NYSE has guaranteed the debt securities;

(4) an NRSRO has assigned a current rating to the debt securities that is no lower than a "B" rating by Standard & Poor's or an equivalent rating by another NRSRO; or

(5) if no NRSRO has assigned a rating to the issue, an NRSRO has currently assigned an investment grade rating to a senior issue or a rating that is no lower than a "B" rating by Standard & Poor's, or an equivalent rating by another NRSRO, to a *pari passu* or junior issue.

Listing Debt Securities on the NYSE Arca

In order for debt securities to be listed on the NYSE Arca, the issuer must (i) have a net worth of at least U.S.$4 million, (ii) have pre-tax income from continuing operations of at least U.S.$1 million in the last fiscal year or two of the last three fiscal years and (iii) meet and appear to be able to satisfy interest and principal when due on the bond or debenture to be listed.

In addition, the NYSE Arca will require that the following public distribution requirement be satisfied:

(1) if the issuer's common stock is traded on the NYSE Arca, or any of the NYSE, the NASDAQ Global Market or the NYSE Alternext US, the issue must have an

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aggregate market value and principal amount of at least U.S.$5 million each, and at least 100 public beneficial holders; and

(2) if the issuer's common stock is not traded on any of the above referenced exchanges, the issue must have an aggregate market value and principal amount of at least U.S.$20 million each, and at least 100 public beneficial holders; and

(3) in the case of municipal debt securities, the issue must have an aggregate market value and principal amount of at least U.S.$20 million each, at least 100 public beneficial holders, and be rated as investment grade by at least one NRSRO.

Debt securities that are convertible into equity securities may be listed on the NYSE Arca only if the underlying equity securities meet the NYSE Arca's criteria for continued listing and real-time last sale information with respect to the underlying equity securities is available.

Listing Equity-Linked Debt Securities ("ELDS") on the NYSE

These securities are non-convertible debt of an issuer where the value of the debt is based, at least in part, on the value of another issuer's common stock, non-convertible preferred stock, common units of a master limited partnership, or any other common equity security of a type classified for trading as stock by the NYSE.

Issuer Requirements. The NYSE requires that an issuer, if the issuer is a NYSE-listed company, be an issuer in good standing (*i.e.*, meeting the NYSE's criteria for continued listing); if an issuer is an affiliate of a NYSE-listed company, the NYSE-listed company must be an issuer in good standing; and if not listed, the issuer must meet the size and earnings requirements set forth in the NYSE listing standards.

The issuer must also have (1) a minimum tangible net worth of U.S.$250 million or (2) a minimum tangible net worth of U.S.$150 million, where the original issue price of the ELDS, combined with all of the issuer's other ELDS listed on a national securities exchange or otherwise publicly traded in the United States, is not greater than 25% of the issuer's net worth at the time of issuance.

ELDS Listing Standards. The issue must have at least one million ELDS outstanding, at least 400 securityholders, an aggregate market value of U.S.$4 million, and a minimum life of one year.

Linked Equity Listing Standard. An equity security on which the value of the debt is based must:

- have a market capitalization and trading volume in the United States in the one-year period preceding the listing of the ELDS that meets one of the following sets of criteria:

  (a) U.S.$3 billion in market capitalization and trading volume of 2.5 million shares;

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(b) U.S.$1.5 billion in market capitalization and trading volume of 10 million shares; or

(c) U.S.$500 million in market capitalization and trading volume of 15 million shares.

- be issued by an issuer that has a continuous reporting obligation under the 1934 Act and the security must be listed on a national securities exchange or traded through the facilities of a national securities association and be subject to last sale reporting.

- be issued either by:

(a) a U.S. issuer; or

(b) a non-U.S. issuer (including an issuer that is traded in the United States through sponsored ADRs) if there are at least 2,000 holders of the security, and either:

(i) the Exchange has in place with the primary exchange in the country where the security is primarily traded (in the case of a sponsored ADR, the Exchange has in place with the primary exchange in the country where the security underlying the ADR is primarily traded) an effective, comprehensive surveillance information sharing agreement; or

(ii) the "Relative U.S. Volume"[50] is at least 50%; or

(iii) during the preceding six months:

(A) the combined trading volume of the security and "related securities," consisting of other classes of common stock related to the security (including ADRs overlying such other classes, on a share-equivalent basis), in the U.S. market is at least 20% of the combined worldwide trading volume in the security and in related securities;

(B) the average daily trading volume for the security (or, if traded in the form of an ADR, the ADR overlying such security) in the U.S. market is 100,000 or more shares; and

(C) the trading volume for the security (or, if traded in the form of an ADR, the ADR overlying such security) is at least

[50] "Relative U.S. Volume" is the ratio of (i) the combined trading volume, on a share-equivalent basis, of the security and related securities (including ADRs overlying such security) in the United States and in any other market with which the Exchange has in place an effective, comprehensive surveillance information sharing agreement to (ii) the worldwide trading volume in such securities.

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60,000 shares per day in the U.S. market on a majority of the trading days during the six-month period.

Limits on Number of ELDS. The issuance of ELDS relating to any underlying U.S. security may not exceed 5% of the total outstanding shares of such underlying security.

The issuance of ELDS relating to any underlying non-U.S. security or ADR may not exceed:

- 2% of the total worldwide outstanding shares of such security if at least 20% of the worldwide trading volume in the security and related securities during the six-month period preceding the date of listing occurs in the U.S. market;
- 3% of the total worldwide outstanding shares of such security if at least 50% of the worldwide trading volume in the security and related securities during the six-month period preceding the date of listing occurs in the U.S. market; or
- 5% of the total worldwide outstanding shares of such security if at least 70% of the worldwide trading volume in the security and related securities during the six-month period preceding the date of listing occurs in the U.S. market.

If an issuer proposes to issue ELDS that relate to more than the allowable percentages of the underlying security specified above, then the NYSE, with the concurrence of the staff of the Division of Trading and Markets of the SEC, will evaluate the maximum percentage of ELDS that may be issued on a case-by-case basis. Historically, the Division of Trading and Markets has been reluctant to exceed the above-described limits.

In the case of ELDS, delisting will be considered if: (i) the number of publicly-held shares is fewer than 100,000; (ii) the number of holders is fewer than 100; (iii) the aggregate market value of shares outstanding is less than U.S.$1 million; (iv) the issuer of the linked security is no longer subject to reporting obligations under the 1934 Act; (v) the linked security no longer trades in a market in which there is last sale reporting; or (vi) the issuer is not able to meet its obligations on the ELDS.

Listing Preferred Stock on the NYSE and the NYSE Arca

The NYSE has not set any minimum numerical criteria for the listing of preferred stock. The issue must be of adequate size and distribution, however, to warrant trading in the NYSE system. The NYSE has set certain numerical delisting criteria for preferred stock. The NYSE will normally consider suspending or removing a preferred stock if the aggregate market value of publicly-held shares is less than U.S.$2 million and the number of publicly-held shares is fewer than 100,000.

In order for preferred stock to be listed on the NYSE Arca, the following requirements must be met:

(1) if the common stock or common stock equivalent security of the issuer is listed on the NYSE Arca, the NYSE, the NASDAQ Global Market or the NYSE Alternext

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US, the preferred stock must have: (i) at least 200,000 publicly-held shares; (ii) a market value of publicly-held shares of at least U.S.$4 million; (iii) a minimum closing price per share of U.S.$5; and (iv) a minimum of 100 round lot shareholders; and

(2) if the issuer's common stock or common stock equivalent security is not listed on any of the above referenced exchanges, the preferred stock must meet the NYSE Arca's applicable initial listing criteria for the common stock of the issuer.

In the case of an issuer whose common stock or common stock equivalent security is listed on the NYSE Arca, the NASDAQ Global Market or the NYSE Alternext US, the NYSE Arca will normally consider suspending or removing such issuer's preferred stock if the preferred stock has: (i) fewer than 100,000 publicly-held shares; (ii) a market value of publicly-held shares of less than U.S.$1 million; (iii) a closing price per share of less than U.S.$1; or (iv) fewer than 100 round lot shareholders. In the case of a non-listed issuer, the NYSE Arca will normally consider suspending or removing such issuer's preferred stock if the preferred stock does not meet the NYSE Arca's applicable continued listing criteria for the common stock of the issuer.

The NYSE Arca will not list convertible preferred issues containing a provision that permits the issuer, at its discretion, to change the conversion price other than in accordance with the terms of the issuer's stated articles of incorporation or any amendments thereof.

Listing Equity-Linked Term Notes ("ELTNs") on the NYSE Alternext US and the NYSE Arca

ELTNs are income instruments that are linked, in whole or in part, to the market performance of up to 30 common stocks or non-convertible preferred stocks. Such securities will be considered for listing on the NYSE Alternext US or the NYSE Arca under the following conditions:

(1) both the issue and issuer of such security meet certain numerical criteria relating to the assets and equity of the issuer, minimum level of distribution of the issuer's securities, aggregate market value, and other provisions;

(2) the security must have a minimum term of one year;

(3) the issuer of such security must have either (A) a minimum tangible net worth in excess of U.S.$250 million, and otherwise substantially exceed, in the case of the NYSE Alternext US, the earnings requirements under the NYSE Alternext US Initial Listing Standards or, in the case of the NYSE Arca, pre-tax income from continuing operations of at least U.S.$750,000 in its last fiscal year or in two of its last three fiscal years or (B) the issuer will be expected to have (a) a minimum tangible net worth of U.S.$150 million, and otherwise substantially exceed, in the case of the NYSE Alternext US, the earnings requirements under the NYSE Alternext US Initial Listing Standards or, in the case of the NYSE Arca, pre-tax income from continuing operations of at least U.S.$750,000 in its last fiscal year or in two of its last three fiscal years and (b) not to have issued such securities

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where the original issue price of all the issuer's other equity-linked note offerings (combined with equity-linked note offerings of the issuer's affiliates) listed on a national securities exchange exceeds 25% of the issuer's net worth;[51]

(4) each issuer of an underlying stock that the instrument is to be linked must be a reporting company under the 1934 Act that is listed on a national securities exchange and, in the case of the listing requirements of the NYSE Alternext US, must also be subject to last sale reporting;

(5) if any underlying security to which the instrument is to be linked is the stock of a non-U.S. issuer that is traded in the U.S. market as sponsored ADSs,[52] ordinary shares or otherwise, then for each such security the NYSE Alternext US or the NYSE Arca, as the case may be, must either (A) have in place a comprehensive surveillance sharing agreement with the primary exchange on which each non-U.S. security is traded, (in the case of an ADS, the primary exchange on which the security underlying the ADS is traded); (B) the combined trading volume of each non-U.S. security and other related non-U.S. securities occurring in the U.S. market or in markets with which the NYSE Alternext US or the NYSE Arca, as the case may be, has in place a comprehensive surveillance sharing agreement represents (on a share-equivalent basis for any ADSs) at least 50% of the combined worldwide trading volume in each non-U.S. security, other related non-U.S. securities, and other classes of common stock related to each non-U.S. security over the six-month period preceding the date of listing; or (C) (i) the combined trading volume of each non-U.S. security and other related non-U.S. securities occurring in the U.S. market represents (on a share-equivalent basis) at least 20% of the combined worldwide trading volume in each non-U.S. security and in other related non-U.S. securities over the six-month period preceding the date of selection of the non-U.S. security for listing, (ii) the average daily trading volume for each non-U.S. security in the U.S. markets over the six months preceding the selection of each non-U.S. security for listing is 100,000 or more shares and (iii) the trading volume is at least 60,000 shares per day in the U.S. markets on a majority of the trading days for the six months preceding the date of selection of each non-U.S. security for listing;

(6) each underlying linked stock to which the instrument relates may not exceed 5% of the total outstanding common shares of such entity, provided however, if any non-U.S. security and related securities has less than 20% of the worldwide trading volume occurring in the U.S. market during the six-month period

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[51] Rule 5.2(j)(2) of the NYSE Arca Company Guide.

[52] The AMEX Company Guide and the NYSE Arca Equities Rules both use "American Depositary Share" (or "ADS") in the context of equity-linked term note listing requirements. The term "American Depositary Receipt" (or "ADR") is used in the context of index-linked securities. Although market participants do not typically differentiate between an ADS and an ADR, the NYSE Alternext US listing standards and the NYSE Arca listing standards employ the terms in different contexts. The information in this chapter reflects this difference of usage. See Johnson, Jr., Charles J. and Joseph McLaughlin, CORPORATE FINANCE AND THE SECURITIES LAWS, Section 9.03[B].

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preceding the date of listing, then the instrument may not be linked to that non-U.S. security. If any underlying linked stock is a non-U.S. security represented by ADSs, common shares, or otherwise, then for each such linked security the instrument may not exceed: (A) 2% of the total shares outstanding worldwide provided at least 20% of the worldwide trading volume in each non-U.S. security and related non-U.S. security during the six-month period preceding the date of listing occurs in the U.S. market; (B) 3% of the total worldwide shares outstanding, provided at least 50% of the worldwide trading volume in each non-U.S. security and related non-U.S. security during the six-month period preceding the date of listing occurs in the U.S. market; and (C) 5% of the total shares outstanding worldwide, provided at least 70% of the worldwide trading volume in each non-U.S. security and related non-U.S. security during the six-month period preceding the date of listing occurs in the U.S. market;

(7) if any underlying security to which the instrument is to be linked is the stock of a non-U.S. issuer which is traded in the U.S. market as a sponsored ADS, ordinary shares or otherwise, then the minimum number of holders of such underlying linked security must be 2,000;

(8) in the case of the NYSE Alternext US, the underlying linked stock either (A) has a minimum market capitalization of U.S.$3 billion and during the 12 months preceding listing is shown to have traded at least 2.5 million shares, (B) has a minimum market capitalization of U.S.$1.5 billion and during the 12 months preceding listing is shown to have traded at least 10 million shares or (C) has a minimum market capitalization of U.S.$500 million and during the 12 months preceding listing is shown to have traded at least 15 million shares;

(9) in the case of the NYSE Arca, the underlying linked stock either (A) has a minimum market capitalization of U.S.$3 billion and trading volume in the United States of at least 2.5 million shares in the one-year period preceding listing, (B) has a minimum market capitalization of U.S.$1.5 billion and trading volume in the United States of at least 10 million shares in the one-year period preceding listing or (C) has a minimum market capitalization of U.S.$500 million and trading volume in the United States of at least 15 million shares in the one-year period preceding listing; and

(10) Equity-Linked Term Notes will be listed as equity securities.

If an issuer proposes to list an ELTN that relates to more than the allowable percentages in paragraph (6) above, the NYSE Alternext US or the NYSE Arca, as the case may be, with the concurrence of the staff of the Division of Market Regulation of the SEC, will evaluate the maximum percentage of ELTN that may be issued on a case-by-case basis.

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Listing Preferred Stock on the NYSE Alternext US

The listing of preferred issues on the NYSE Alternext US is considered on a case-by-case basis, in light of the suitability of the issue for continuous auction market trading. The NYSE Alternext US generally will not consider listing convertible preferred stock of an issuer unless current last sale information is available with respect to the underlying common stock into which the preferred stock is convertible. In the case of an issuer whose common stock is traded on the NYSE Alternext US (or NYSE), such issuer should meet the size and earnings requirements described in the NYSE Alternext US Initial Listing Standards and should maintain a minimum of 100,000 publicly-held shares, an aggregate public market value of U.S.$2 million and a minimum price of U.S.$10 per share. A non-listed issuer must maintain 400,000 publicly-held preferred shares, at least 800 public round-lot shareholders, an aggregate public market value of U.S.$4 million and a minimum price of U.S.$10 per share.

The NYSE Alternext US will not list convertible preferred issues containing a provision that gives the issuer the right, at its discretion, to reduce the conversion price for periods of time or from time to time unless the issuer establishes a minimum period of ten business days within which such price reduction will be in effect.

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SECTION III: ONGOING COMPLIANCE OBLIGATIONS

An issuer that has registered securities under the 1933 Act or has securities listed on a U.S. securities exchange will be subject to the ongoing reporting and other requirements of the 1934 Act and the requirements of Sarbanes-Oxley as discussed in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume. Many of these requirements need to be satisfied at the time of the offering and sale of securities in the U.S. capital markets or at the time of listing on a U.S. securities exchange, as well as on an ongoing basis. An issuer that has securities listed on a U.S. securities exchange has more ongoing obligations than an issuer that is subject or has voluntarily subjected itself to the reporting requirements of the 1934 Act, but has no securities listed on a U.S. securities exchange.

Also, as mentioned in Chapter 1 (*The U.S. Offering Process*) of this volume, it is important for issuers to consider the ongoing reporting and other requirements of the 1934 Act and other applicable U.S. laws at the time they are deciding between raising capital or funds in the U.S. capital markets pursuant to a 1933 Act-registered offering or through an exempt transaction, such a Rule 144A offering, or by issuing exempt securities. While there are fewer ongoing requirements applicable to exempt offerings and offerings of exempt securities, some, such as those under the Foreign Corrupt Practices Act, the rules administered by OFAC and the Federal Reserve Board's margin rules, are applicable to exempt offerings and offerings of exempt securities.

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CHAPTER 7

ONGOING REPORTING AND OTHER REQUIREMENTS

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GENERAL

An issuer becomes subject to the 1934 Act’s registration and reporting regime as a result of any of the following:

- listing a class of either equity or debt securities on a U.S. securities exchange under, Section 12(b) of the 1934 Act;

- registering a class of equity securities under Section 12(g) of the 1934 Act either voluntarily or because it has 500 or more securityholders of record and more than U.S.$10 million in total assets and, if the issuer is a foreign private issuer, more than 300 shareholders resident in the United States, on the last day of its most recently completed fiscal year;[1] or

- registering either equity or debt securities under a 1933 Act registration statement, which has gone effective, thus triggering 1934 Act reporting obligations under Section 15(d) of the 1934 Act, which generally require the issuer to file an annual report on Form 10-K, 20-F or 40-F, as applicable, for the fiscal year of the issuer in which the registration statement became effective.[2]

If any of the foregoing occur, with certain exceptions, the issuer is required to register the applicable securities under the 1934 Act. Once the securities are registered, the issuer’s reporting obligations continue, and it remains subject to the other provisions of the 1934 Act and the SEC’s rules thereunder, until it de-registers, as discussed in Chapter 18 (*De-registering under the 1934 Act*) of this volume. As a general matter, it is the issuer’s responsibility to terminate its 1934 Act registration obligations with respect to a class of securities and, failing to do so, it will

[1] A foreign private issuer may avoid a 1934 Act registration obligation under Section 12(g) by establishing the exemption under Rule 12g3-2(b) under the 1934 Act as described in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume. However, Canadian issuers filing an MJDS registration statement under the 1933 Act or 1934 Act will be precluded from claiming this Rule 12g3-2(b) exemption, as described in Chapter 13 (*Canadian Issuers*) of this volume.

[2] For these purposes, effectiveness of the registration statement triggers the obligation to file an annual report with respect to the fiscal year in which the registration statement was declared effective by the SEC.

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continue to be subject to the ongoing compliance and other requirements that are discussed in this chapter.

While there are generally fewer ongoing requirements applicable to exempt offerings and offerings of exempt securities (and some of the requirements are the result of the requirements of the applicable exemption, as described in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume), some obligations described in this chapter, such as those under the FCPA, the rules administered by OFAC and the Federal Reserve Board's margin rules, may also be applicable to exempt offerings and offerings of exempt securities.

HOLDERS OF RECORD

Rule 12g5-1 under the 1934 Act provides that securities shall be deemed to be "held of record" by each person who is identified on the records maintained by or on behalf of the issuer as the owner of the securities with the following qualifications:

- if the issuer's records of securityholders have not been maintained in accordance with accepted practice, each additional person who would be identified as an owner on those records had the record been kept properly must be counted as a holder of record;
- securities identified as held of record by a corporation, a partnership, a trust or other organization shall be counted as held of record by one person;
- securities identified as held of record by one or more persons acting as trustees, executors, guardians, custodians or in other fiduciary capacities with respect to a single trust, estate or account shall be counted as held of record by one person;
- securities held by two or more persons as co-owners shall be counted as held by one person;
- each outstanding unregistered or bearer certificate shall be counted as held of record by a separate person unless the issuer can establish that if they were registered securities they would be held of record in accordance with the provisions of this rule by a lesser number; and
- securities registered in substantially similar names shall be counted as held by one person if the issuer has reason to believe because of the address or other indicators that they represent the same person.

The qualifications above are subject to the following three provisions:

(1) if the issuer knows that securities are held subject to a voting trust, deposit agreement or similar arrangement, the number of record holders of interests in that arrangement shall be included as the number of record holders of those securities (for these purposes, the issuer may rely in good faith on the information it receives from a non-affiliated issuer of the interests in such an arrangement);

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(2) where the issuer is a savings and loan association, building and loan association, cooperative bank, homestead association or similar institution, securities, whole or fractional, issued for the sole purpose of qualifying a borrower for membership in the issuer, and which are to be redeemed or repurchased by the issuer when the borrower's loan is terminated, shall not be included as held of record by any person; and

(3) if the issuer knows or has reason to know that the form through which securities of record are held is used primarily to circumvent the registration and reporting provisions of the 1934 Act, the beneficial owners of such securities shall be deemed to be the record owners thereof.[3]

PERIODIC REPORTING REQUIREMENTS

An issuer that has a class of securities registered under the 1934 Act or has had a 1933 Act registration statement become effective is required to file periodic disclosure reports with the SEC until it terminates its obligations as described in Chapter 18 (*De-Registering under the 1934 Act*) of this volume. The periodic disclosure requirements established by the SEC are designed to ensure that the issuer makes available to holders of and prospective investors in its securities reasonably current information about itself, its business, its financial results and condition and any other matter that might be material to holders and prospective investors.

For "S" form filers, which largely consist of issuers domiciled in the United States, the applicable periodic disclosure forms are Form 10-K for annual reports, Form 10-Q for quarterly reports and Form 8-K for reports of material matters not disclosed in an issuer's most recent Form 10-K or Form 10-Q. The SEC's 1934 Act filing requirements for "S" form filers is as follows:

- Form 10-K must be filed within 60 days after the end of the fiscal year covered by the report for large accelerated filers,[4] within 75 days after the fiscal year end for

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[3] For further information regarding the determination of holders of record for purposes of de-registering under the 1934 Act, see the discussion under the heading "Holders of Record" in Chapter 18 (*De-Registering under the 1934 Act*) of this volume.

[4] A "large accelerated filer" is defined in Rule 12b-2 under the 1934 Act as an issuer after it first meets the following conditions as of the end of its fiscal year:

(i) the issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of U.S.$700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter;

(ii) the issuer has been subject to the requirements of Section 13(a) of the 1934 Act (*i.e.*, has securities listed on a U.S. securities exchange) or 15(d) of the 1934 Act (*i.e.*, had a 1933 Act registration statement become effective) for at least twelve calendar months;

(iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the 1934 Act; and

(iv) the issuer is not eligible to use the SEC's rules for smaller reporting companies.

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accelerated filers[5] and within 90 days after the fiscal year end for all other registrants;

- Form 10-Q must be filed within 40 days after the end of the fiscal quarter covered by the report for large accelerated filers and accelerated filers and within 45 days after the end of the fiscal quarter covered for all other registrants; and

- Form 8-K generally must be filed within four business days of the occurrence of the event that triggers the filing obligation. Special rules apply to timing requirements for filings required by Regulation FD, as discussed below under the heading "—Communications with Investors and the Public—Regulation FD." Information filed pursuant to the requirement of Item 2.02 of Form 8-K (Results of Operations and Financial Condition) or Item 7.01 (Regulation FD Disclosure) is not deemed filed for 1934 Act Section 18 liability purposes (*i.e.*, in determining whether the information contains any material misstatements or omits any material information) unless the issuer elects that to be the case.

For "F" form filers, which consist of foreign private issuers, the applicable periodic disclosure forms are Form 20-F or, in the case of Canadian issuers under the MJDS, Form 40-F, for annual reports and Form 6-K for reports of material matters not disclosed in an issuers' most recent Form 20-F or 40-F, which generally includes, among other things, interim financial statements published by the issuer in its home country, other material matters made public in the issuer's home country and, in the case of Canadian issuers under the MJDS, information required by the MJDS. The SEC's filing requirements for "F" form filers is as follows:

- Form 20-F currently must be filed within six months after the fiscal year covered by the report.[6] However, for fiscal years ending on or after December 15, 2011, foreign private issuers must file Form 20-F within four months after the fiscal

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[5] An "accelerated filer" is defined in Rule 12b-2 under the 1934 Act as an issuer after it first meets the following conditions as of the end of its fiscal year:

(i) the issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of U.S.$75 million or more but less than U.S.$700 million, as of the last business day of the issuer's most recently completed second fiscal quarter;

(ii) the issuer has been subject to the requirements of Section 13(a) of the 1934 Act (*i.e.*, has securities listed on a U.S. securities exchange) or 15(d) of the 1934 Act (*i.e.*, had a 1933 Act registration statement become effective) for at least twelve calendar months;

(iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the 1934 Act; and

(iv) the issuer is not eligible to use the SEC's rules for smaller reporting companies.

[6] As many foreign private issuers publish financial statements every six months, in order to avoid being effectively "blacked out" of the U.S. public markets due to the financial statement requirements for 1933 Act-registered offerings many foreign private issuers file their annual report on Form 20-F much earlier than required by the form. See the discussion under the heading "Disclosure for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 8: Financial Information" in Chapter 4 (*Disclosure Requirements*) of this volume.

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year covered by the report. The assessment of eligibility to file Form 20-F is to be made once a year on the last business day of the issuer's second fiscal quarter;[7]

- Form 40-F, as part of the MJDS, must be filed the same day that the information included therein is due to be filed with any securities commission or equivalent regulatory authority in Canada; and

- Form 6-K must be furnished promptly after the information contained in the report is made public. Information furnished on Form 6-K is not deemed filed for 1934 Act Section 18 liability purposes (*i.e.*, in determining whether the information contains any material misstatements or omits any material information).

The disclosure requirements for annual reports on Forms 10-K and 20-F, quarterly reports on Form 10-Q and periodic reports on Forms 8-K and 6-K are discussed in Chapter 4 (*Disclosure Requirements*) of this volume. The disclosure requirements for annual reports on Form 40-F are discussed in Chapter 13 (*Canadian Issuers*) of this volume. The 1934 Act disclosure forms, including the filing and disclosure requirements, for foreign governmental issuers are discussed in Chapter 14 (*Foreign Governmental Issuers*) of this volume.

U.S. Securities Exchange Reporting

While an issuer has securities listed on a U.S. securities exchange,[8] it must periodically file certain reports and other information with the applicable exchange.

The requirements of the NYSE, NASDAQ and the NYSE Alternext US are similar. The NYSE, for example, requires a listed issuer to agree to provide the exchange with such documents and information as the following:

(1) prompt notification of such events as a change in the general character or nature of the issuer's business, any changes in the issuer's officers or directors, any changes in the form, nature, rights or privileges of the issuer's listed security or any change in accountants;

(2) copies of proxy materials filed with the SEC;

(3) copies of amendments to the issuer's certificate of incorporation or by-laws;

(4) prompt notification of record dates; and

(5) on demand, such information concerning the issuer as the NYSE may reasonably require.

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7 SEC Release No. 33-8959 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf).

8 See Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

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Reports to Shareholders

Non-U.S. issuers generally are exempt from the requirements of the proxy rules by virtue of Rule 3a12-3 under the 1934 Act. If a foreign private issuer, however, has equity listed on a U.S. securities exchange, then the foreign private issuer will have to comply with the requirements of the relevant exchange. The NYSE requires that actively operating listed issuers solicit proxies for all meetings of shareholders. This requirement may be waived where applicable law precludes or makes virtually impossible the solicitation of proxies in the U.S. NASDAQ, on the other hand, while requiring listed issuers to solicit proxies and provide proxy statements for all meetings of shareholders will allow foreign private issuers to follow home country practices. NYSE Alternext US also considers home country practices and does not require the solicitation of proxies by non-U.S. issuers, but it does require the distribution of annual reports. The NYSE and NASDAQ have modified their rules to allow issuers to post their annual reports on their web site in lieu of distributing them.

EXTENSIBLE BUSINESS REPORTING LANGUAGE ("XBRL")

XBRL is an interactive data technology that uses tags uniquely to identify individual items in an issuer's financial statements so they are more searchable on the Internet and more readable by spreadsheets and other comparative and analytical tools used by investors and financial analysts. These tags generally allow investors to identify more readily specific facts disclosed by issuers and compare that information with comparable data from other companies. The SEC's IDEA system was created and is maintained to accept interactive data filings and facilitate faster and easier access to information filed with the SEC.

In January 2009, the SEC issued rules that will phase in XBRL reporting.[9] Issuers that file using U.S. GAAP and have a worldwide public float of over U.S.$5 billion will be required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2009. The remaining issuers who file using U.S. GAAP will be required to provide interactive data reports on a phased-in schedule over the following two years. Issuers reporting in IFRS as issued by the IASB will be required to provide their interactive data reports starting with fiscal years ending on or after June 15, 2011.[10] Interactive financial data will need to be filed as an exhibit to any 1933 Act registration statement, annual report under the 1934 Act or report on Form 6-K that includes updated or revised financial information. The interactive data will also need to be posted on the issuer's web site for a period of 12 months.

Under the new rules, financial statement footnotes and schedules will be tagged individually as a block of text for one year, after which time the issuer will be required to tag the detailed quantitative disclosures within the footnotes and schedules. The issuer will also be permitted to tag each narrative disclosure if it so chooses.

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9 See SEC Release No. 33-9002 (Jan. 30, 2009) (http://www.sec.gov/rules/final/2009/33-9002.pdf). For further discussion of these rules, see the related Client Update at http://www.sidley.com.

10 Since 2005 the SEC has maintained a Voluntary Filer Program for those issuers that have chosen to report in XBRL; these filings are available on the IDEA system.

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Foreign private issuers that do not provide or post the required interactive data will be deemed not current with their 1934 Act reporting requirements and, as a result, will not be eligible to use Form F-3, or elect under Form F-4 to provide information at a level prescribed by Form F-3. Similarly, such issuer will not be deemed to have available adequate current public information for purposes of the resale exemption safe harbor provided by Rule 144. However, an issuer that is deemed not current with its 1934 Act reporting requirements solely as a result of not providing or posting an interactive data exhibit when required will be deemed current upon providing or posting the interactive data. As such, it will not lose its status as having "timely" filed its 1934 Act reports solely as a result of the delay in providing interactive data.

Prior to the date 24 months from the date an issuer is first required to file interactive data files (but no later than October 31, 2014), such files will be treated in a modified manner for certain liability purposes. During this time, such files will not be subject to certain liability provisions under U.S. federal securities laws (including Sections 11 and 12 of the 1933 Act), and, with respect to the anti-fraud provisions of the 1934 Act, will be protected from liability for any failure to comply with the tagging requirements if the interactive data file failed to meet those requirements (despite the issuer's good faith effort) and the issuer corrected the failure promptly after becoming aware of it.

The new rules will not alter the requirements to provide financial statements and any required financial statement schedules with the traditional format filings.

SARBANES-OXLEY

Sarbanes-Oxley and the related rules adopted by the SEC require certain corporate governance practices and prescribe certain disclosures for public companies in the U.S. markets, including non-U.S. issuers that file periodic reports with the SEC. Sarbanes-Oxley places responsibilities on principal executive officers, principal financial officers, audit committees and lawyers who are involved in the disclosure process. Sarbanes-Oxley also strengthens the regulation of accounting firms that perform audit and review services for public companies and emphasizes the independence standards for such accounting firms.

In enacting Sarbanes-Oxley, Congress intended to bring about increased transparency in the U.S. capital markets and to improve the information available for use by investors in analyzing an issuer's performance.

Sarbanes-Oxley applies to "issuers," as that term is defined in Sarbanes-Oxley Section 2(a)(7). That term includes foreign private issuers that have securities registered under Section 12 of the 1934 Act, are required to file reports under Section 15(d) of the 1934 Act or are conducting an IPO of equity or debt securities in the United States and have filed a registration statement with the SEC under the 1933 Act in respect of the IPO (and which registration statement has not been withdrawn).[11]

[11] Most of the provisions of Sarbanes-Oxley do not apply to issuers who voluntarily file reports under Section 15(d) of the 1934 Act. See Question 1 of the Division of Corporation Finance: Sarbanes-Oxley Act of 2002 – Frequently Asked Questions (http://www.sec.gov/divisions/corpfin/faqs/soxact2002.htm). However, the CEO/CFO certification requirements, criminal provisions and employee whistleblower

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Sarbanes-Oxley does not apply to issuers that are exempt from SEC reporting requirements, such as those who sell their securities in the United States pursuant to Rule 144A under the 1933 Act or that make available certain "home country" information pursuant to Rule 12g3-2(b) under the 1934 Act. It also does not apply to foreign governmental issuers.[12]

The SEC has enacted numerous rules under Sarbanes-Oxley, most of which apply to reporting issuers. In considering whether exceptions should be granted for foreign private issuers, SEC officials have stated that exceptions are more likely in the area of corporate governance, which tend to be supervised by regulatory authorities in the foreign private issuer's home jurisdiction, than in the area of disclosure.

Disclosure and Related Requirements

The disclosure and related requirements of Sarbanes-Oxley are discussed below and in the discussion of the related items of Form 20-F under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F" in Chapter 4 (*Disclosure Requirements*) of this volume.

Disclosure Certification, Controls and Procedures[13]

Foreign private issuers and their management should be aware of the chief executive officer and chief financial officer certification requirements of Sarbanes-Oxley Sections 302 and 906. An issuer's chief executive officer and chief financial officer must personally certify as to the accuracy of disclosure and the fair presentation of financial information contained in quarterly reports on Form 10-Q and annual reports on Form 10-K, 20-F or 40-F filed with the SEC. In this regard, issuers should focus on:

- reports that are current reports, such as reports on Form 8-K and 6-K, are not covered by the certification requirement;
- the chief executive officer and chief financial officer certifications called for by Sections 302 and 906 of Sarbanes-Oxley must be filed as exhibits to annual reports; and
- there are severe penalties for those that "knowingly" (U.S.$l million/ten years in prison) or "willfully" (U.S.$5 million/20 years in prison) make a false Sarbanes-Oxley Section 906 certification.[14]

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protections, among other provisions, do apply to such issuers. Voluntary filers should consult their U.S. counsel with respect to applicable Sarbanes-Oxley requirements.

[12] As a technical matter, a foreign governmental issuer could be encompassed within the definition of "issuer" under Section 2(a)(7) of Sarbanes-Oxley and therefore be subject to its requirements and prohibitions. As a practical matter, however, it is unlikely that Congress intended to apply Sarbanes-Oxley to such issuers. For example, though not dispositive of the matter or Congressional intent, the SEC specifically exempted foreign governmental issuers from Sarbanes-Oxley standards relating to listed company audit committees. See SEC Release No. 33-8220 (Apr. 9, 2003) (http://www.sec.gov/rules/final/33-8220.htm). See also Chapter 14 (*Foreign Governmental Issuers*) of this volume.

[13] See Sarbanes-Oxley Sections 302 and 906; Rules 13a-14, 13a-15, 15d-14 and 15d-15 under the 1934 Act.

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The forms of the required certifications are detailed and discussed under the heading "Disclosure Requirements for 'F' Form Issuers—Signatures and Certifications" in Chapter 4 (*Disclosure Requirements*) of this volume.

In the Section 906 certification, the certifying officer must certify two items: (1) that the relevant periodic report fully complies with the requirements of the 1934 Act and (2) that the information contained therein fairly presents, in all material respects, the financial condition and results of operation of the issuer.

An issuer must maintain disclosure controls and procedures designed to enable the issuer to report required disclosure in a timely fashion. Management must supervise, participate in and report on an annual evaluation of these controls and procedures on Forms 10-Q, 20-F and 40-F, as applicable.[15]

Internal Control Reports in Annual Reports[16]

Section 404 of Sarbanes-Oxley directed the SEC to adopt rules that require each annual report of a reporting company under the 1934 Act to contain (i) an internal control report by management stating its responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including an assessment, as of the end of the issuer's most recent fiscal year, of the effectiveness of the issuer's internal control structure and procedures for financial reporting and (ii) the independent auditor's attestation and report. The SEC adopted rules implementing Sarbanes-Oxley Section 404 with regard to management's obligations to report on internal control structure and procedures on June 5, 2003.[17] Issues with the implementation of these rules led to significant amendments in 2007.[18]

The SEC has issued interpretive guidance that sets forth an approach by which management can conduct a top-down, risk-based evaluation of internal control over financial reporting under Section 404. This guidance is broadly based on two principles: (i) management should evaluate whether it has implemented controls that adequately address the risk that a

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14 The SEC stated in Release No. 33-8124 that a false Section 302 certification could give rise to liability consequences under Sections 13(a) or 15(d) of the 1934 Act, as well as Sections 11 and 12(a)(2) of the 1933 Act in cases where an annual report on Form 10-K, 20-F or 40-F is incorporated by reference into a registration statement on Form F-3 or into a prospectus filed pursuant to Rule 424(b) under the 1933 Act. Furthermore, SEC and private rights of action may arise under Section 10 and Rule 10b-5 under the 1934 Act. See SEC Release No. 33-8124 (Aug. 28, 2002) (http://www.sec.gov/rules/final/33-8124.htm). For a further discussion of liability under U.S. securities laws, see Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume.

15 While not required either by Sarbanes-Oxley or the SEC rules thereunder, it is sensible that a "disclosure committee" of management be established with detailed responsibilities for both an overall assessment of an issuer's reporting process and a review thereafter of specified SEC (and perhaps even home country) filings. The SEC suggested the need for such a committee in connection with its original certification proposal in June 2002. Members of this committee should probably include senior financial, legal and compliance officers.

16 See Sarbanes-Oxley Section 404; Rule 13a-15(a) under the 1934 Act.

17 SEC Release No. 33-8238 (June 5, 2003) (http://www.sec.gov/rules/final/33-8238.htm).

18 See SEC Release No. 33-8829 (Aug. 3, 2007) (http://www.sec.gov/rules/final/2007/33-8829.pdf).

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material misstatement of the financial statements would not be prevented or detected in a timely manner; and (ii) management's evaluation of evidence about the operation of its controls should be based on its assessment of risk to reliable financial reporting. The guidance itself, however, is not mandated and only represents one way to satisfy the annual evaluation requirement.[19] The independent auditors are required to render an opinion on the effectiveness of the issuer's internal control over financial reporting.[20]

Because of the costs associated with implementation, the SEC has granted several extensions for compliance with its internal control over financial reporting rules for various categories of issuers. Section 404 management assessment and auditor attestations of internal control and procedures are compulsory for either U.S. or non-U.S. large accelerated issuers and accelerated issuers. However, while non-accelerated issuers must include a report from management on the issuer's internal control over financial reporting, the requirement to include an auditor's report begins with fiscal years ending on or after December 15, 2009.[21] First-time registrants are exempt from these rules until their second annual report filed with the SEC; however, new registrants must comply with the auditor's report requirement at the time it furnishes its first management report on internal control over financial reporting.[22]

As discussed under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 15: Controls and Procedures" in Chapter 4 (*Disclosure Requirements*) of this volume, an issuer's management must also include in a Form 10-K, 20-F, 40-F or 10-Q report, as applicable, any material changes to its internal control over financial reporting for the period covered by the report.[23] Internal control over financial reporting is defined as a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
- provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the issuer are being

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19 See SEC Release No. 33-8810 (June 27, 2003) (http://www.sec.gov/rules/interp/2007/33-8810.pdf).

20 See PCAOB Auditing Standard No. 5 (http://www.pcaobus.org/Rules/Rules_of_the_Board/Auditing_Standard_5.pdf).

21 On June 26, 2008, the SEC extended by an additional year the deadline for non-accelerated filers to comply with the requirement that an independent auditor provide an attestation report on the issuer's internal control over financial reporting. The extension did not change the deadline for non-accelerated filers to include a report from management on the issuer's internal control over financial reporting for fiscal years ending on or after December 15, 2007. See SEC Release No. 33-8934 (June 26, 2008) (http://www.sec.gov/rules/final/2008/33-8934.pdf).

22 See SEC Release No. 33-8731 (Aug. 9, 2006) (http://www.sec.gov/rules/proposed/2006/33-8731.pdf).

23 See Rules 13a-15(d) and 15d-15(d) under the 1934 Act.

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made only in accordance with authorizations of management and directors of the issuer; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements.[24]

The internal control over financial reporting must be designed by the principal executive and financial officers (or under their direction) and effected by the board of directors, management and other personnel. The report must include an assessment of any material weaknesses in internal control that could adversely affect an issuer's ability to record, process, summarize and report financial data consistent with the statements of management in the issuer's financial statements. As defined in Rule 12b-2 under the 1934 Act, a "material weakness" is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis.

Disclosure of Financial Experts on the Audit Committee[25]

An issuer must disclose in its annual report on Form 10-K, 20-F or 40-F whether at least one audit committee[26] member is an "audit committee financial expert" and, if not, why not and, if so, the name of the expert or experts.

An audit committee financial expert is defined as someone who:

- understands applicable generally accepted accounting principles and financial statements (for a foreign private issuer, this is "home country" GAAP);
- can assess estimates, accruals and reserves under applicable general accepted accounting principles;
- has experience preparing, auditing or analyzing financial statements comparable to those of the issuer, or experience actively supervising those who do so;
- understands internal controls over financial reporting; and
- understands audit committee functions.

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[24] See Rules 13a-15(f) and 15d-15(f) under the 1934 Act.

[25] See Sarbanes-Oxley Section 407; Regulation S-K Item 407(d)(5); Form 40-F Gen'l Inst. B.(8); Form 20-F Item 16A.

[26] Issuers, including non-U.S. issuers, that have securities listed on the NYSE, NYSE Alternext U.S. or NASDAQ must have an audit committee. See Section 10A(m) of the 1934 Act and Rule 10A-3(a)(1) thereunder.

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Under the SEC rules, the expert may acquire the attributes through any one or more of the following:

- education and experience as a principal officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;
- experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;
- experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or
- other relevant experience.

If a person qualifies as an expert by virtue of possessing "other relevant experience," the issuer's disclosure must briefly describe that experience.[27]

An audit committee financial expert is not deemed to be an expert for purposes of Section 11 of the 1933 Act or any other purpose. Further, pursuant to Item 407(d)(5)(iv) under Regulation S-K, a designation or identification as an audit committee financial expert will not impose on such person any duties, obligations or liabilities that are greater than the duties, obligations and liabilities imposed on any other member of the audit committee and board of directors in the absence of such designation or identification. Also, such designation or identification of an audit committee financial expert does not affect the duties, obligations or liabilities of any other member of the audit committee or board of directors.

An issuer that has listed securities on a U.S. securities exchange must disclose whether its audit committee financial expert is independent, as that term is defined by the applicable listing standards. An issuer with no listed securities must select one of the definitions of audit committee member independence used by a major U.S. securities exchange and disclose whether its audit committee financial expert is independent under that definition.[28] If an issuer does not have an "audit committee" (and if it is not listed in the U.S. it is not required to), its full board of directors will be deemed to be its audit committee and the issuer is required to provide disclosure as to whether there is an audit committee financial expert on its board of directors.[29]

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[27] See supra footnote 25.

[28] See the discussion under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 16A: Audit Committee Financial Expert" in Chapter 4 (*Disclosure Requirements*) of this volume.

[29] Section 10A(m) of 1934 Act and Rule 10A-3 thereunder. See also SEC Release No. 33-8220 (Apr. 9, 2003) (http://www.sec.gov/rules/final/33-8220.htm).

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Disclosure of Executive Officer Code of Ethics[30]

An issuer must disclose in its annual report on Form 10-K, 20-F or 40-F whether it has adopted a code of ethics for the issuer's principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions or, if not, why not. U.S. issuers are required to promptly disclose any changes or waivers to this code,[31] but non-U.S. issuers are only required to do so in the next annual report filed with the SEC.

The term "code of ethics" is defined broadly to include standards promoting honest and ethical conduct, governing full, fair, accurate, timely and understandable disclosure in reports and documents the issuer files with or submits to the SEC, and compliance with applicable governmental laws and regulations.[32] A copy of the code of ethics must be attached to the issuer's annual report, posted on the issuer's web site or provided free of charge on request.

The SEC has suggested, but not required, foreign private issuers to include disclosure of waivers to the code of ethics on Form 6-K. Such disclosure would be required, however, in a foreign private issuer's annual report.[33]

Audit, Auditor and Audit Committee Requirements

Audit Committee Standards for Listed Issuers[34]

Sarbanes-Oxley Section 301 requires that the SEC mandate that all issuers listed in the United States have a fully independent audit committee of the board of directors. Pursuant to Sarbanes-Oxley Section 301, the SEC adopted Rule 10A-3 under the 1934 Act.[35] Rule 10A-3 implements the listing standard requirements for audit committees required by Sarbanes-Oxley and requires certain additional disclosures. These standards for audit committees apply to issuers whose securities are listed on registered U.S. securities exchanges under the 1934 Act.[36]

The audit committee standards require the following:

- *Independence*. Each member of an issuer's audit committee must be independent, *i.e.*, (A) no member or any specified relative may receive fees from the issuer

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[30] See Sarbanes-Oxley Section 406; Item 406 under Regulation S-K; Form 40-F Gen'l Inst. B.(9); Form 20-F Item 16B.

[31] See the discussion of waivers under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 16B: Code of Ethics" in Chapter 4 (*Disclosure Requirements*) of this volume.

[32] The required contents of a "code of ethics" is discussed under the heading "Disclosure Requirements for 'F' Form Issuers—Disclosure Requirements of Form 20-F—Item 16B: Code of Ethics" in Chapter 4 (*Disclosure Requirements*) of this volume.

[33] See SEC Release No. 33-8177 (Jan. 23, 2003) (http://www.sec.gov/rules/final/33-8177.htm).

[34] See Sarbanes-Oxley Section 301; Section 10A(m) of the 1934 Act; Rule 10A-3 under the 1934 Act.

[35] SEC Release No. 33-8220 (Apr. 9, 2003) (http://www.sec.gov/rules/final/33-8220.htm).

[36] See Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

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other than as a director, although normal commercial transactions between the issuer and an entity with which the director has a relationship would be permitted ("no-fee requirement"), and (B) no member may be an affiliated person of the issuer or any subsidiary thereof.[37]

- *Authority to Engage Auditor*. The audit committee must have the authority to engage the issuer's auditor, including appointing, compensating, retaining and overseeing the work of the auditor and resolving disputes between management and the auditor. (This requirement will not be deemed to conflict with any home country requirements that specify that shareholders must elect, approve or ratify the selection of auditors, but the audit committee must be responsible for making any nomination or recommendation to shareholders.)

- *Complaint Resolution Procedures*. The audit committee must establish procedures to receive and resolve complaints regarding accounting, internal accounting controls and auditing matters, including procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

- *Authority to Employ Advisors*. The audit committee must have the authority to engage independent counsel and other advisors necessary for the performance of its duties.

- *Appropriate Funding*. The audit committee must be appropriately funded.

If an issuer avails itself of any exemption under the rule, it must disclose, in its annual report on Form 10-K, 20-F or 40-F, as applicable, that fact and any material impact on the independence of the audit committee and the other requirements of the rule.[38]

If an issuer does not have an audit committee, the rule requires disclosure that the issuer's board of directors is acting as the audit committee.

The following exceptions from audit committee rules apply to a foreign private issuer:

- *Non-management Employees*. Employees that are not executive officers of a foreign private issuer may serve as audit committee members if the employee is elected or designated to the board of directors or the audit committee pursuant to

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[37] An "affiliate" or a person affiliated with a specified person means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the specified person. For the purposes of the independence requirement, a person will not be deemed to control a specified person (such as an issuer or any subsidiary thereof) if that person (i) is not the beneficial owner, directly or indirectly, of more than 10% of any class of voting equity securities of the specified person and (ii) is not an executive officer of the specified person. See supra footnote 35.

[38] U.S. issuers that are subject to the proxy rules would have to similarly disclose the availment of the exemption in proxy statements or information statements for shareholders' meetings at which elections for directors are held. See supra footnote 35.

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that issuer's governing law or documents, home country legal or listing requirements or an employee collective bargaining or similar agreement.[39]

- *Controlling Shareholder*. A member of the audit committee can be an affiliate of a foreign private issuer or a representative of such an affiliate so long as such person (i) satisfies the no-fee requirement, (ii) has only observer status, and cannot vote and is not the chair of the audit committee and (iii) is not, and the affiliate is not, an executive officer of that issuer.

- *Foreign Government Representatives*. If a foreign government is an affiliate of the foreign private issuer, a member of the audit committee may be a representative or designee of that government so long as such person (i) satisfies the no-fee requirement and (ii) is not an executive officer of that issuer.

- *Foreign Governments as Issuers*. Listed issuers that are foreign governments (as defined by Rule 3b-4(a) under the 1934 Act) are exempt from the rule.

- *Boards of Auditors, etc*. The independence and authority to engage auditor requirements do not apply where a foreign private issuer is overseen by a board of auditors, statutory auditors or similar bodies.

- *Dual Holding Company Structure*. Where a foreign private issuer operates under a dual holding company structure, the companies may establish a joint audit committee made up of directors who serve on one or both companies' boards of directors. Such companies may designate one audit committee for both companies so long as each member of the audit committee is a member of the board of directors of at least one of such dual holding companies.

Audit Committee Pre-Approvals and Consultations[40]

An issuer's audit committee must pre-approve all audit services and permitted non-audit services provided by the issuer's auditors. An issuer's audit committee may delegate its pre-approval responsibilities if, pursuant to procedures detailed as to the particular service, the audit committee is informed of each non-audit service approved via delegation and the procedures do not delegate the audit committee's obligations to management.

Before the filing of an auditor's report with the SEC, the auditor must timely report to the issuer's audit committee:

- all critical accounting policies and practices to be used by the issuer;

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39 Rule 3b-7 under the 1934 Act defines an "executive officer," with respect to a registrant, as its president, any vice president in charge of a principal business unit, division or function (such as sales, administrative or finance), any other officer who performs a policy making function, or any other person who performs similar policy making functions for the registrant. Executive officers of subsidiaries may be deemed officers of the registrant if they perform such policy making functions for the registrant.

40 See Sarbanes-Oxley Section 202; Section 10A(i) of the 1934 Act; Rule 2-01(c)(7) under Regulation S-X; Sarbanes-Oxley Section 204; Section 10A(k) of the 1934 Act; Rule 2-07(a) under Regulation S-X.

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- all alternative treatments within generally accepted accounting principles for policies and procedures related to material items discussed with management, and the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditors; and
- other material written communications provided by the auditor to management, such as any management letter or schedule of unadjusted differences.

If an issuer does not have an audit committee because it is not otherwise required to have an audit committee, a voluntary audit committee could be formed to receive the required communications.

Prohibition or Limitation of Specified Non-Audit Services[41]

An accounting firm may not provide specified non-audit services to an audit client, including:

- book-keeping, financial information services and design and implementation, or appraisal or valuation services;
- fairness opinions or contribution-in-kind reports;
- actuarial services, internal audit outsourcing services, management functions or human resources; or
- broker-dealer, investment advisor or investment banking services; or
- legal services or expert services unrelated to the audit.

An accounting firm may provide an issuer with tax services such as tax compliance, tax planning and tax advice but may not represent the issuer within a prohibited category before a court.

Rotation of Audit Partners[42]

Lead and concurring partners of an issuer's accountant must rotate every five years. A minimum five-year time-out period must apply before lead or concurring partners may rotate back to the issuer. Other partners who provide audit services to an issuer must rotate after seven years, with a minimum two-year time-out period between rotations. Foreign audit partners for calendar-year issuers became subject to the rules on January 2, 2004, which would be deemed to be the foreign audit partner's first year of service for the issuer.

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[41] See Sarbanes-Oxley Section 201 and Sections 10A(g) and (h) of the 1934 Act; Rule 2-01(c)(4) under Regulation S-X.

[42] See Sarbanes-Oxley Section 203 and Section 10A(j) of the 1934 Act; Rule 2-01(c)(6) under Regulation S-X.

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Accounting Firms' Retention of Audit and Review Records[43]

The documents used by an accounting firm in conducting an audit or review of an issuer's financial statements completed on or after October 31, 2003, including workpapers, must be kept for seven years.[44] Certain documents, such as superseded drafts or other records such as e-mails, are not required to be kept unless they contain information relating to a significant matter that is inconsistent with the auditor's final conclusion on that matter, such as documentation of the consultation on or resolution of differences of professional judgment. In the event of a violation, criminal penalties may apply.[45]

Limitation on Issuer's Employment of Former Member of Audit Engagement Team[46]

If an audit engagement team member of an accountant is employed by an issuer to serve in a "financial reporting oversight role" for the issuer and if that person performed audit-related work during the one-year period prior to that accounting firm's commencement of audit procedures for that issuer for a given year, the accounting firm is not independent with respect to that issuer.[47]

Prohibition of Improper Influence on Conduct of Audits[48]

Under the SEC's rules, no officer or director of an issuer may make or cause to be made a materially false or misleading statement to an accountant, or omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading, in connection with (i) any audit, review or examination of the financial statements of the issuer or (ii) the preparation or filing of any document or report required to be filed with the SEC.[49] Further, rules adopted by the SEC prohibit an issuer's directors and officers, and any other person acting under their direction, from taking action to coerce, manipulate, mislead or fraudulently influence any independent public or certified accountant in connection with the conduct of any audit of financial statements or the preparation or filing of any document or report with the SEC required under the 1934 Act, if that person knew or should have known that such actions, if successful, could render the financial statements materially misleading.[50]

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43 See Sarbanes-Oxley Section 802 and Rule 2-06 under Regulation S-X.

44 "Workpapers" are defined as the documentation of auditing or review procedures applied, evidence obtained, and conclusions reached by the accountant in the audit or review engagement, as required by the standards established or adopted by the SEC or the PCAOB. Rule 2-06(b) under Regulation S-X.

45 See SEC Release No. 33-8180 (Jan. 24, 2003) (http://www.sec.gov/rules/final/33-8180.htm).

46 See Sarbanes-Oxley Section 206 and Section 10A(l) of the 1934 Act; Rule 2-01(c)(2)(iii) under Regulation S-X.

47 See SEC Release No. 33-8183 (Jan. 28, 2003) (http://www.sec.gov/rules/final/33-8183.htm).

48 See Sarbanes-Oxley Section 303; Rule 13b2-2(b) under the 1934 Act.

49 See Rule 13b2-2(a) under the 1934 Act.

50 SEC Release No. 34-47890 (May 20, 2003) (http://www.sec.gov/rules/final/34-47890.htm).

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Registration of Public Accounting Firms with the Public Company Accounting Oversight Board[51]

Rules adopted by the PCAOB pursuant to Sarbanes-Oxley Sections 102 and 106(a) require that any U.S. or non-U.S. public accounting firm that "prepares or issues" or "plays a substantial role in the preparation or furnishing of" any audit report with respect to any "issuer," as that term is defined in Sarbanes-Oxley, register with the PCAOB.[52] Non-U.S. public accounting firms were required to register by July 19, 2004. U.S. or non-U.S. public accounting firms that do not register with the PCAOB are prohibited from preparing or issuing or participating in audit reports of foreign private issuers that have either registered, or are in the process of registering, a class of securities with the SEC or are otherwise subject to SEC reporting requirements.[53]

Requirements for Attorneys Representing Issuers[54]

SEC rules adopted pursuant to Sarbanes-Oxley Section 307 apply to attorneys who "appear and practice" before the SEC "in the representation of issuers" that file periodic reports with the SEC. The rules provide that a "non-appearing foreign attorney" does not "appear and practice" before the SEC for the purposes of the rule and thus would not be covered. A "non-appearing foreign attorney" is defined as an attorney who:

- is admitted to practice law in a jurisdiction outside the United States;
- does not hold himself or herself out as practicing, or giving legal advice regarding, U.S. federal and state securities or other laws; and
- conducts activities that would constitute appearing and practicing before the SEC only incidentally to, and in the ordinary course of, a foreign law practice, or only in consultation with U.S. counsel.

The rule requires in-house and outside attorneys "appearing and practicing" before the SEC "in the representation of an issuer" who become aware of "evidence of a material violation" of U.S. law that has occurred or is "reasonably likely" to occur, by the issuer or by an officer, director, employee or agent of the issuer to report that violation internally to the issuer's chief legal officer (or equivalent) or to both the chief legal officer and the chief executive officer

51 See Sarbanes-Oxley Section 102 and 106(a); PCAOB Rule 2100(a).

52 The phrase "plays a substantial role in the preparation or furnishing of an audit report" means (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer or (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer. PCAOB Rule 1001(p)(ii).

53 SEC Release No. 34-49473 (Mar. 25, 2004) (http://www.sec.gov/rules/pcaob/34-49473.htm) and PCAOB Release No. 2003-007 (May 6, 2003) (http://www.pcaobus.org/Rules/Docket_001/2003-06-06_Release_2003-007.pdf).

54 See Sarbanes-Oxley Section 307.

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(reporting "up the ladder") "forthwith" and to determine whether an "appropriate response" has been made. In some cases, further reports to the board of directors or audit committee may be required or permitted. As the alternative to the above procedure, an attorney may notify the qualified legal compliance committee ("QLCC"), if the issuer has previously formed such a committee. After reporting a material violation to the QLCC, the attorney has satisfied his or her obligation to report such evidence and is not required to assess the issuer's response to the reported evidence. A QLCC must:

- consist of at least one member of the issuer's audit committee (or, if the issuer has no audit committee, one member from an equivalent committee of independent directors) and two or more independent members of the issuer's board of directors;
- be duly established and authorized by the issuer's board of directors; and
- have written procedures for the confidential receipt, retention and consideration of any report of evidence of a material violation.

"Appearing and practicing" is defined as:

(i) transacting business with the SEC, including communications in any form;

(ii) representing an issuer in an SEC administrative proceeding or an investigation, inquiry, information request or subpoena;

(iii) providing advice on U.S. securities laws or SEC rules or regulations regarding any document that the attorney has notice will be filed with, or submitted to, the SEC, including providing that advice in the context of preparing, or participating in the preparation of, such a document; or

(iv) advising an issuer whether information or a statement, opinion or other writing is required to be filed with, or submitted to, or incorporated into a document filed with, or submitted to, the SEC.

The phrase "in the representation of the issuer" applies to attorneys providing "any legal services as an attorney for an issuer, regardless whether the attorney is employed or retained by the issuer." "Evidence of a material violation" is defined as "credible evidence, based upon which it would be unreasonable under the circumstances for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." A "material violation" is defined as "a material violation of an applicable U.S. federal or state securities law, a material breach of fiduciary duty arising under U.S. federal or state law, or a similar material violation of any U.S. federal or state law."

An attorney supervising or directing another attorney who is appearing and practicing before the SEC in the representation of an issuer is a "supervisory attorney." An attorney who appears and practices before the SEC in the representation of an issuer under the supervision or direction of another attorney (other than the issuer's chief legal officer) is a "subordinate attorney." A supervisory attorney must make reasonable efforts to ensure that his or her

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subordinate attorney complies with the rule's reporting requirements. The supervisory attorney is responsible for complying with the reporting requirements when a subordinate attorney has reported evidence of a material violation to the supervisory attorney. The subordinate attorney must comply with the reporting requirements notwithstanding that the subordinate attorney acted at the direction of or under the supervision of another person. A subordinate attorney has complied with the reporting requirement once he or she has reported evidence of a material violation to the supervisory attorney.

A subordinate attorney that has reported evidence of a material violation to a supervisory attorney, but who believes that the supervisory attorney has failed to comply with the reporting requirements, would be permitted – but not required – to report the evidence up the ladder within the issuer or to the QLCC.

Authority for enforcement of requirements regarding attorneys representing issuers lies solely with the SEC, and the rules state that a private cause of action has not been created against attorneys. Violations could be grounds for SEC action against an attorney under Rule 102(e) of the SEC's Rules of Practice, which could result in the attorney being barred from practicing before the SEC.

Miscellaneous Requirements

Prohibition of Issuer Loans to Directors and Executive Officers[55]

Except as discussed below, it is unlawful for any issuer, directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit in the form of a personal loan to or for any of its directors or executive officers. Any extension of credit "maintained" by an issuer on July 30, 2002 is not subject to the prohibition, so long as there is no subsequent material modification to any term of the credit or renewal of the credit. Sarbanes-Oxley provides no guidance on whether a binding credit commitment that was unfunded on July 30, 2002 would represent an extension of credit that was "maintained" at that date, or whether a funded line of credit could be paid down and re-drawn after July 30, 2002.

Affected Executive Officers

The affected executive officers under Sarbanes-Oxley should be the same group identified as executive officers in the issuer's annual report. Although there are circumstances where an officer of a subsidiary can be an executive officer of the parent, loans to directors and officers of subsidiaries who are not directors or executive officers of the parent are not affected.[56]

Permitted Loans

Travel advances, cash advances and issuer-sponsored credit cards should be permitted, provided they are used only in the ordinary course of business and, in the case of issuer-

[55] See Sarbanes-Oxley Section 402 and Section 13(k) of the 1934 Act.

[56] SEC Release No. 34-49616 (Apr. 26, 2004) (http://www.sec.gov/rules/final/34-49616.htm).

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sponsored credit cards, the terms are not more favorable than the terms the issuer offers to the public.

Any loan made by an "insured depository institution," as defined in the Federal Deposit Insurance Act, is exempt from the prohibition if the loan is subject to the insider lending restrictions of the Federal Reserve Act.[57] Rule 13k-1 under the 1934 Act exempts from the insider lending prohibition those non-U.S. banks that meet specified criteria similar to those that qualify insured depository institutions for the exemption. Furthermore, foreign governmental issuers that file registration statements under the 1933 Act on Schedule B are exempted from 1934 Act Section 13(k)(1).[58]

Chief Executive Officer and Chief Financial Officer Forfeiture of Bonus Following a Restatement[59]

If an issuer is required to restate its financial statements due to material non-compliance of the issuer, as a result of misconduct, with any financial reporting requirements under U.S. securities laws, the chief executive officer and chief financial officer are required to reimburse the issuer for any bonus, incentive compensation or equity-based compensation they received, during the twelve-month period following the first public issuance or filing with the SEC (whichever first occurs) of the financial document that required restatement. In addition, the chief executive officer and chief financial officer must reimburse the issuer for any profits they realized from the sale of the issuer's securities during that twelve-month period.

Whistleblower Protections[60]

Issuers that file periodic reports with the SEC (and their agents and certain other persons) may not retaliate against an "employee" because of the employee's alleged "whistle blower" activities. An employee protected by the prohibition has a private right of action against the employer.[61] The prohibition may also apply to employees of U.S. subsidiaries of a reporting company, whether the retaliation is alleged to have been originated with the parent company or with the U.S. subsidiary.

Criminal protections for employees against retaliation have been broadened and carry a penalty of imprisonment for up to 20 years.[62]

Any person, whether or not it files periodic reports with the SEC, is subject to the Sarbanes-Oxley provisions that extend the prohibitions on and increase the criminal penalties for

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57 Section 13(k)(3) of the 1934 Act.

58 Supra footnote 56.

59 See Sarbanes-Oxley Section 304.

60 See Sarbanes-Oxley Sections 301, 806 and 1107; Section 10A(m) of the 1934 Act.

61 18 U.S.C. 1519A(b)(1)(B).

62 18 U.S.C. 1513(a)(2)(B).

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document destruction or witness tampering in a matter within the jurisdiction of a U.S. department or agency or in a bankruptcy proceeding.[63]

An issuer's audit committee (or the full board if no audit committee exists) is required to establish a procedure for employees to anonymously submit concerns regarding questionable accounting or auditing matters.[64]

Insider Trading Prohibited during Pension Blackout Periods[65]

The SEC has adopted rules (Regulation BTR) relating to insider trading during blackout periods under sponsored individual account plans. Under the rules, directors and executive officers of an issuer of any equity security may not, directly or indirectly, purchase or sell or otherwise acquire or transfer any equity security of the issuer (other than exempted securities) during any "blackout period" with respect to such equity security if the director or officer acquires the equity security in connection with his or her service or employment with the issuer.[66]

"Blackout period" means a period of more than three consecutive business days during which the ability of not less than 50% of the participants and beneficiaries who are located in the United States and participate in any individual account plan maintained by the issuer or any member of the issuer's group to purchase, sell or otherwise acquire or transfer an interest in an equity security of the issuer is temporarily suspended.[67]

The rule applies to a foreign private issuer if the number of participants located in the United States who are subject to the temporary trading restriction exceeds either 15% of the total number of employees of the issuer and its consolidated subsidiaries or 50,000.[68]

Under the rules, the prohibition on insider trading during blackout periods would not apply to a blackout period that affects a plan maintained outside the United States primarily for the benefit of persons located outside the United States, as such plans are not considered "individual account plans."[69]

BENEFICIAL OWNERSHIP REPORTING

The Williams Act imposes certain disclosure obligations on persons owning beneficially more than 5% of a voting class of equity securities registered under Section 12 of the 1934 Act. All such shareholders are required to file initial reports on Schedule 13D within ten days of the

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[63] See Sarbanes-Oxley Sections 806 and 1107.

[64] See Sarbanes-Oxley Section 301.

[65] See Sarbanes-Oxley Section 306 and Regulation BTR.

[66] See Sarbanes-Oxley Section 306(a)(1); Rule 101(a) under Regulation BTR.

[67] See Sarbanes-Oxley Section 306(a)(4); Rule 100(b) under Regulation BTR.

[68] Rule 100(b)(2) under Regulation BTR.

[69] Rule 100(b)(3)(ii) under Regulation BTR.

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acquisition[70] or, where permissible, on the shorter form and more flexible timeframe[71] of Schedule 13G. Certain institutional investors who qualify, including non-U.S. institutional investors who have obtained an appropriate no-action letter from the SEC, may be eligible to file a Schedule 13G rather than Schedule 13D.[72] All investors beneficially owning less than 20% of the outstanding class that are not reporting as qualified institutional investors and that have not acquired and do not hold the securities for the purpose of changing or influencing the control of the issuer of the securities may also file a Schedule 13G.[73] Those persons already owning beneficially more than 5% of a voting class of an issuer at the time the class of equity securities are registered pursuant to Section 12 must file a Schedule 13G within 45 days of the end of the first calendar year during which they become subject to this requirement (*e.g.*, following an initial public offering of equity securities in the U.S. capital markets).[74]

Amendments to Schedule 13D are required to be filed promptly if any material changes in their holdings occur. Any acquisition or disposition of 1% or more of the same class of securities is deemed material. Any smaller change may be material depending on the circumstances.[75] Once a Schedule 13G filing has been made, a follow-up filing is not required if a change in the percentage of shares owned by a reporting person is caused solely by a change in the number of outstanding shares.[76] Amendments to Schedule 13G are, however, required for other changes to the amount of shares beneficially owned. Moreover, persons filing on Schedule 13G as passive investors would be required to amend and commence filing on Schedule 13D at such time as their ownership percentage exceeds 20% or their investment purpose no longer satisfies the passive criteria.

FOREIGN CORRUPT PRACTICES ACT OF 1976 ("FCPA")

The FCPA, which consists principally of Sections 13(b)(2) and (3) and Section 30A of the 1934 Act, and the regulations thereunder, imposes requirements on issuers with securities registered under the 1934 Act.

Record Keeping. Issuers subject to the FCPA must maintain books, records and accounts which, in reasonable detail, accurately and fairly reflect the issuer's transactions and dispositions of assets. In effect, such issuers have a statutory obligation under U.S. law to maintain proper internal books and records, in addition to any obligations relating to financial statements filed with the SEC or otherwise publicly disclosed. In addition, issuers subject to the

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[70] Rule 13d-1(a) under the 1934 Act.

[71] Filing required by February 14 of following year.

[72] In addition, non-U.S. institutional investors filing Schedule 13G would (1) certify that they are subject to a non-U.S. regulatory regime substantially comparable to their U.S. counterparts and (2) be required to furnish, upon SEC request, information otherwise provided in Schedule 13D. Rule 13d-1(b)(1)(i) under the 1934 Act and (ii); SEC Release No. 33-8957 (Sept. 19, 2008) (http://www.sec.gov/rules/final/2008/33-8957.pdf).

[73] Rule 13d-1(c) under the 1934 Act.

[74] Rule 13d-1(d) under the 1934 Act.

[75] Rule 13d-2(a) under the 1934 Act.

[76] Rule 13d-2(b) under the 1934 Act.

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FCPA must adopt and maintain a system of internal accounting controls sufficient to provide reasonable assurances[77] that:

- transactions are executed in accordance with management's general or specific authorization;
- transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets;
- access to assets is permitted only in accordance with management's general or specific authorization; and
- the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[78]

Rules adopted by the SEC under the FCPA prohibit any person, including but not limited to directors and officers of the issuer, from directly or indirectly falsifying or causing to be falsified any book, record or account subject to the FCPA.[79] Such rules also prohibit directors or officers of the issuer from directly or indirectly making any materially false, misleading or incomplete statement to an accountant in connection with an audit or any filing with the SEC.[80]

Limitations on Gifts, Etc. Other provisions of the FCPA prohibit any issuer subject to the FCPA from making use of the U.S. mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or the authorization of the giving of anything of value, to foreign governments, foreign officials,[81] foreign political parties, candidates for foreign political office and other persons known to be conduits to such recipients in order to assist the issuer in obtaining or retaining business for or with any person, directing business to any person or securing any improper advantage.[82] Issuers not subject to the 1934 Act reporting requirements are also subject to the FCPA to the extent their officers, directors, employees or agents conduct any prohibited activity within the United States. Specifically, the FCPA prohibits any person (including foreign private issuers not subject to the 1934 Act reporting requirements)

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[77] The terms "reasonable detail" and "reasonable assurances" are defined to mean "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." Section 13(b)(7) of the 1934 Act.

[78] Section 13(b)(2) of the 1934 Act.

[79] Section 13(b)(5) of the 1934 Act.

[80] Rule 13b2-2 under the 1934 Act.

[81] "Foreign official" is defined to include officers or employees of public international organizations (*e.g.*, the World Bank and the United Nations). See Section 30A(f)(1)(A) of the 1934 Act.

[82] Section 30A(a) of the 1934 Act.

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from committing any act in furtherance of an FCPA offense while in the territory of the United States.[83]

The foregoing prohibitions, however, do not apply to any facilitating or expediting payment made to a foreign official, political party or party official, the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official, political party or party official.[84] Certain affirmative defenses also are available.

Violations of the FCPA are punishable by various SEC civil enforcement actions, as well as criminal sanctions of fines and/or imprisonment.

THE OFFICE OF FOREIGN ASSETS CONTROL ("OFAC")

Unless they can reorganize their business or ownership structure, certain issuers may be prohibited from selling securities to U.S. investors by executive order of the President of the United States ("Executive Order"). The U.S. President is authorized to restrict trade with foreign countries under various statutes.[85] OFAC is authorized to adopt regulations to implement the Executive Orders in this regard. Under regulations adopted by OFAC and in force as of the date of publication of this volume, without a license from OFAC, U.S. investors are prohibited from or limited in engaging in financial transactions within the Balkans, Belarus, Burma, Cote d'Ivoire, Cuba, Democratic Republic of the Congo, Iran, Iraq, Former Liberian Regime of Charles Taylor, North Korea, Sudan, Syria and Zimbabwe.[86] In addition, U.S. investors may not engage in transactions with entities that are either Specially Designated Nationals and Blocked Nationals ("SDNs") identified on OFAC's SDN list or entities that are owned by SDNs but not separately identified on OFAC's SDN list.[87]

COMMUNICATIONS WITH INVESTORS AND THE PUBLIC

In addition to the specific filing and reporting requirements described above, the anti-fraud provisions of the U.S. federal securities laws and reporting requirements of the relevant U.S. securities exchanges give rise to a general obligation to report material events promptly to investors.[88] In the case of a foreign private issuer, this general reporting obligation may not differ greatly from its home country obligations.

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83 Section 30A(a) of the 1934 Act; 15 U.S.C. 78dd-3.

84 Section 30A(b) of the 1934 Act.

85 For example, such authorizations include the International Emergency Economic Powers Act of 1977, as amended, and the Trading with the Enemy Act of 1917, as amended.

86 http://www.treas.gov/offices/enforcement/ofac/programs/. The SDN list is available on the U.S. Treasury Department's web site at http://www.treas.gov/offices/enforcement/ofac/sdn/index.shtml and is periodically updated.

87 For a brief discussion of OFAC in the context of non-U.S. banks, see Appendix D (*U.S. Regulation of Activities of Non-U.S. Banks in the United States*) of this volume.

88 U.S. courts, however, have recognized that a variety of proper business purposes will justify a delay in disclosure. See the discussion in this chapter below under the heading "—Communications with Investors and the Public—Duty to Disclose."

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Press Releases

Typically, the obligation to report material events to shareholders is satisfied through a press release. In some cases, press releases are mailed directly to shareholders and distributed to the wire services and other financial information channels. Certain developments are appropriate for public disclosure, but may not be so critical as to require an immediate press release. Such developments may be communicated in the issuer's interim reports.

Press releases must avoid material misstatements or omissions. A high degree of accuracy, completeness and balance between positive and negative factors is required. There is no room for the degree of "puffing" in financial disclosures which would be acceptable in general commercial advertising or other areas of commercial communication.

Communications with Analysts

An issuer may have individual discussions with an analyst covering general or background information. It is important, however, not to release "material" information to a person who may purchase or sell securities based on that information without simultaneously releasing it to the general financial community. Disclosing material information selectively to analysts that regularly follow the issuer's stock or selectively to large shareholders raises questions of improper motive and risks charges of "insider trading."[89] For example, if an issuer has a specific material internal projection of earnings which is disclosed to one analyst (whether intentionally or inadvertently), it may become necessary to disclose the information to the public at large.[90]

Materiality Standards

While there is no standard which can be applied with mechanical certainty, a fact will be considered "material" if there is a substantial likelihood that reasonable investors would consider it important, as part of the total mix of available information, in reaching their investment decisions (that is, if the investors would attach actual significance to the information in making their deliberations). It is impossible to make a complete catalog of all material information, but typical examples include significant mergers or acquisitions, stock splits, adoption of a dividend policy or changes in dividends, major increases or decreases in revenues or profits, important new contracts or projects, and changes in senior corporate management or basic corporate business policies.

In this connection, courts have treated the confirmation of a general market expectation as being material information in some circumstances. For example, if an issuer confirms to one analyst the accuracy of its projection that it will achieve a specific level of earnings, this confirmation may give the analyst "material information," and may trigger the obligation to

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[89] See the discussion under the heading "1934 Act – Insider Trading" in Chapter 17 (*Liabilities under U.S. Securities Laws*) of this volume.

[90] See discussion of Regulation FD in this chapter below under the heading "—Communications with Investors and the Public—Regulation FD."

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make a general public announcement, even if outside analysts are also arriving at the same projection based on their own analyses of published data.

Duty to Disclose

It is generally recognized that good corporate practice requires prompt public disclosure of material events. There has been some discussion among legal practitioners, however, concerning the extent to which the law requires such disclosure.

Under the 1934 Act, an "S" Form issuer must file a Form 8-K that reports a material event generally within four business days of the event and an "F" Form issuer must report promptly on Form 6-K any information not contained in its latest Form 20-F that the foreign private issuer (1) makes or is required to make public in its home country, (2) files or is required to file with a non-U.S. stock exchange on which its securities are traded and which was made public by that exchange or (3) distributes or is required to distribute to its securityholders, in each case regarding only certain specified types of "material" reportable events, as discussed in Chapter 4 (*Disclosure Requirements*) of this volume. The anti-fraud rules, such as Rule 10b-5 under the 1934 Act, prohibit material misstatements and the omission of information necessary to make the statements made, in the light of the circumstances under which they were made, not misleading. They do not, however, deal directly with total silence.

An issuer with securities listed on a U.S. securities exchange is subject to an additional affirmative obligation to make timely public disclosure of material information. For example, Section 202.05 of the NYSE Listed Company Manual states: "A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange." However, U.S. courts have held that there is not a private right of action for a violation of rules of a securities exchange.

Arguably, an issuer does not violate any legal requirements if, for good business reasons, it delays an announcement of important developments, absent special circumstances creating an affirmative duty to disclose. There may be an affirmative duty to disclose when there has been a news leak or selective disclosure by the issuer or one of its officers, when insider trading has occurred, when the issuer is acquiring its own equity securities or when there is a rumor or a market report circulating for which the issuer has some responsibility.

Notwithstanding the foregoing, the SEC's enforcement policies, as well as the trend of the law as interpreted by the courts, favor full and fair disclosure. Accordingly, withholding material information is not recommended unless there is a countervailing, *bona fide* and important business reason for doing so. In general, issuers subject to the U.S. federal securities laws should adopt a policy of disclosing material events on a timely basis.

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Regulation FD

Regulation FD (Fair Disclosure) applies to all U.S. public companies reporting under the 1934 Act (other than foreign governmental issuers and foreign private issuers[91]), including closed-end investment companies, but not including other investment companies. Regulation FD is designed to restrict "selective disclosure," which the SEC considers as the disclosure of material non-public information on a limited, rather than widespread, basis. The SEC believes that this practice provides the privileged parties that receive such information with an unfair advantage over the investing public-at-large.

In general, issuers subject to the regulation must ensure that any material non-public information intentionally disclosed to certain specified persons outside the issuer is simultaneously disclosed to the public-at-large (in the case of a "non-intentional" disclosure, public disclosure must be made "promptly"[92]). Although Regulation FD currently does not apply to foreign governmental and foreign private issuers, in the release adopting Regulation FD the SEC stated that foreign private issuers have obligations to make timely disclosure of material information pursuant to applicable self-regulatory organization rules and policies. To some extent, Regulation FD is simply a codification of the SEC's previous position on permissive and non-permissive selective disclosure by registered public companies under the SEC's anti-fraud rules under the 1934 Act (including Rule 10b-5).

Section 10(b) of the 1934 Act and Rule 10b-5 thereunder impose liability for fraud committed in connection with the purchase or sale of any security. Rule 10b-5 provides that it is unlawful in connection with the purchase or sale of any security for any person to (1) employ any device, scheme, or artifice to defraud, (2) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. Rule 10b-5 has been construed to prohibit insiders from engaging in a purchase or sale while in possession of inside information.[93]

In addition to the SEC's adoption of Regulation FD, certain foreign regulators have recently reevaluated disclosure standards applicable to selective disclosure. For example, the United Kingdom Financial Services Authority already imposes requirements regarding disclosure of material, non-public information. Other foreign jurisdictions are either taking or contemplating appropriate steps to help curtail the selective disclosure of material, non-public information.

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[91] Rule 101(b) under Regulation FD exempts foreign governmental issuers and foreign private issuers.

[92] "Promptly" means "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange)" after a senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser) learns of the non-intentional disclosure by the issuer or person acting on behalf of the issuer and the senior official knows (or is reckless in not knowing) that the relevant information is both material and non-public. Rule 101(d) under Regulation FD.

[93] See the discussion under the heading "1934 Act – Insider Trading" in Chapter 17 (*Liabilities Under U.S. Securities Laws*) of this volume for further analysis of the anti-fraud rules.

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The following discussion of Regulation FD is in the context of a U.S. issuer but, as discussed above, is instructive for a foreign private issuer.

Operation of Regulation FD

Regulation FD addresses the problem of selective disclosure by providing that whenever a U.S. public company (or any of its directors, executive officers, investor relations or public relations officers or any other officer, employee or agent who regularly communicates with securities industry professionals or holders of the issuer's securities) discloses material non-public information regarding the issuer or its securities to a securities industry professional (such as a broker, dealer or investment adviser) or a holder of the issuer's securities, then the issuer is required to make public disclosure of that information. In the case of an intentional disclosure, public disclosure must be made simultaneously. In the case of a non-intentional disclosure, public disclosure must be made promptly (and, in any event, by the later of 24 hours or commencement of the next day's trading on the NYSE).[94] Regulation FD is technically a reporting rule, not an anti-fraud measure, although the regulatory concerns leading to the adoption of Regulation FD are very similar to those policed by the anti-fraud rules (including Rule 10b-5).

Regulation FD generally does not apply to disclosures by an issuer made (i) to a person owing a duty of trust or confidence to the issuer (such as an attorney, investment banker or accountant), (ii) to a person who expressly agrees to maintain the information in confidence (and not use it for trading), (iii) to a credit rating agency in connection with public credit ratings and (iv) in certain registered public offerings of securities.

Discussions with Analysts and Disclosures to the Financial Community

Discussions with securities analysts have historically presented difficult questions for financial officers of public companies. The SEC has recognized the benefit that informed analysts provide to the market and has indicated on several occasions that issuers should not be discouraged from disseminating information to analysts. Nevertheless, if an analyst is provided with material information that has not been made available to the public, severe consequences can befall the issuer.

An example of the potential problems is presented by the pre-Regulation FD case of SEC v. Bausch & Lomb,[95] in which the SEC brought an enforcement proceeding against the chairman of Bausch & Lomb on the basis of various statements that he made to securities analysts regarding the issuer's business and prospects. The issuer's chairman had held a series of private meetings with analysts over several days. After the last meeting, in reaction to a rumor that the chairman had leaked a quarterly earnings estimate to one of the analysts, the chairman called an analyst and in this call released a specific corrected earning estimate that had not yet been publicly disseminated. Although the SEC did not prevail in the Bausch & Lomb case, it presents an instructive case study of the dangers presented when communicating with analysts.

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[94] Rule 100 under Regulation FD.

[95] SEC v. Bausch & Lomb, 420 F.Supp. 1226 (S.D.N.Y. 1976), aff'd, 565 F.2d 8 (2d Cir. 1977).

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The general rule when dealing with analysts is: Do not provide analysts with material information that is not public. If a spokesman of the issuer has done so, a press release should be issued immediately in order to make the information available to the entire investing public. It is also advisable to limit the group of individuals authorized to speak with analysts or the press to one or two senior officers.

Information is generally considered "material" if there is a substantial likelihood that a reasonable investor would consider it important in reaching his or her investment decision. As can be seen from Bausch & Lomb, earnings forecasts are likely to be found material. The court seemed to give the issuer latitude with statements regarding whether or not someone else's earnings estimate was "in the ball park," but once the issuer itself put out a specific earnings number, it was found to be material information.

SEC Regulation FD Actions

The following actions by the SEC illustrate its commitment to zealously enforce Regulation FD and its willingness to seek large penalties from issuers, as well as from individual executives, who violate the Regulation's disclosure requirements. The actions are briefly summarized below.

In Secure Computing Corporation and John McNulty,[96] Secure Computing, the issuer, had entered into an agreement with one of the nation's largest computer networking companies to bundle one of its products with the buyer's network systems. Mr. McNulty, Secure Computing's CEO, disclosed material non-public information about the contract on March 6 and 7, 2002. The initial March 6 disclosures were apparently unintentional since Mr. McNulty had mistakenly believed that existence of the contract was already publicly disclosed. Thus, Secure needed to make prompt public disclosure of the information concerning the contract. However, prior to such public disclosure and after being informed of the non-public nature of the information, Mr. McNulty again selectively disclosed the information. Secure Computing made public disclosure in a press release describing the contract three hours after Mr. McNulty had disclosed information to a portfolio manager on March 7. The press release did not afford a valid defense to a violation of Regulation FD because the regulation requires simultaneous public disclosure, except in unintentional cases, where "prompt" public disclosure must be made.

In Siebel Systems, Inc. ("Siebel I"),[97] Siebel's CEO made positive comments about the issuer's business that were based on what the issuer was observing in its sales pipeline to an invitation-only technology conference sponsored by an investment bank. This was in direct contradiction to negative statements the CEO had made three weeks earlier, in which he predicted a bleak business environment for the information technology market and said Siebel's weak performance would continue for the rest of the year. Siebel failed to make simultaneous disclosure of the CEO's optimistic statements to the public and therefore was found to have violated Regulation FD.

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[96] SEC Release No. 34-46895 (Nov. 25, 2002) (http://www.sec.gov/litigation/admin/34-46895.htm).

[97] SEC Release No. 34-46896 (Nov. 25, 2002) (http://www.sec.gov/litigation/admin/34-46896.htm).

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In Raytheon Company and Franklyn A. Caine,[98] Raytheon's chief financial officer held one-on-one telephone calls with sell-side analysts whose earnings per share estimates were included in Thompson Corporation's First Call Service. Realizing that the analysts' projections were less seasonal than Raytheon's internal forecasts, the CFO held "one-on-one conversations" with most of the sell-side analysts who covered Raytheon, in which he disclosed that in 2001, Raytheon's earnings would have the same seasonal distribution as in 2000, and more specifically, that Raytheon would generate one third of earnings per share in the first half of the year and the remaining two thirds in the second half of the year. Raytheon did not provide any comparable quarterly earnings guidance in its public investor conference calls. Its disclosures during the phone calls with analysts were therefore found to be violations of Regulation FD.

In its Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Motorola, Inc.,[99] the SEC found that Motorola's Director of Investor Relations, in private telephone conversations with analysts, elaborated on the meaning of "significant weakness" in sales, as the phrase had been described in Motorola's earlier press release and public conference calls. In the private discussions, he mentioned that a "significant" drop meant a 25% or more decline and suggested that this should be reflected in the analysts' research notes. The SEC noted that Motorola should have issued a new press release or made another timely public disclosure of this additional information instead of disclosing the corrected message in private communications with industry professionals. However, the SEC did not issue a cease-and-desist order because the Director acted in good faith based on legal advice of Motorola's in-house counsel.

In Schering-Plough,[100] the CEO met in private meetings with analysts and portfolio managers. The SEC determined that Schering violated Regulation FD and that the CEO caused such violations by providing guidance that included material non-public information about the issuer's earnings prospects during the private meetings, and by failing to make public disclosure of the information as required by Regulation FD. The SEC noted that the CEO's "statements, demeanor and general expressions of concern for Schering's prospects" amounted to prohibited selective disclosure.

In Senetek PLC,[101] the issuer's CFO and CEO provided material non-public information about Senetek's projected earnings to two analysts covering the issuer. The SEC determined that Senetek violated Regulation FD by disclosing material, non-public information about its earnings on both occasions without simultaneously disclosing such information publicly.

In Flowserve Corp,[102] the issuer's CEO reaffirmed publicly-released earnings guidance and provided additional material, non-public information at a private analyst event in violation of Regulation FD.

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98 SEC Release No. 34-46897 (Nov. 25, 2002) (http://www.sec.gov/litigation/admin/34-46897.htm).

99 SEC Release No. 34-46898 (Nov. 25, 2002) (http://www.sec.gov/litigation/investreport/34-46898.htm).

100 SEC Release No. 34-48461 (Sept. 9, 2003) (http://www.sec.gov/litigation/admin/34-48461.htm).

101 SEC Release No. 34-50400 (Sept. 16, 2004) (http://www.sec.gov/litigation/admin/34-50400.htm).

102 SEC Release No. 34-51427 (Mar. 24, 2005) (www.404.gov/litigation/admin/34-51427.pdf).

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In the second enforcement action against Siebel Systems, Inc. under Regulation FD ("Siebel II"), the SEC filed a civil action against Siebel charging the issuer, its CFO and its former investor relations (IR) director with a violation of Regulation FD and of a prior cease-and-desist order, made in Siebel I, barring it from future violations of Regulation FD.[103] In its complaint, the SEC alleged that Siebel's CFO released material non-public information by making optimistic comments (stating that its sales pipeline was "growing" or "building") in private meetings with institutional investors that contrasted with allegedly less optimistic public statements made in the three weeks prior (qualifying that the issuer's performance would depend upon the overall performance of the economy). The U.S. District Court for the Southern District of New York dismissed all claims against Siebel, its CFO and the former IR director, finding that the private statements made by Siebel's officers did not constitute material non-public information.[104] Taking the private statements in context, the Court found that they did not add to, contradict or significantly alter the material information that was publicly available. The Court criticized the SEC for overzealous enforcement efforts, stating that the SEC was placing "an unreasonable burden on an issuer's management and spokespersons to become linguistic experts, or otherwise live in fear of violating Regulation FD should the words they use later be interpreted by the SEC as connoting even the slightest variance from the issuer's public statements."[105]

In EDS,[106] the issuer selectively disclosed the amount that it would be required to pay under certain derivative contracts to securities professionals at three broker-dealers on September 19 and 23, 2002. The issuer publicly announced that it had settled the contracts through issuance of other securities on September 24, 2002 but it was not until its 2002 third quarter Form 10-Q (filed more than 50 days later) that it publicly disclosed the U.S.$225 million cost of settlement and other material information. The SEC found this to be a violation of Regulation FD and Section 13(b) of the 1934 Act.

Lessons to be Learned from Regulation FD Enforcement Actions

First, senior officials of issuers should be extremely cautious in private conversations with analysts. As the SEC noted in its complaint in Siebel II, "private one-on-one meetings between an issuer and institutional investors or analysts pose serious risk under Regulation FD." As the actions indicate, private disclosure to analysts and other covered persons under Regulation FD concerning estimates and similar information relevant to corporate earnings will likely result in an allegation of a violation of Regulation FD. The SEC noted that a violation of Regulation FD will be more probable when officials of issuers deliberately call investment analysts (as was the case in Raytheon and Motorola) than in a situation where the topic comes up unexpectedly during discussions. Nevertheless, whenever possible, an official familiar with Regulation FD and determinations of materiality should accompany senior officers to meetings with analysts and investors to serve as a witness as to what is disclosed, to guard against inadvertent disclosures and to ensure that unintentional disclosures are promptly remedied.

[103] SEC Litigation Release No. 18766 (June 29, 2004) (http://www.sec.gov/litigation/litreleases/lr18766.htm).

[104] SEC v. Siebel Systems, Inc., 2005 WL 2100269 (S.D.N.Y. Sept. 1, 2005).

[105] Id.

[106] SEC Release No. 34-56519 (Sept. 25, 2007) (http://www.sec.gov/litigation/admin/2007/34-56519.pdf).

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Second, issuers should bear in mind that the SEC threshold for "material" information is apparently quite low. Regulation FD applies the definition of "materiality" established by existing case law. Information is material if there is a substantial likelihood that a reasonable investor would consider the information important or if the information would significantly alter the total mix of available information (the formulation used by the Supreme Court in Basic, Inc., v. Levinson). The SEC, however, appears to treat any issuer guidance concerning its earnings as categorically material. Under this view, the earnings guidance in Raytheon was material simply by reason of the subject matter. Even simple clarification or quantitative definition of qualitative terms – clarifying information that "significant" decline in sales meant more than a 25% drop – is likewise material in the SEC's view. The materiality element of a Regulation FD violation may be easier for the SEC to prove when the issuer's stock price fluctuates significantly immediately following the disclosure in question, as in the Secure Computing, Siebel and Raytheon cases above.

Third, when a selective disclosure is not intentional, the issuer should make prompt public disclosure of the information to avoid a Regulation FD violation. In Secure Computing, the CEO's first disclosure of material information to portfolio managers was unintentional, because of his erroneous belief that the information had already been published. Even after he learned that the information had not yet been publicly disclosed, he made a further disclosure of the information to another portfolio manager which itself was a violation of Regulation FD in as much as simultaneous public disclosure was not made. Furthermore, since the issuer's press release following the first disclosure was more than 24 hours after a senior officer had learned of the problem, the maximum allowed in unintentional cases, the press release was not the "prompt" public disclosure required after the first selective disclosure.

Fourth, when an issuer makes public disclosure of material information but later learns that it did not fully communicate the intended message, it should make additional public disclosure. In Motorola, when the director of investor relations realized that the investment house analysts did not reflect Motorola's "significant" drop in sales in their research notes, he individually contacted selected analysts to quantify earnings information. The SEC indicated that Motorola should have made broad public disclosure of the additional information.

Fifth, although the SEC only published an investigation report in Motorola, the report warns that the advice of counsel is not a reliable defense to liability. In Motorola, in-house counsel advised the director of investor relations that he could contact selected analysts to provide them quantitative definitions of qualitative terms, based on the good-faith belief – albeit mistaken in the SEC's view – that the quantification was not material. The SEC stated that it did not take enforcement action against Motorola because legal advice was sought and given in good faith. However, the SEC noted that consultation with counsel will not relieve the officer from responsibility and that the SEC is less likely to credit reliance on counsel's advice after Motorola.

Sixth, notwithstanding the Court's decision in Siebel II, issuers should not relax their Regulation FD compliance practices and procedures. In Siebel II, the Court determined that the particular private statements before it did not constitute disclosure of material non-public information. However, determinations as to what constitutes material non-public information are extremely difficult and are dependent upon an in-depth analysis of the facts and circumstances

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presented. Any determination that information is immaterial may be viewed skeptically by courts or the SEC with the benefit of hindsight.

Procedures to Guard Against Inadvertent Selective Disclosure

To effect a policy of timely disclosure, an issuer should, to the extent it has not done so already, adopt internal procedures regarding disclosures to the financial community.[107] The issuer should be certain that material information is disclosed on a timely basis when appropriate, and that there are no leaks or inadvertent disclosures when the release of information is inappropriate. There should be clear lines of authority and responsibility within the issuer, and the number of persons authorized to deal with the financial community should be limited. All employees should be alerted to these basic principles, with particular emphasis on the obligations to maintain the confidentiality of undisclosed material information and to refrain from trading while privy to such information.

The person or persons authorized to deal with the financial community should be kept informed about material developments, or should be instructed not to make comments until the accuracy of information regarding such developments is verified by more senior officials.

As a corollary to the foregoing, it is essential that the confidentiality of material information be strictly maintained within the issuer by all persons who may have access to that information, regardless of title or position. An issuer normally has some degree of discretion in determining when an event is ripe for public disclosure, assuming that no leaks have occurred. A reasonable standard, consistently applied for affirmative as well as negative information, usually will avoid difficulties. There are certain circumstances, however, where an issuer may be required to disclose, in accordance with good practice. Examples would include a leak of information or where rumors are circulating in the financial community that can be attributed to the issuer. Care should be taken to prevent these circumstances.

[107] In addition to the internal procedures adopted with respect to disclosures to the financial community, as discussed above, Rules 13a-15 and 15d-15 under the 1934 Act require every company reporting under the 1934 Act to maintain "disclosure controls and procedures" that are designed to ensure that information required to be disclosed under the 1934 Act is recorded, processed, summarized and reported within the required time periods. See the discussion in this chapter above under the heading "—Sarbanes-Oxley—Disclosure and Related Requirements—Disclosure Certification, Controls and Procedures" and Chapter 4 (*Disclosure Requirements*) of this volume.

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SECTION IV: EXEMPT OFFERINGS, SECURITIES AND ISSUERS

Section IV examines the exemptions to the 1933 Act's registration requirements for securities offerings in the United States, and exemptions from the need to register as an investment company under the 1940 Act.

The offering procedures necessary to establish an exemption from the 1933 Act's registration requirements differ depending on the exemption sought. Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume details the exemptions from registration under the 1933 Act that are available and the applicable offering procedures. Whether or not an offering is registered under the 1933 Act, unless the issuer is prepared to register as an investment company under the 1940 Act and endure the requirements of that statute and the SEC's rules thereunder, it is important that the issuer is exempt from the provisions of the 1940 Act both before and after the offering. Chapter 9 (*1940 Act-Exempt Issuers*) of this volume explores various exemptions from the 1940 Act available to issuers.

Generally speaking, the U.S. offering process, including the disclosure and due diligence requirements, for a broadly-marketed Rule 144A offering (versus an overnight or other private placement to a limited group of investors that performs its own due diligence) of medium– or long–term fixed income securities or equity is substantially the same as the U.S. offering process for a 1933 Act-registered offering, but, in most cases, without the registration or ongoing compliance issues.

In certain cases, such as the issuance of securities by U.S. banks and U.S. branches of foreign banks, the exemption from having to register under the 1933 Act does not necessarily mean that no regulatory regime applies; rather, it means that a regulator other than the SEC administers the registration process, as discussed, in the case of securities issued by banks, in Chapter 12 (*Bank Issuers*) and Appendix D (*U.S. Regulation of Activities of Non-U.S. Banks in the United States*) of this volume.

In many cases, however, the 1933 Act does not impose specific disclosure or registration requirements because the nature of the securities, such as commercial paper, or the nature of the investors, such as purchasers in traditional private placements pursuant to Section 4(2) and Regulation D, or the nature of the issuers, such as foreign government-sponsored enterprises, is such that prescribing a particular form of disclosure is not necessary. In those cases, the disclosure standards have developed to suit the market and are very much a product of custom and practice.

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CHAPTER 8

1933 ACT-EXEMPT OFFERINGS AND SECURITIES

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GENERAL

There are many ways of offering securities in the U.S. capital markets without having to register the offering under the 1933 Act as discussed in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume. The offering itself may be made in a manner that does not require registration, which we call an "exempt offering," or the securities being offered may not be required to be registered, which we call "exempt securities."

This chapter discusses exempt offerings and exempt securities under the 1933 Act.

EXEMPT OFFERINGS UNDER THE 1933 ACT

The two primary offering exemptions are Section 4(2) of the 1933 Act, which applies to private placements in the U.S. capital markets, and Regulation S under the 1933 Act, which applies to securities sold in offshore transactions to non-U.S. persons.

Private Placements

Pursuant to Section 4(2) of the 1933 Act, issuers may offer their securities in the United States without registration under the 1933 Act if those securities are privately placed in transactions that do not involve a public offering. Most private placements are structured to comply with one of two "safe harbors" that the SEC has adopted for conformity with Section 4(2): either Regulation D or Rule 144A. Because Rule 144A is effectively a resale exemption, a Rule 144A offering typically refers to a private placement to a wide group of institutional investors that are "qualified institutional buyers" as defined in Rule 144A, usually in a transaction in which the underwriters buy the securities from the issuer pursuant to Section 4(2) and resell them to investors pursuant to Rule 144A. A Regulation D private placement typically refers to a traditional private placement either to a small group of institutional investors or to a combination of institutional and individual accredited investors. [1] As an alternative to Regulation D offerings, small issues of securities can also be conducted under Regulation A.

Securities purchased in a private placement may not be publicly resold unless registered for resale under the 1933 Act or otherwise exempt from registration. The issuer and its financial intermediary must take reasonable care to ensure that purchasers are not acquiring the securities for the purpose of immediate distribution. This obligation may be satisfied by reasonable inquiry of the purchasers, written disclosure and the use of a legend on certificates evidencing the

[1] See *Accessing the U.S. Capital Markets – Securities Products*.

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securities. The appropriate procedures, however, will depend on the issuer and the securities offered.

Private placements may be integrated with public offerings in certain circumstances, thus losing their status as a "private placement." The doctrine of integration is designed to prevent issuers from circumventing the 1933 Act registration requirements by, for example, conducting a public offering and, in an attempt to take advantage of increased investor interest, immediately making a private placement of substantially identical securities. Despite any position taken by the issuer that these are two separate offerings, the SEC might integrate the offerings and conclude that all of the securities had been offered pursuant to a general solicitation. The second portion of the offering would involve a public offering which precludes reliance on the private placement exemption provided by Section 4(2) of the 1933 Act. Whether or not separate offerings of securities will be viewed as a single offering depends upon the particular facts and circumstances.

Regulation D provides that offers and sales made more than six months before the commencement of a Regulation D offering or more than six months after completion of a Regulation D offering will not be considered part of that offering, provided no offers or sales of similar securities are made by the issuer during that time period. In 2007, responding to a recommendation by small business advocates, the SEC proposed changes to Regulation D that would reduce the integration safe harbor from six months to 90 days.[2] As of the date of publication of this volume, final action on the proposals had not been taken.

Rule 152 under the 1933 Act, as interpreted by the staff of the SEC, provides that the filing of a 1933 Act registration statement following an offering otherwise exempt under Section 4(2) does not invalidate the Section 4(2) exemption. Furthermore, depending upon the facts and circumstances, an offering that is truly private may be eligible for the Section 4(2) exemption even though a 1933 Act registration statement was filed prior to the completion of the offering.[3] Commentary included in the SEC's 2007 proposals for amendments to Regulation D both confirmed these constructions of Rule 152 and expounded at some length on the circumstances under which simultaneous public and private offerings might be effected without integration. Central to the SEC's analysis is the necessity that solicitation efforts in public and private offers be entirely separate. Where marketing efforts for the public offering are wholly distinct from solicitations for the private placement, the claim of exemption under Section 4(2) will not depend on the status of the offerees in the unregistered offering as QIBs or institutional accredited investors.[4]

Regulation D Private Placements

Section 4(2) of the 1933 Act exempts from the registration and prospectus delivery requirements "transactions by an issuer not involving any public offering." The procedures that

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2 See SEC Release No. 33-8828 (Aug. 3, 2007) (the "2007 Regulation D Proposing Release") (http://www.sec.gov/rules/proposed/2007/33-8828.pdf).

3 See, *e.g.*, SEC No-Action Letters Black Box Incorporated, available June 26, 1990, and Squadron Ellenoff, available Feb. 28, 1992.

4 See supra footnote 2.

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an issuer must implement in order to establish the exemption vary depending upon the type of private placement. A private placement of long-term debt securities, for example, typically involves a limited number of institutional investors, normally only QIBs, and, therefore, requires less elaborate compliance procedures than other types of private placements. Private placements of limited partnership interests and other equity securities to sophisticated individuals and institutions, on the other hand, require more elaborate procedures. Private placements of commercial paper and medium-term notes typically require the issuer to consider the continuous or delayed offering features of the programs.[5]

Regulation D under the 1933 Act provides a set of non-exclusive guidelines (*i.e.*, a "safe harbor") for determining whether a private placement of securities qualifies for the Section 4(2) exemption. Although issuers are not required to adhere to the guidelines set forth in Regulation D to establish a Section 3(b)[6] or Section 4(2) exemption, most private placement offerings are patterned upon the general principles set forth in Regulation D. Any proposed variation from the guidelines should be reviewed with counsel to ensure that such variation would not require the offering to be registered under the 1933 Act.

Set forth below are general guidelines for issuers seeking to privately place securities pursuant to Regulation D.

No General Solicitation or Advertising

Neither the issuer nor any person acting on its behalf (including selling agents) may offer or sell the securities by any form of general solicitation or general advertising. This also includes any seminar or meeting whose attendees have been invited by general solicitation or advertising. Placing offering materials on the Internet with general access may also result in a general solicitation.[7] Because any public communication that creates interest in the offering may be deemed to constitute a general solicitation, public communications by the issuer should be reviewed by counsel to assure compliance with this requirement.

Number and Nature of Purchasers

Regulation D does not limit the number of accredited investors who may purchase the securities, but Rule 505 and Rule 506 limit the number of non-accredited investors to 35. The

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[5] Private placement procedures for ADR offerings, commercial paper programs and medium-term note programs are discussed in *Accessing the U.S. Capital Markets – Securities Products*.

[6] Section 3(b) of the 1933 Act allows the SEC to exempt certain classes of securities by virtue of the small amount involved or the limited character of the public offering.

[7] For example, it is probably not adequate, at least for the purposes of avoiding general solicitation, to permit unrestricted access to a web site that contains offering material and to rely solely on disclaimers, even ones to which a visitor is required to agree, that the web site is not intended to be a solicitation. On these facts, a state securities regulator sued a hedge fund complex in 2007 alleging violations of the State's securities registration requirements. See In the matter of Bulldog Investors General Partnership, et al. (Mass. SECS. Div. Docket No. E-07-0002, Jan. 31, 2007). The SEC has provided interpretive guidance in the "Use Of Electronic Media." See SEC Release No. 33-7856 (Apr. 28, 2008) (http://www.sec.gov/rules/interp/34-42728.htm).

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term "accredited investors"[8] is defined to include banks, insurance companies, registered and small business investment companies, certain business development companies, certain employee benefit plans, organizations with total assets in excess of U.S.$5 million and certain wealthy individuals.

Although Regulation D does not impose a numerical limitation on the number of offerees involved in a transaction, the offering of securities to a large number of potential accredited investors may warrant additional safeguards on the manner of offering to ensure that a general solicitation has not occurred.

For suitability and state securities law reasons, private placements under Regulation D are often limited to "institutional accredited investors," that is, those categories identified above except for natural persons.[9]

Information Requirements

If the securities are sold only to accredited investors, Regulation D does not require the issuer to provide investors with specific information. Investors in private placements are typically limited to accredited investors. Even if a private placement is limited to accredited investors, however, a private placement memorandum will usually be prepared and circulated to prospective purchasers, both for marketing reasons and to reduce the potential liabilities of participants in the offering. Where non-accredited investors are involved, Regulation D provides guidelines for disclosure that vary depending upon (a) whether the issuer is or is not a reporting company under the 1934 Act and (b) the dollar value of the securities offered.

In connection with securities being privately placed in the United States, issuers and underwriters frequently seek to maintain the same disclosure standards as those required for 1933 Act-registered offerings of the same security. As a result, the SEC disclosure rules for 1933 Act-registered offerings often serve as a disclosure guide for private placements. It is important to remember that Section 4(2) (and likewise the Regulation D and Rule 144A safe harbors) only exempt offerings from the registration requirements of the 1933 Act (and from certain statutory liabilities related to the filing of registration statements). It does not exempt offerings from federal or state anti-fraud or civil liability laws.

Regulation D also requires the issuer to provide potential investors, for a reasonable time prior to the sale of its securities, the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and to obtain any additional information that the issuer possesses or can acquire without unreasonable effort or expense. While this obligation represents a standard undertaking in private placement disclosure documents, except where the

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[8] Key terms, such as "accredited investor," are defined in Rule 501 under Regulation D.

[9] In the 2007 Regulation D Proposing Release, the SEC proposed to adopt a new Rule 507 under Regulation D that would permit offers and sales of securities to a new category of investors called "large accredited investors." The rule would permit limited advertising and would be adopted under the SEC's general exemption authority, thus preserving federal pre-emption of state registration or qualification requirements. As of the date of publication of this volume, final action has not been taken on the proposals.

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offering is a limited placement to only a few institutional investors, it is unlikely that an issuer will be subject to any burdensome questions from potential investors.

Notice Requirements

If the offering is made pursuant to Regulation D, the issuer must make a Form D filing with the SEC within 15 days of the first sale of securities in the offering. The SEC in 2008 adopted rules requiring electronic filings for all Form D filings on or after March 16, 2009. [10] Because Regulation D is only a "safe harbor" for complying with Section 3(b) or Section 4(2) (*i.e.*, it is not the exclusive means for ensuring that a public distribution has not been made), issuers sometimes do not file Form D in reliance upon counsel's opinion that, in light of all of the facts and circumstances of the offering, the offering will be exempt from registration despite the failure to file the form.

Aggregate Offering Price

Rule 504 of Regulation D provides a safe-harbor Section 3(b) exemption for sales of securities not exceeding an aggregate offering price of U.S.$1 million so long as the issuer is not a reporting company under the 1934 Act, investment company or blank check company. Similarly, Rule 505 of Regulation D, which also provides a Section 3(b) exemption, limits the aggregate offering price to U.S.$5 million. The calculation of the maximum aggregate offering price under both rules is reduced by the aggregate offering price for Section 3(b) exempt securities sold in the previous 12 months. For example, if an issuer sells U.S.$850,000 on March 20, 2008 under a Section 3(b) exemption, a second offering under Rule 504 would be limited to U.S.$150,000 until November 20, 2009. Rule 506, on the other hand, is a Section 4(2) exemption and does not limit the maximum aggregate offering price.

As an alternative to a Rule 505 offering, Regulation A provides a safe-harbor Section 3(b) exemption for small issues of securities. Regulation A, like Rule 505, limits the maximum aggregate offering price to U.S.$5 million, less the aggregate offering price of securities sold in the previous 12 months. The U.S.$5 million limitation under Regulation A, however, is only reduced by prior offerings in reliance on Regulation A; whereas Rule 505's maximum limit is reduced by all Section 3(b) exempt offerings. Another attractive feature of Regulation A, as opposed to Regulation D, is that the issuer is not prohibited from using forms of general solicitation or advertising to sell securities. This allows small issuers who do not have a previous relationship with investors to be able to more quickly and more easily raise capital.

Regulation A also provides greater protection against integration with other offerings than does Regulation D. Offerings made under Regulation A are not integrated with prior transactions as long as those transactions have been completed before the commencement of the Regulation A offering. Additionally, Regulation A provides "double-sided" protection against integration with other specified future offerings. This means that not only is the future

[10] See SEC Release No. 33-8891 (Feb. 6, 2008) (http://www.sec.gov/rules/final/2008/33-8891.pdf). The SEC found it necessary to include a safe harbor from the "general solicitation" prohibition for a Form D filed with the SEC where the information is provided in good faith and the issuing company makes reasonable efforts to comply with Regulation D.

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non-Regulation A offering not integrated into the Regulation A offering, but that the Regulation A offering will not be integrated into that other offering.

Rule 144A Offerings

Rule 144A is technically a resale exemption for buyers of restricted securities. It only permits persons *other than the issuer* to resell securities in a transaction not involving a public offering. QIBs include, for example, specified institutions that in the aggregate own and invest at least U.S.$100 million of specified types of securities[11] and dealers that own and invest at least U.S.$10 million of those types of securities (excluding unsold allotments of public offerings).

Securities offered pursuant to Rule 144A may not, when issued, be of the same class as securities listed on a U.S. securities exchange or automatic quotation system. Securities convertible into a class of securities that are listed on a U.S. securities exchange may not be sold in reliance on Rule 144A unless the conversion premium or exercise price is at least 10%. Unless the issuer of securities offered pursuant to Rule 144A is subject to 1934 Act reporting requirements or exempt from those requirements pursuant to Rule 12g3-2(b),[12] the issuer must agree to provide certain limited information about its business and financial condition to holders of the securities and to prospective purchasers designated by the holders so long as the securities remain subject to Rule 144A transfer restrictions.

There are two types of Rule 144A offerings: Rule 144A-only offerings and Rule 144A-eligible offerings. These two types of offerings differ with respect to how privately-placed securities may be resold.

Rule 144A-only offerings generally provide that any resale in the U.S. capital markets of the securities may only be made pursuant to Rule 144A (until the securities become freely tradable under Rule 144 or are registered under the 1933 Act). In addition, 144A-only offerings usually require that QIBs be the initial purchaser of the securities.

Rule 144A-eligible offerings are drafted to permit resales in the U.S. capital markets in accordance with Rule 144A. However, unlike the Rule 144A-only offerings, resales of securities in the U.S. capital markets in a Rule 144A-eligible offering may be made pursuant to some or all of the other available 1933 Act exemptions as well (*e.g.*, “Section 4(1½)”).

Regulation S Offerings

Regulation S is not technically an “exemption” from the 1933 Act filing requirements. Regulation S provides safe-harbor guidelines for determining when an offering of securities will be deemed to have occurred outside the United States and, therefore, not be subject to registration under the 1933 Act. Regulation S encompasses one safe harbor that applies to

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[11] In determining the aggregate amount of securities owned, an investor or dealer must exclude bank deposit notes, certificates of deposit, loan participations, repurchase agreements and securities owned but subject to repurchase agreements and currency, interest rate and commodity swaps.

[12] For a more complete discussion of issuers subject to this requirement and their obligations, see the discussion under the heading “Information Reporting under Rule 12g3-2(b) for Foreign Private Issuers” in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

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transactions by issuers and distributors (generally underwriters of securities), and another safe harbor that applies to resales. Both require (1) the presence of an offshore transaction, (2) the absence of directed selling efforts in the United States and (3) sales only to non-U.S. persons.[13] In addition, depending on the category of securities (as discussed below), other requirements must be satisfied.

Offers or sales of securities are considered "offshore transactions" when two conditions are satisfied. First, the offer must be made to a person outside the United States other than a distributor. The second condition is met if, at the time the buy order is originated, the buyer is outside the United States or the seller and any person acting on his behalf reasonably believes the buyer is outside the United States. The second condition can also be met for the purposes of the safe harbor for issuer and distributor transactions if the transaction is executed through a physical trading floor of an established foreign securities exchange located outside the United States.

"Directed selling efforts" are defined as activities undertaken for the purpose of conditioning the U.S. market for any of the securities being offered in reliance on Regulation S. Activities that could reasonably be expected to have this conditioning effect are also considered directed selling efforts. Common problems arising under this definition of directed selling efforts relate to advertising, foreign press-related activity, quotation services, Internet postings and research.

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[13] A "U.S. person" means: (i) any natural person resident in the United States; (ii) any partnership or corporation organized or incorporated under the laws of the United States; (iii) any estate of which any executor or administrator is a U.S. person; (iv) any trust of which any trustee is a U.S. person; (v) any agency or branch of a foreign entity located in the United States; (vi) any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person; (vii) any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the United States; and (viii) any partnership or corporation if: (A) organized or incorporated under the laws of any foreign jurisdiction; and (B) formed by a U.S. person principally for the purpose of investing in securities not registered under the 1933 Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501(a) under the 1933 Act) who are not natural persons, estates or trusts.

The following are not "U.S. persons": (i) any discretionary account or similar account (other than an estate or trust) held for the benefit or account of a non-U.S. person by a dealer or other professional fiduciary organized, incorporated, or (if an individual) resident in the United States; (ii) any estate of which any professional fiduciary acting as executor or administrator is a U.S. person if: (A) an executor or administrator of the estate who is not a U.S. person has sole or shared investment discretion with respect to the assets of the estate; and (B) the estate is governed by foreign law; (iii) any trust of which any professional fiduciary acting as trustee is a U.S. person, if a trustee who is not a U.S. person has sole or shared investment discretion with respect to the trust assets, and no beneficiary of the trust (and no settlor if the trust is revocable) is a U.S. person; (iv) an employee benefit plan established and administered in accordance with the law of a country other than the United States and customary practices and documentation of such country; (v) any agency or branch of a U.S. person located outside the United States if: (A) the agency or branch operates for valid business reasons; and (B) the agency or branch is engaged in the business of insurance or banking and is subject to substantive insurance or banking regulation, respectively, in the jurisdiction where located; and (vi) the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies, affiliates and pension plans, and any other similar international organizations, their agencies, affiliates and pension plans.

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The safe harbor for issuers and distributors is comprised of three different exemptions from the registration requirements that are based on factors such as (1) the jurisdiction of incorporation of the issuer, (2) the issuer's reporting status under the 1934 Act and (3) the degree of U.S. market interest in the issuer's securities. Offshore transactions that comply with Regulation S will not be integrated with registered offerings in the United States or with offerings that qualify for an exemption under the 1933 Act, such as Rule 144A offerings, even if such offerings are undertaken simultaneously. However, Regulation S is not available with respect to any transaction or series of transactions that constitute a scheme to evade the registration requirements of the 1933 Act.

In addition to satisfying the offshore transaction requirement and the prohibition on directed selling efforts and limiting sales to non-U.S. persons, other requirements may apply depending on the "category" of securities being offered.

Category 1

No additional requirements apply to Category 1 securities, which include:

- securities offered by a non-U.S. issuer who reasonably believes at the commencement of the offering that there is no "substantial U.S. market interest"[14] in the securities offered;
- securities offered and sold in an "overseas directed offering;"[15]

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[14] (1) "Substantial U.S. market interest" or "SUSMI" with respect to a class of an issuer's equity securities means: (i) the securities exchanges and inter-dealer quotation systems in the United States in the aggregate constituted the single largest market for such class of securities in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation; or (ii) 20% or more of all trading in such class of securities took place in, on or through the facilities of securities exchanges and inter-dealer quotation systems in the United States and less than 55% of such trading took place in, on or through the facilities of securities markets of a single foreign country in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation.

(2) "Substantial U.S. market interest" with respect to an issuer's debt securities means: (i) its debt securities, in the aggregate, are held of record (as that term is defined in Rule 12g5-1 under the 1934 Act and used for purposes of this paragraph (2) by 300 or more U.S. persons; (ii) U.S.$1 billion or more of: the principal amount outstanding of its debt securities, the greater of liquidation preference or par value of its securities described in Rule 902(a)(1) under the 1933 Act, and the principal amount or principal balance of its securities described in Rule 902(a)(2) under the 1933 Act, in the aggregate, is held of record by U.S. persons; and (iii) 20% or more of: the principal amount outstanding of its debt securities, the greater of liquidation preference or par value of its securities described in Rule 902(a)(1) under the 1933 Act, and the principal amount or principal balance of its securities described in Rule 902(a)(2) under the 1933 Act, in the aggregate, is held of record by U.S. persons.

(3) Notwithstanding paragraph (2) above, substantial U.S. market interest with respect to an issuer's debt securities is calculated without reference to securities that qualify for the exemption provided by Section 3(a)(3) of the 1933 Act.

[15] An "overseas directed offering" means (i) an offering of securities of a non-U.S. issuer that is directed into a single country other than the United States to the residents thereof and that is made in accordance with the local laws and customary practices and documentation of such country; or (ii) an offering of non-convertible debt securities of a domestic issuer that is directed into a single country other than the

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- securities backed by the full faith and credit of a foreign government; or
- securities offered and sold pursuant to certain employee benefit plans established and administered under the laws of a non-U.S. jurisdiction.

Category 1 does not contemplate any distribution compliance period during which the offering is subject to the offering restrictions discussed in this chapter below for Category 2 and Category 3. Out of an abundance of caution, however, some participants in Category 1 transactions impose a 40-day distribution compliance period as a prophylactic measure, particularly where there is a 144A component and, in the case of a continuous offering program, the issuer intends to increase U.S. interest in its securities.

Category 2

Category 2 applies to securities that are not eligible for Category 1 and that are either equity securities of a non-U.S. issuer that is a reporting company under the 1934 Act or debt securities of a reporting issuer (U.S. or non-U.S.) and a non-reporting non-U.S. issuer. Issuers of Category 2 securities may take advantage of the safe harbor if they satisfy the following conditions:

- Certain "offering restrictions" must be implemented in addition to the general Regulation S requirements, including:
  - each distributor must agree in writing that (i) all offers and sales during a 40-day distribution compliance period[16] may be made only in accordance with safe harbors under Regulation S, pursuant to registration under the 1933 Act or an exemption from such registration and (ii) for offers and sales of equity securities of U.S. issuers, not to engage in hedging transactions with regard to such securities during the 40-day distribution compliance period, unless in compliance with the 1933 Act; and
  - all offering materials and documents (other than press releases, and including advertisements) used in connection with offers and sales during

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United States to the residents thereof and that is made in accordance with the local laws and customary practices and documentation of such country, provided that the principal and interest of the securities (or par value, as applicable) are denominated in a currency other than U.S. dollars and such securities are neither convertible into U.S. dollar-denominated securities nor linked to U.S. dollars (other than through related currency or interest rate swap transactions that are commercial in nature) in a manner that in effect converts the securities to U.S. dollar-denominated securities.

[16] The 40-day distribution compliance period begins on the later of the date of the closing for the securities being offered or the date on which securities were first offered to persons other than distributors (generally, the pricing date). However in a continuous offering, the 40-day distribution compliance period begins on the later of the date of the closing for the securities being offered or the completion of distribution, as determined and certified by the managing underwriter or lead dealer. The distribution compliance period is a requirement distinct from the 40-day "restricted period" required under U.S. Department of the Treasury regulations under the Tax Equity and Fiscal Responsibility Act of 1982 for bearer instruments, although the periods often overlap. For a discussion of the "restricted period," see *Accessing the U.S. Capital Markets – Securities Products*.

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the 40-day distribution compliance period must (i) disclose that the securities are not registered under the 1933 Act and cannot be sold in the United States or to U.S. persons (as defined in Regulation S) (other than distributors) unless the securities are registered or an exemption from registration is available and (ii) in the case of offers and sales of equity securities of U.S. issuers, state that hedging transactions involving those securities may not be conducted unless in compliance with the 1933 Act.

- During the 40-day distribution compliance period, offers and sales of the security cannot be made to a U.S. person other than a distributor;[17] and
- Each distributor selling securities during the 40-day distribution compliance period to another distributor, dealer, or person receiving a selling concession or fee must send a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restriction on offers and sales as the distributor.

Category 3

Category 3 securities include all securities that are not eligible for Category 1 or 2, such as equity securities of a non-U.S. issuer that is not a reporting company under the 1934 Act (with substantial U.S. market interest in the equity securities of that issuer) or debt or equity securities of a non-reporting U.S. issuer. In addition to the general Regulation S requirements, the issuer must satisfy the following conditions:

- Each of the offering restrictions discussed in this chapter above for Category 2 securities must be met, except that a six-month distribution compliance period (one year if the issuer does not file 1934 Act reports with the SEC) applies to offerings of equity securities and a 40-day distribution compliance period applies to offerings of debt securities.[18]
- During the applicable distribution compliance period, offers or sales cannot be made to a U.S. person other than a distributor.[19]
- Equity securities may be sold prior to the expiration of a six-month distribution compliance period (one year if the issuer does not file 1934 Act reports with the SEC) so long as the following conditions are satisfied:
    - the purchaser (other than a distributor) certifies that it is not a U.S. person or is a U.S. person who purchased the securities in an exempt transaction under the 1933 Act;

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[17] As discussed above, exempt sales to U.S. persons during the distribution compliance period are permissible and will not be integrated with the Regulation S offering.

[18] “Equity securities” are defined in Rule 405 under the 1933 Act and include debt securities that are convertible into equity securities. Regulation S defines “debt securities” to include certain non-participating preferred stock and asset-backed securities.

[19] See supra footnote 17.

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- ○ the purchaser agrees to resell the securities only in accordance with Regulation S, pursuant to registration under the 1933 Act or an exemption from such registration, and agrees not to engage in hedging transactions with regard to the securities unless in compliance with the 1933 Act; and

- ○ certain other restrictions are satisfied, including a prohibition against corporate registration of transfers not made in accordance with Regulation S.

- Debt securities generally must be represented upon issuance by a temporary global security not exchangeable for definitive securities until the expiration of the 40-day distribution compliance period and, for persons other than distributors, until certification of beneficial ownership by a non-U.S. person or a U.S. person who purchased the securities in an exempt transaction under the 1933 Act.[20]

- Any distributor selling the securities during the applicable distribution compliance period to another distributor, dealer, or person receiving a selling concession or fee must send a notice or confirmation to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales as the distributor.

Resales of Securities Sold in Exempt Offerings

While securities that have been registered under the 1933 Act may be freely resold by investors without re-registration,[21] securities sold pursuant to an exemption may be resold only if subsequently registered for resale under the 1933 Act or if resold pursuant to an available exemption. Discussed below are available 1933 Act registration methods and 1933 Act exemptions for secondary market transactions involving unregistered securities.

Registration Rights

In many private placements, investors are given the right to have the securities they acquire registered for resale under the 1933 Act. Registration rights are normally afforded under a separate agreement between the issuer and the initial investors known as a registration rights agreement. Registration rights have been popular in fixed-income and convertible securities Rule 144A offerings as they enable issuers to tap the capital markets quickly and opportunistically while avoiding, at the time of the offering, the delay and uncertainties of the SEC registration process.

There are four general categories of registration rights: demand registration rights, "piggy-back" registration rights, shelf registration rights and exchange rights. Demand registration rights provide investors holding a specified amount of securities with the right to

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20 There has been considerable difficulty in getting the European clearing systems to accept temporary global securities for securities in registered form as opposed to bearer form. This problem is exacerbated when the securities have a short tenor (*i.e.,* less than one year).

21 This is true so long as the seller is not affiliated with the issuer. See the further discussion in this chapter below under the heading "—Exempt Offerings under the 1933 Act—Regulation S Offerings—Resales of Securities Sold in Exempt Offerings—Resales by Control Persons."

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demand registration of the securities at the issuer's expense. Piggy-back registration rights provide investors with the right to register their securities whenever the issuer files a registration statement covering securities of the same class. Shelf registration rights require the issuer to register the privately-placed securities under a shelf registration statement pursuant to Rule 415[22] for sale from time to time in so-called "uncoordinated distributions."

Privately-placed securities with exchange rights provide investors with the right to exchange the privately-placed securities for securities that are freely tradable, while other registration rights provide investors with the right to require the issuer to register a sale by that investor of privately-placed securities. At this time, the SEC has acknowledged that exchanges of certain categories of debt and equity securities will result in investors receiving unrestricted securities provided the investor acquires the new securities in its ordinary course of business and is not participating in the distribution of those securities.[23] In no-action letters, the staff of the SEC has refused to extend exchange rights to common stock and functionally equivalent securities of U.S. issuers, such as debt securities convertible into common stock.

Registration rights continue to be popular with investors, particularly where book-entry securities are involved, despite the adoption of amendments to Rule 144 in February 2008 (discussed below), that reduced the minimum holding period prior to privately-placed securities becoming freely tradable from two years to one year and sometimes six months. This is primarily due to the difficulty currently involved in converting a CUSIP number, and therefore a DTC trading position, from a restricted or "private" trading position to a freely-tradable trading position.

Resales by Control Persons

Resales of securities, even if registered, present unique concerns for control persons of issuers. Generally, "control persons," or "affiliates," include those who have the power to compel registration of the issuer's securities or have the ability to direct management and business policies of the issuer. Under Section 4(1) of the 1933 Act, securities sold in transactions not involving an underwriter need not be registered. The 1933 Act defines an underwriter as one who purchases securities from an issuer with a view to the distribution of those securities. To determine whether securities have been sold in a transaction involving an

[22] See Chapter 5 (*Shelf Registration*) of this volume.

[23] These exchange offers are called "Exxon Capital" exchange offers after the first SEC no-action letter that approved the technique. See SEC No-Action Letter Exxon Capital Holdings Corp., available May 13, 1988. Other significant SEC no action letters include Vitro, Sociedad Anonima, available Nov. 19, 1991, Corimon C.A. S.A.C.A., available Mar. 22, 1993 and Espírito Santo Financial Holding S.A., available June 30, 1993 (Rule 144A and/or Regulation S ADRs or GDRs); Epic Properties, Inc., available Oct. 21, 1991 (mortgage notes); Warnaco, Inc., available Oct. 11, 1991 (discount notes); Morgan Stanley & Co. Incorporated, available June 5, 1991 (any debt security, investment grade-rated preferred stock or substantially similar security that is not convertible into or exchangeable for any equity security other than preferred stock); Mary Kay Cosmetics, Inc., available June 5, 1991 (guaranteed senior notes) and K-III Communications Corp., available May 14, 1993 (non-rated preferred stock exchangeable for subordinated debt securities). In another no-action letter, the SEC imposed conditions on a broker-dealer's participation in an issuer's registered exchange offer. See SEC No-Action Letter Shearman & Sterling, available July 2, 1993. The SEC also has confirmed this position with respect to exchanges of capital securities. See SEC No-Action Letter Brown & Wood LLP, available Feb. 7, 1997.

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underwriter, a control person who sells securities is treated as an issuer. For example, suppose a control person sells registered securities to an individual who then immediately resells those securities in a distribution. This would constitute a transaction involving an underwriter because the securities were purchased from an issuer (the control person) with a view to their distribution. As such, these securities, despite previously being registered, now would become subject to the 1933 Act's registration requirements. The 1933 Act requires each offering to be registered or exempt; in effect, offerings, rather than securities, are registered. Control persons may, however, resell securities absent registration by taking advantage of various safe harbors, such as Rule 144 and Rule 144A.

Rule 144

Rule 144 under the 1933 Act generally permits limited public resales of defined restricted securities without registration six months after the issue date (in the case of an issuer that is a reporting company under the 1934 Act) or one year after the issue date (in the case of an issuer that is not a reporting company under the 1934 Act). An affiliate (*i.e.*, control person) or any other person who sells restricted securities for his own account pursuant to Rule 144 is not engaged in a distribution and therefore is not engaged in a transaction involving an underwriter. Additionally, persons selling both restricted or unrestricted securities for the account of an affiliate under Rule 144 are not considered underwriters.

"Restricted securities"[24] of a reporting company under the 1934 Act may not be resold until a minimum of six months (one year in the case of a company that does not file reports under the 1934 Act) has elapsed from the later of the date of acquisition from the issuer or from an affiliate of the issuer, and any resale of such securities in reliance on Rule 144. When selling restricted securities, Rule 144 requires that current public information about the issuer be made available to purchasers. The amount and type of information that must be provided depends

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[24] The term "restricted securities" is defined under Rule 144 under the 1933 Act to mean:

(1) Securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering;

(2) Securities acquired from the issuer that are subject to resale limitations of Rule 502(d) or Rule 701(c) under the 1933 Act;

(3) Securities acquired in a transaction or chain of transactions meeting the requirements of Rule 144A;

(4) Securities acquired from the issuer in a transaction subject to the conditions of Regulation CE;

(5) Equity securities of U.S. issuers acquired in a transaction or chain of transactions subject to the conditions of Rule 901 or Rule 903 under Regulation S;

(6) Securities acquired in a transaction made under Rule 801 under the 1933 Act to the same extent and proportion that the securities held by the securityholder of the class with respect to which the rights offering was made were, as of the record date of the rights offering, "restricted securities;"

(7) Securities acquired in a transaction made under Rule 802 under the 1933 Act to the same extent and proportion that the securities were tendered or exchanged in the exchange offer or business combination were "restricted securities;" and

(8) Securities acquired from the issuer in a transaction subject to an exemption under Section 4(6) of the 1933 Act.

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upon whether the issuer is a reporting company. Effective February 15, 2008, the manner-of-sale and volume conditions of the rule no longer apply to sales by unaffiliated persons. Based on recently-adopted rule amendments regarding the provision of interactive financial data, an issuer that does not file the required interactive data (or post such data on its web site) will not be deemed to have available adequate current public information for purposes of the resale exemption safe harbor provided by Rule 144. [25]

Additionally, restricted equity securities must be resold in broker's transactions where the broker does no more than execute the order. In other words, the broker is not permitted to solicit or arrange for the solicitation of customers' orders to buy securities. Restricted debt securities are not subject to any "manner of sale" requirements.[26] Finally, Rule 144 limits the amount of securities that can be sold in a three-month period and imposes various filing requirements.

A holder of restricted securities of a reporting company under the 1934 Act that, at the time of sale, is not an affiliate of the issuer and has not been an affiliate of the issuer in the preceding three months, may resell such restricted securities after six months have elapsed since the later of the date the securities were acquired from the issuer or an affiliate of the issuer, subject only to the current public information requirements of Rule 144. After a twelve-month holding period, unlimited resales by such persons are permitted, whether or not the issuer is a reporting company under the 1934 Act.

"Section 4(1½)"

Although not formally adopted as a safe harbor by the SEC, the terms of some privately-placed securities permit investors (in accordance with specified procedures) to resell those securities to other institutional accredited investors that would have been eligible to purchase the securities in the original private placement. This is the so-called "Section 4(1½)" exemption. Resales pursuant to the Section 4(1½) exemption are generally considered exempt from the registration requirements of the 1933 Act.

Rule 144A Resales

As discussed in more detail above, Rule 144A under the 1933 Act permits resales of privately-placed securities to QIBs. [27] In order to allow its investors to take advantage of this safe harbor, an issuer that neither files reports with the SEC under the 1934 Act nor satisfies the information and other requirements of Rule 12g3-2(b) thereunder must agree to provide on

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[25] See the discussion under the heading "Extensible Business Reporting Language ('XBRL')" in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

[26] Rule 144(a)(iv) under the 1933 Act defines "debt securities" as any security other than an equity security, except that non-convertible preferred securities with generally customary terms would also be within the definition; however, preferred securities are only eligible to be treated as debt if their terms include a liquidation preference in excess of par, which may constitute a trap for the unwary. Asset-backed securities are also within the definition.

[27] Prior to the adoption of Rule 144A, underwriters often relied on the so-called Section 4(1½) exemption, an SEC bar-developed concept that the SEC has acknowledged only in no-action letters, which involves resales to institutional accredited investors following methods comparable to the initial Section 4(2) private placement.

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request to secondary market purchasers at or prior to the time of sale (1) a very brief statement of the nature of the business of the issuer and the products and services it offers and (2) its most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available).

Offshore Resales

In addition to applying to primary offerings, Regulation S provides a safe harbor for resales of restricted securities. The resale safe harbor applies to persons other than the issuer, any distributor, any of their affiliates (except an officer or director who is an affiliate solely by virtue of such position) or any person acting on their behalf. Similar to the Regulation S safe harbor for issuer and distributor transactions, the resale safe harbor requires that the offer and sale be made in an offshore transaction and prohibits any directed selling efforts in the United States. The offshore transaction requirement means that the buyer must be outside the United States or that the seller and any person acting on the seller's behalf must reasonably believe this to be the case. In the alternative, the transaction must be executed on or through a "designated offshore securities market" without any knowledge on the part of the seller or any person acting on the seller's behalf that the transaction has been pre-arranged with a buyer in the United States.

Additional conditions apply to resales by certain affiliates or securities professionals. Those who are affiliates of an issuer or a distributor solely because they hold officer or director positions may rely on the resale safe harbor if they pay no more than the usual and customary broker's commission received by those who execute such transactions as agent. Dealers or others receiving selling compensation in connection with a Regulation S offering may rely on the safe harbor to resell securities prior to the expiration of the applicable distribution compliance period if (1) neither the seller nor any person acting on its behalf knows the offeree or buyer to be a U.S. person and (2) a confirmation or other notice of applicable restrictions is sent to any purchaser known to be another securities professional.

Equity securities of domestic issuers acquired in a Regulation S transaction are deemed restricted securities under Rule 144. As such, these securities may only be resold if the offshore purchaser does so in accordance with Regulation S, the registration requirements of the 1933 Act or an exemption therefrom.

EXEMPT SECURITIES UNDER THE 1933 ACT

Exempt securities under the 1933 Act include commercial paper, securities issued or guaranteed by a U.S. bank or a regulated U.S. branch or agency of a non-U.S. bank, securities exchanged for securities held by existing securityholders and other exempt securities.

Commercial Paper

Section 3(a)(3) of the 1933 Act exempts short-term securities with maturities of nine months or less where the proceeds are to be used for current transactions. This is referred to as the "commercial paper" exemption. In determining whether the proceeds of an offering are to be used for current transactions, there is no requirement to trace the proceeds of the offering. It is sufficient if an issuer has qualifying current assets and operating expenses incurred during the

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past year in an amount equal to or exceeding the amount of the issuer's outstanding commercial paper. The SEC and the courts have said that this exemption is only available for prime-quality securities (*e.g.*, securities rated investment grade by at least one NRSRO) that are of a type not ordinarily sold to the general public.

Commercial paper that cannot satisfy the requirements of the commercial paper exemption under the 1933 Act may nevertheless be exempt from registration if it is offered pursuant to the private placement exemption afforded by Section 4(2) or if the commercial paper is supported by a letter of credit issued by a U.S. bank or a regulated U.S. branch or agency of a non-U.S. bank.

See *Accessing the U.S. Capital Markets – Securities Products* for a further discussion on commercial paper.

Securities Issued or Guaranteed by a U.S. Bank or a Regulated U.S. Branch or Agency of a Non-U.S. Bank

Section 3(a)(2) of the 1933 Act exempts any security issued or guaranteed by a U.S. bank. The SEC has interpreted Section 3(a)(2) to exempt debt securities (including deposits) issued or guaranteed by a U.S. branch or agency of a non-U.S. bank provided that the nature and extent of state or federal supervision of the U.S. branch is substantially equivalent to that applicable to state- or federally-chartered U.S. banks doing business in the same jurisdiction.[28] On the basis of the foregoing, debt securities issued or guaranteed by the U.S. branches and agencies of non-U.S. banks should qualify as exempt securities pursuant to Section 3(a)(2). It is not necessary that the branch or agency of the non-U.S. bank be a separate subsidiary incorporated in the United States. Securities issued or guaranteed by a bank holding company are not exempt under Section 3(a)(2).

Letters of credit constitute guarantees for purposes of the Section 3(a)(2) exemption. Accordingly, bank letters of credit that support the securities of non-banks have been used in the U.S. capital markets not only as credit enhancement, but also as a way to avoid registration of the non-bank securities under the 1933 Act.

See Chapter 12 (*Bank Issuers*) of this volume for a further discussion of bank issuers.

Exchanged Securities

Section 3(a)(9) of the 1933 Act exempts any securities exchanged by an issuer exclusively with its existing securityholders where no commission or other remuneration is paid for soliciting the exchange. This exemption is frequently relied upon in connection with recapitalizations where an issuer offers to exchange new debt securities for existing debt securities.[29]

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[28] See SEC Release No. 33-6661 (Sept. 23, 1986) (hyperlink unavailable).

[29] Non-U.S. issuers also rely on Section 3(c)(10) of the 1933 Act, which similarly exempts from 1933 Act registration offers and sales of securities in specified exchange transactions without cash, with court or

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Other Exempt Securities

Other exempt securities include:

- U.S. government obligations (securities issued or guaranteed by the United States or any person "controlled or supervised by and acting as an instrumentality" of the U.S. government pursuant to statutory authority);
- municipal obligations (securities issued or guaranteed by the States of the United States and territories, their political subdivisions and public instrumentalities, or the District of Columbia);
- railroad equipment trust certificates;
- insurance contracts;[30] and
- securities issued by charitable organizations, intrastate offerings and certain small issues (Regulation A offerings and those made in compliance with Rule 504 of Regulation D).

governmental approval of the fairness of the terms as determined by a hearing. See Staff Legal Bulletin No. 3A (CF) (June 18, 2008) (http://www.sec.gov/interps/legal/cfslb3a.htm).

30 Applies only to insurance contracts and policies, not securities issued by insurance companies.

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CHAPTER 9

1940 ACT-EXEMPT ISSUERS

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GENERAL

Any issuer holding significant amounts of securities (which are broadly defined under the 1940 Act to include loans, minority interests in affiliated companies and other assets not normally thought of as securities) may be viewed as an investment company. An issuer is a prima facie investment company subject to regulation under the 1940 Act if it is engaged in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. As discussed below, an exemption from registration under the 1940 Act is often available to an issuer.

The 1940 Act exemptions that are relied upon by issuers that might otherwise be viewed as an investment company under the 1940 Act include:

- Rule 3a-1 issuers;
- transient investment companies;
- commercial paper finance subsidiaries;
- finance subsidiaries;
- non-U.S. banks, insurance companies and similar institutions;
- structured finance vehicles;
- certain research and development companies;
- private investment companies;
- qualified purchaser exemption; and

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- entities primarily engaged in holding receivables, real estate or mortgages.

It should be noted that, if an issuer would fall under the definition of an investment company under the 1940 Act, the problem generally cannot be solved by issuing securities through a special-purpose finance subsidiary. For the most part, exemptions for finance subsidiaries under the 1940 Act do not apply when the parent of the issuer is an investment company within the meaning of the 1940 Act.

NON-PRIMA FACIE INVESTMENT COMPANIES AND RULE 3a-1 ISSUERS

An issuer can avoid application of the 1940 Act if it is not a prima facie investment company or if it can take advantage of the exemption afforded by Rule 3a-1 under the 1940 Act. In either case, the issuer cannot be engaged or hold itself out as being engaged primarily in the business of investing, reinvesting or trading in securities.[1]

Non-Prima Facie Investment Company

Whether less than 40% of the value of an issuer's assets constitute investment securities is determined by dividing the value of the issuer's investment securities by the aggregate value of those investment securities and the other assets (other than Government securities and cash items)[2] owned, on an unconsolidated basis, by the issuer.

It is important to emphasize that, for purposes of the above computation, the analysis is done on an unconsolidated basis. Thus, it becomes necessary to analyze each subsidiary separately to determine whether or not that subsidiary is itself an investment company (or an issuer relying on Sections 3(c)(1) or 3(c)(7) of the 1940 Act) in order to determine whether or not the issuer's holdings in that subsidiary should be considered investment securities.

An alternative way to perform the above computation, which is often easier because it helps to avoid uncertainties that exist in the definition of "securities," is to focus on assets that clearly are not securities (*e.g.*, inventory, property, plant and equipment) and determine whether these assets exceed 60% of total assets.

Rule 3a-1 Issuer

Even if an issuer constitutes a prima facie investment company under the 1940 Act, it will not be deemed an investment company under the 1940 Act if, pursuant to Rule 3a-1, (i) no

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[1] The Rule 3a-1 exemption is only available to those issuers falling under the 1940 Act's definition of "investment company" in Section 3(a)(1)(C), but not to those covered by Sections 3(a)(1)(A) and (B). See 1 TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS §6.17 (2d ed. Supp. 2004).

[2] *E.g.*, cash on hand, demand (not time) deposits, checks payable in immediately available funds, cashier checks, bank drafts and letters of credit. Certificates of deposit generally would not be considered cash items. In SEC No-Action Letter, Willkie Farr & Gallagher, available Oct. 23, 2000, the SEC agreed that (subject to the terms and conditions set forth in the letter) an issuer may treat as cash items for purposes of Section 3(a)(1)(C) of the 1940 Act , and Rule 3a-1 thereunder, shares of a registered investment company that holds itself out as a money market fund and seeks to maintain a stable net asset value of U.S.$1.00 per share.

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more than 45% of the aggregate value of the issuer's assets, consolidated only with the assets of any wholly-owned subsidiary (exclusive of Government securities and cash items), consists of securities other than "Good Assets" and (ii) no more than 45% of the issuer's net income after taxes, again consolidated only with the net income of any wholly-owned subsidiary (for the last four fiscal quarters combined) is derived from securities other than "Good Assets."[3] "Good Assets" include government securities, securities issued by employees' securities companies, securities issued by wholly owned subsidiaries[4] as well as companies controlled primarily by the issuer that are not themselves investment companies, and various assets other than securities.

TRANSIENT INVESTMENT COMPANIES

Rule 3a-2 under the 1940 Act permits an issuer to be deemed not to be engaged in the business of investing, reinvesting, owning, holding or trading in securities during a period not exceeding one year provided that the issuer has a *bona fide* intent to be engaged primarily as soon as reasonably possible in a business other than the foregoing and meets the other conditions of the Rule (including an appropriate resolution of the issuer's board of directors). This exemption may be relied upon only once in three years.

COMMERCIAL PAPER FINANCE SUBSIDIARIES

Generally speaking, Rule 3a-3 under the 1940 Act exempts from the registration provisions thereof any wholly-owned finance subsidiary that only issues short-term paper with a maturity of no more than nine months and whose parent does not fall within the 1940 Act definition of an investment company. Subsidiaries of certain types of parents (*e.g.*, those described below as primarily engaged in holding receivables) may not rely on Rule 3a-3 since the parent is technically an investment company in the first instance and relies on Section 3(c) of the 1940 Act for exemption.[5]

FINANCE SUBSIDIARIES

Rule 3a-5 under the 1940 Act is intended to exempt from the definition of investment company any issuer that is organized primarily to finance the business operations of its parent company and any subsidiaries of the parent company. Rule 3a-5 applies to any finance subsidiary wholly-owned by the parent or companies controlled by the parent if the securities it sells to the public in the United States are unconditionally guaranteed by its parent and at least 85% of the funds raised are advanced to its parent or an issuer controlled by its parent. In the case of non-voting preferred stock issued by the finance subsidiary, the guarantee need only extend to dividends which have been declared by the subsidiary's board of directors and, upon liquidation, the lower of the liquidation preference plus accumulated and unpaid dividends, or

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[3] The issuer's holdings of securities of less than wholly-owned subsidiaries, and its net income derived therefrom, are examined on an unconsolidated basis.

[4] Although Rule 3a-1 under the 1940 Act has not been revised specifically to exclude securities issued by Section 3(c)(7) companies from being treated as "Good Assets," there is a significant risk that the SEC will interpret the rule in that fashion.

[5] For additional information, see Chapter 10 (*Finance Subsidiaries*) of this volume.

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the subsidiary's remaining assets after satisfaction of prior claims.[6] It is uncertain whether the parent company must guarantee the cash equivalent value of the subsidiary's assets, or whether it is enough for the parent company only to guarantee that the subsidiary's asset be distributed. Although the SEC has granted a no-action letter where the company argued in favor of the latter, the SEC has not explicitly stated its position on this issue.[7]

As presently interpreted by the SEC, a support agreement does not satisfy the guarantee requirements of Rule 3a-5. However, the staff of the SEC has acknowledged that a guarantee is not required in connection with securities that are privately placed[8] or sold pursuant to Regulation S,[9] even if the securities are eligible for resale pursuant to Rule 144A.[10] Moreover, a letter of credit meeting certain prescribed conditions and issued by a parent that is a "foreign bank" under Rule 3a-6 under the 1940 Act may be used in lieu of a guarantee.

Rule 3a-5 also limits the types of short term investments that a finance subsidiary may make. The SEC has granted no action relief to finance subsidiaries investing in instruments not specifically listed in the rule when such instruments are consistent with the rule's purpose.[11] No-action relief has also been granted with respect to business trusts under the rule.[12]

NON-U.S. BANKS, INSURANCE COMPANIES AND SIMILAR INSTITUTIONS

Rule 3a-6 under the 1940 Act provides that non-U.S. banks, insurance companies and certain other specified institutions that issue securities in the United States and meet the definitional and other requirements of the Rule do not have to register under the 1940 Act. Among other applicable requirements, a foreign bank must be "engaged substantially in commercial banking activity."[13] U.S. branches of non-U.S. banks, however, may be exempt under Section 3(c)(3) of the 1940 Act, the same statutory exception available to U.S. banks. Because Rule 3a-6 exempts their subsidiaries, non-U.S. banks or insurance holding companies generally need not register under the 1940 Act.

STRUCTURED FINANCING VEHICLES

Rule 3a-7 under the 1940 Act exempts from the definition of investment company any structured financing vehicle that complies with the terms of the rule. In the release adopting

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6 See SEC No-Action Letter Chieftain International Funding Corp., available Nov. 3, 1992.

7 See SEC No-Action Letter KDSM, Inc., Sinclair Capital, available Feb. 21, 1997.

8 See SEC No-Action Letter PSEG Capital Corp., available July 13, 1988; see also SEC No-Action Letter Econo Lodges of America, Inc., available Dec. 22, 1989.

9 See SEC No-Action Letter Societe Generale and SGA Societe Generale Acceptance, available Feb. 14, 1992.

10 See SEC No-Action Letter Sony Capital Corporation, available Apr. 27, 1992.

11 See SEC No-Action Letter Hewlett Packard Finance Company, available July 17, 1996.

12 See Chapter 10 (*Finance Subsidiaries*) of this volume.

13 For discussion of what might be deemed to constitute such activity, see SEC No-Action Letter Seward & Kissel, available Oct. 12, 2005.

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Rule 3a-7,[14] the SEC indicated that the terms of Rule 3a-7 are intended to reflect the structural and operational distinctions between registered investment companies and structured financing vehicles and incorporate investor protections currently imposed by the market. Rule 3a-7 also is intended to accommodate future innovations in the structured finance market, consistent with investor protection. However, the SEC staff is currently construing the terms of Rule 3a-7 very narrowly, making it especially important to identify potential interpretative issues.

Rule 3a-7 exempts qualifying structured financing vehicles that invest in virtually any type of security (other than common or preferred stock), including notes, bonds, debentures, evidences of indebtedness, certificates of deposit, leases, installment contracts, interest rate swaps, repurchase agreements, guaranteed investment contracts, accounts receivable, chattel paper, guarantees, annuities, credit card receivables, revolving home equity loans, dealer warehouse receivables and mortgage pass-through certificates. Rule 3a-7 also permits the holding of various assets for the purpose of credit enhancement, as well as ancillary or incidental assets.

In order to qualify for Rule 3a-7, an issuer must be engaged in the business of purchasing, or otherwise acquiring, and holding eligible assets[15] (and in activities related or incidental thereto), and may not issue securities redeemable at the option of the holder. A redeemable security has been broadly defined by the SEC staff to include many types of securities containing put provisions.[16]

The following conditions also apply:

(1) The issuer must issue fixed-income securities or other securities which entitle their holders to receive payments that depend primarily on the cash flow from eligible assets. Thus, securities that depend upon market value fluctuations of underlying assets do not qualify.

(2) Securities sold by the issuer or any underwriter must be fixed-income securities rated, at the time of initial sale, in one of the four highest categories assigned to long-term debt or in an equivalent short-term debt category by at least one NRSRO that is not an affiliated person of the issuer or of any person involved in the organization or operation of the issuer, except that:

- any fixed-income securities, rated or not, may be sold to institutional accredited investors; and

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14 See SEC Release No. IC-19105 (Nov. 19, 1992) (hyperlink unavailable).

15 The term "eligible assets" is defined as "financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure servicing or timely distribution of proceeds to the securityholders." Compare to the definition of "asset-backed security" in Regulation AB referenced in the instructions to Form S-3.

16 See SEC No-Action Letter Nebraska Higher Education Loan Program, Inc., available Apr. 3, 1998.

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- any securities may be sold to QIBs and to persons (other than any rating agency rating the issuer's securities) involved in the organization or operation of the issuer or an affiliate of such person,

provided that the issuer or any underwriter effecting such sale exercises reasonable care to ensure that such securities are sold and will be resold to institutional accredited investors or QIBs, as the case may be.

(3) The issuer may acquire additional eligible assets, or dispose of eligible assets, only if:

- the assets are acquired or disposed of in accordance with the terms and conditions set forth in the agreements, indentures, or other instruments pursuant to which the issuer's securities are issued;

- the acquisition or disposition of the assets does not result in a downgrading of the rating of the issuer's outstanding fixed-income securities; and

- the assets are not acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes.

(4) If the issuer issues any securities other than Section 3(a)(3) commercial paper, the issuer must appoint an independent trustee which, among other things, meets the requirements of the 1940 Act. The trustee need not be a U.S. bank.[17] The issuer must take reasonable steps to cause the trustee to have a perfected security interest or ownership interest valid against third parties in the eligible assets that principally generate the cash flow needed to pay the fixed-income securityholders. The cash flows must be deposited periodically in a segregated account maintained or controlled by the trustee.

[17] Effective May 12, 2001, the Gramm-Leach-Bliley Act of 1999 expanded the 1940 Act's definition of "bank" to include not only those organized pursuant to the laws of the United States, but also "branch[es] or agenc[ies] of a foreign bank (as such terms are defined in Section 1(b) of the International Banking Act of 1978)" as well. As such, a branch or agency of a non-U.S. bank (as defined above) may also be an acceptable trustee for purposes of Rule 3a-7 under the 1940 Act.

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CERTAIN RESEARCH AND DEVELOPMENT COMPANIES

Rule 3a-8 under the 1940 Act provides a nonexclusive safe harbor from the definition of investment company for certain *bona fide* research and development companies. An issuer will be eligible to use Rule 3a-8 if:

(1) its research and development expenses, for the last four fiscal quarters combined, are a substantial percentage of its total expenses for the same period;[18]

(2) its net income derived from investments in securities, for the last four fiscal quarters combined, does not exceed twice the amount of its research and development expenses for the same period;

(3) its expenses for investment advisory and management activities, investment research and custody, for the last four fiscal quarters combined, do not exceed 5% of its total expenses for the same period;

(4) its investments in securities, with certain exceptions, are capital preservation investments;

(5) it does not hold itself out as being engaged in the business of investing, reinvesting or trading in securities, and it is not a special situation investment company;

(6) it is primarily engaged, directly, through majority-owned subsidiaries, or through companies which it controls primarily, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities; and

(7) its board of directors has adopted a written investment policy with respect to the issuer's capital preservation investments.

The SEC has provided guidance on proposed investments that may constitute "capital preservations investments" for purposes of Rule 3a-8(b)(4).[19]

PRIVATE INVESTMENT COMPANIES

Section 3(c)(1) of the 1940 Act affords an exemption from 1940 Act registration that is commonly used in connection with structured financings and in financings where the issuer is an operating company whose assets (*e.g.*, leases or promissory notes) cause the issuer to be considered an investment company. Section 3(c)(1) excludes from the definition of investment company:

[18] The SEC has provided guidance on what constitutes a "substantial percentage" for this purpose. See SEC No-Action Letter Cooley Godward Kronish LLP, available July 12, 2007.

[19] See SEC No-Action Letter Ark Therapeutics Group plc, available Apr. 13, 2005.

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> [a]ny issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities.

In order for an issuer to comply with Section 3(c)(1) as interpreted by the SEC, all of its securities must be privately offered pursuant to Section 4(2) or Regulation D under the 1933 Act and the number of beneficial owners of its securities (other than holders of its short term paper) must be 100 or less.[20] The 100-owner limit is an ongoing restriction, which necessitates certain transfer restrictions and related procedures. When counting the number of securityholders, attribution rules apply to certain investors holding 10% or more of an issuer's voting securities.[21] The SEC has adopted Rule 3c-5 under the 1940 Act which generally permits "knowledgeable employees" of a Section 3(c)(1) issuer, subject to the requirements of the rule, to acquire securities issued by the issuer without being counted as a beneficial owner for purposes of the 100-owner limit. There are various SEC interpretations regarding ownership by certain entities such as retirement plans, trusts and partnerships.[22]

Despite compliance with the express provisions of Section 3(c)(1), the SEC may look through entities that exist only to circumvent the 1940 Act. Such determinations are ultimately based on an analysis of all of the surrounding facts and circumstances.[23] However, when an issuer represents that it will not invest more than 40% of its committed capital in the Section 3(c)(1) company, the SEC has generally granted no-action relief.

QUALIFIED PURCHASER EXEMPTION

Section 3(c)(7) of the 1940 Act exempts from the provisions of the 1940 Act any issuer whose securities are (1) privately offered and (2) beneficially owned exclusively by one or more persons who were "qualified purchasers" at the time of the acquisition.[24] Section 2(a)(51) of the 1940 Act defines "qualified purchaser" to include (1) individuals and certain family companies

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[20] It should be noted that, as interpreted by the SEC, the 100-owner limit is imposed differently depending upon the residency of the issuer. If the issuer is a U.S. issuer, the 100-owner limit applies to all holders. If, on the other hand, the issuer is a non-U.S. issuer, the 100-owner limit applies to U.S. residents. See, *e.g.*, SEC No-Action Letter Touche Remnant & Co., available Aug. 27, 1984. Furthermore, in the case of a non-U.S. issuer, the SEC has indicated that the 100-owner limit need not apply to those U.S. residents who purchased their securities while residing outside the United States and have subsequently relocated to the United States or to those U.S. residents who make offshore secondary market purchases without the involvement of the non-U.S. issuer, its affiliates, agents or intermediaries. See SEC No-Action Letter Investment Funds Institute of Canada, available Mar. 4, 1996.

[21] Beneficial ownership by a company is considered beneficial ownership by one person unless the company (1) owns 10% or more the issuer's outstanding voting securities and (2) is an investment company or would be considered an investment company but for the exceptions provided in Section 3(c)(1) or 3(c)(7). If the company satisfies these two conditions, the beneficial ownership is considered that of the holders of the company's outstanding securities (other than short-term paper).

[22] For SEC discussion of these and related issues, see SEC No-Action Letter American Bar Association Section of Business Law, available Apr. 22, 1999 (the "ABA Letter").

[23] See SEC No-Action Letter Cornish & Carey Commercial, Inc., available June 21, 1996.

[24] Section 3(c)(7) was added to the 1940 Act by the NSMIA.

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that have no less than U.S.$5 million in "investments" (as defined by the SEC),[25] (2) certain trusts if both the trustee or other person with investment discretion and all settlors or other contributors are "qualified purchasers," and (3) other persons that own and invest on a discretionary basis no less than U.S.$25 million in "investments." Rule 3c-5, described above, permits knowledgeable employees of a Section 3(c)(7) issuer to acquire securities without being qualified purchasers.

Foreign private issuers not registered under the 1940 Act may privately offer and sell their securities to qualified purchasers in the United States in accordance with the provisions of Section 3(c)(7) without violating Section 7(d) of the 1940 Act, even while offering securities publicly offshore.[26] Securities offered or sold offshore by such issuers may move onshore (even to purchasers who are not qualified purchasers) so long as such movement is not a result of any action taken by the issuer, its agents, affiliates, or intermediaries. Thus, the SEC staff has approached certain interpretive issues under Section 3(c)(7) in a manner similar to approaches taken under Section 3(c)(1).[27]

The qualified purchaser exemption is an ongoing test that applies to resales as well as initial sales of securities. Thus, for an issuer to remain covered by this exemption, every buyer that participates in a resale must satisfy the qualified purchaser definition as provided in Section 2(a)(51) and the rules thereunder. The SEC has simplified this problem somewhat in certain cases by adopting a rule under Section 2(a)(51) that provides that QIBs are generally treated as qualified purchasers for purposes of Section 3(c)(7), so long as they are acting for their own account or the account of another QIB that is a qualified purchaser.[28] In addition, the SEC has adopted a reasonable belief standard to determine whether a prospective qualified purchaser is actually a qualified purchaser. Issuers that reasonably believe a purchaser of securities is a qualified purchaser are covered by the qualified purchaser exemption.

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[25] See Rule 2a51-1 under the 1940 Act.

[26] See, *e.g.*, SEC No-Action Letter Goodwin, Procter & Hoar, available Feb. 28, 1997.

[27] Id. See, generally, the ABA Letter.

[28] Rule 2a51-1(g) under the 1940 Act enumerates two specific exceptions to the treatment of QIBs as qualified purchasers. The first exception relates to dealers. To be considered a qualified purchaser, a dealer must own and invest in a discretionary basis U.S.$25 million of securities of unaffiliated issuers. However, a dealer that does not meet this standard could still be a qualified purchaser if the dealer owns and invests on a discretionary basis U.S.$25 million of investments determined in accordance with Rule 2a51-1. The second exception relates to employee benefit plans and their related trusts. Self-directed employee benefit plans are generally not considered qualified purchasers for purposes of Rule 2a51-1. Issuers should look through the plan to its participants to determine whether each investor is a qualified purchaser. Two other more general exceptions are found in Rule 2a51-3 and Section 2(a)(51)(C) of the 1940 Act. Rule 2a51-3 states that a company will not be deemed a qualified purchaser if it was formed for the specific purpose of acquiring the securities offered by a company excluded from the definition of investment company by Section 3(c)(7) unless each of its beneficial owners is a qualified purchaser. Section 2(a)(51)(C) mandates that privately offered funds wishing to be considered qualified purchasers must obtain the unanimous consent of all beneficial owners that invested in the fund other than for short-term paper on or before April 30, 1996.

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Foreign private issuers intending to rely on Section 3(c)(7) should consult U.S. counsel with respect to procedures to be considered if they wish to use the book-entry facilities of DTC with respect to securities issuances to qualified purchasers.[29]

ENTITIES PRIMARILY ENGAGED IN HOLDING RECEIVABLES, REAL ESTATE OR MORTGAGES

Section 3(c)(5) of the 1940 Act is commonly used by non-bank financial institutions such as traditional sales finance companies and mortgage banks. Section 3(c)(5) provides a statutory exception generally to issuers that do not issue securities redeemable at the option of the holder and are primarily engaged in one or more of the following businesses:

(1) purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance and services;

(2) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services; and

(3) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

Frequently, sales finance companies and leasing companies do not qualify for the Section 3(c)(5) exception because their credit operations are not secured by specific merchandise. The SEC has taken the view that notes representing general loans for unspecified goods and services, even if secured by collateral typically associated with sales financing, do not qualify as receivables under Sections 3(c)(5)(A) and (B).[30] As such, generalized credit operations not tied to sales financings or holding receivables with respect to specific merchandise or services are not entitled to the Section 3(c)(5)(B) exception.[31]

In connection with establishing U.S. commercial paper and medium-term note programs, a number of U.S. leasing company subsidiaries of non-U.S. corporations, particularly non-U.S. leasing companies, have encountered additional difficulties when seeking to avoid registration under the 1940 Act. For example, it is presently unclear whether leases constitute securities for purposes of the 1940 Act. If they do, then the leasing companies would constitute investment companies for purposes of the 1940 Act. If the leases constitute sales financings (*i.e.*, the leased property may be purchased by the lessee for nominal consideration at the end of the lease term), then the Section 3(c)(5)(A) exception may be available.

Another issue that frequently arises is whether the securities proposed to be issued may be viewed by the SEC as redeemable, thus making the Section 3(c)(5) exception unavailable.

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29 See "New Developments in Procedures for Book-Entry Deposit of Rule 144A Securities by 3(c)(7) Issuers," The Investment Lawyer, Vol. 10, March-April 2003.

30 See, *e.g.*, SEC No-Action Letter New England Education Loan Marketing Corporation, available May 22, 1998.

31 See, *e.g.*, SEC No-Action Letter Alleco, Inc., available July 14, 1988.

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The SEC considers debt securities to be redeemable when the holder is able to put the securities back to the issuer or its agent. Where the put is available only under very limited circumstances, however, it will not invalidate the exception. Put features should be examined on a case-by-case basis to determine whether the exception is available.

The Section 3(c)(5) exception under the 1940 Act is used not only by operating companies, but also for many types of structured financings involving mortgages and other financial assets. Regardless of the type of entity relying on the exemption, however, certain asset composition tests must be met. In the case of Sections 3(c)(5)(A) and 3(c)(5)(B), it is generally advisable that at least 65% of the issuer's assets be of the specified type. In the case of Section 3(c)(5)(C), regarding mortgage and real estate assets, there is generally a more complicated formula under which at least 55% of the assets must be of the type specified and at least 80% of the assets must consist of mortgage and real estate assets or a combination of those assets and other assets related thereto.[32] Whole pool mortgage-backed securities have been viewed by the SEC as the equivalent of mortgage loans for purposes of this exception.[33]

32 See, *e.g.*, SEC No-Action Letters Cititrust, available Dec. 19, 1990; Greenwich Capital, available Aug. 8, 1991; see also SEC No-Action Letter NAB Asset Corp., available June 20, 1991.

33 See, SEC No-Action Letter Capital Trust Inc., available May 24, 2007 (in the circumstances outlined in the letter, a Tier 1 mezzanine loan was found to be a "qualifying interest").

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SECTION V: SELECTED ISSUERS

In most cases, the 1933 Act and the 1934 Act and the SEC, through its rules, regulations, interpretations and other actions, establish the disclosure and reporting requirements for issuers of securities in the U.S. capital markets. However, the 1933 Act and the 1934 Act sometimes distinguish among certain types of issuers. Accordingly, the SEC and other applicable U.S. securities industry regulators have adopted rules, regulations and interpretations that apply only to, specific types of issuers. Finance subsidiaries, REITs, banks and bank holding companies, Canadian issuers and foreign governmental issuers are among those and are discussed in this section.

The SEC has also adopted, under the 1933 Act and the 1934 Act, certain industry guides that require specialized disclosure with respect to specified industries. These guides, which can be found at http://www.sec.gov/about/forms/industryguides.pdf, need to be considered whenever preparing disclosure with respect to issuers to which they apply, cover the following matters:

- Disclosure of Oil and Gas Operations (currently Guide 2);[1]
- Statistical Disclosure by Bank Holding Companies (Guide 3);
- Interests in Oil and Gas Programs (Guide 4);
- Interests in Real Estate Limited Partnerships (Guide 5);
- Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters (Guide 6); and
- Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations (Guide 7).

[1] See SEC Release No. 33-8995 (Dec. 31, 2008) (http://www.sec.gov/rules/final/2008/33-8995.pdf), which codifies and revises the provisions currently set forth in Industry Guide 2 in Regulation S-K, and harmonizes oil and gas disclosures by foreign private issuers with disclosures for U.S. issuers for fiscal years ending on or after January 1, 2010.

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CHAPTER 10

FINANCE SUBSIDIARIES

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GENERAL

Many issuers access the U.S. capital markets through a special purpose U.S. finance subsidiary, which may issue commercial paper, medium-term notes, other debt securities and preferred securities. The proceeds from securities issued by these finance subsidiaries are advanced to the parent or to the parent's operating subsidiaries. Issuers also access the U.S. capital markets through sales finance company subsidiaries (*i.e.*, traditional finance companies).

An issuer may derive significant benefits by establishing a special purpose U.S. finance subsidiary. A U.S. finance subsidiary generally expands the market of eligible investors for a foreign issuer because certain U.S. institutional investors are limited (by corporate policy or otherwise) in the amount of non-U.S. securities they may purchase. A special-purpose finance subsidiary provides an effective vehicle for credit-enhancing securities through asset over-collateralization or a letter of credit. With such credit enhancement, a finance subsidiary provides a way to issue highly-rated securities without requiring the parent to go through the rating process. In recent years, finance subsidiaries have enabled issuers to raise funds through the issuance of instruments that count as capital for regulatory, rating agency and other purposes.

Special-purpose finance subsidiaries organized in the United States to issue securities primarily in U.S. capital markets are generally organized under the laws of the State of Delaware. Delaware is customarily chosen because it does not impose burdensome restrictions on corporations, limited liability companies, statutory trusts and similar entities. Also, its entity level taxes are minimal and its corporation and trust laws have been extensively construed by the courts, thereby providing clear and modern precedent defining the rights and obligations of the entity and its directors, partners, trustees and/or securityholders. Organization in Delaware is a simple process. Corporate action may generally be taken by written consent. The board of directors may consist of a single person, and the directors need not be U.S. citizens or residents.

1933 ACT CONSIDERATIONS

To enhance the credit of a finance subsidiary, an issuer may need to issue a guarantee of the subsidiary's securities or enter into a support agreement with the finance subsidiary. If the credit enhancement is a guarantee, then the guarantee and the securities of the finance subsidiary constitute separate securities for purposes of the 1933 Act. Accordingly, for a registered public offering, both the issuer and the finance company would jointly file a 1933 Act registration statement. As discussed in Chapter 3 (*The Securities Registration and Reporting Process*) of this

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volume, the finance subsidiary would be eligible to file on the same 1933 Act registration statement as the issuer, including the abbreviated Forms S-3 and F-3 (if applicable).

The information that a finance subsidiary must provide for guaranteed securities in registration statements under the 1933 Act and registration statements and reports under the 1934 Act will depend on the business of the finance subsidiary and the nature of the guarantee.[1] If the credit enhancement for a finance subsidiary is a guarantee and the subsidiary is only a wholly-owned funding conduit with no independent operations, the SEC's rules will not require the subsidiary to include separate financial statements in the 1933 Act registration or to comply, as a separate registrant, with the reporting requirements of the 1934 Act.[2]

Our understanding of the disclosure required for a finance subsidiary and its non-U.S. parent where the credit enhancement is a support agreement is discussed in this chapter below under the heading "—Support Agreements."

If the credit enhancement for a finance subsidiary consists of a bank letter of credit, its securities should be exempt from registration under the 1933 Act by virtue of Section 3(a)(2).[3]

1940 ACT CONSIDERATIONS

In order to avoid the registration provisions of the 1940 Act, no more than 40% of a finance subsidiary's assets may be "investment securities" (as defined in the 1940 Act), or the finance subsidiary must find an available 1940 Act exemption. The SEC considers advances or loans to other entities, including related companies, to be "securities" for purposes of the 1940 Act. Since most finance subsidiaries are funding conduits with no independent operations, they fail the 40% test and must use another available exemption from the 1940 Act. Rules 3a-5, 3a-3 and 3a-7 and Sections 3(c)(1) and 3(c)(7) provide possible exemptions from the 1940 Act for finance subsidiaries. In addition, Section 3(c)(5) provides an exemption for certain sales finance subsidiaries.

Rule 3a-5

Rule 3a-5 is known as the "finance subsidiary" exemption. It was adopted by the SEC to avoid the definitional problem of the 1940 Act that otherwise would cause finance subsidiaries that are merely funding conduits to be subject to the 1940 Act. A finance subsidiary[4] must satisfy the following conditions in order to qualify under Rule 3a-5:

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1 If the finance subsidiary is an operating company, additional business and financial disclosure will be required.

2 Rule 3-10 under Regulation S-X and Rule 12h-5 under the 1934 Act. Modified financial presentations may be permitted for wholly-owned operating companies enjoying a parent's unconditional guarantee. Separate 1934 Act reports are likewise not required in these circumstances.

3 See Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

4 Paragraph (b)(1) of Rule 3a-5 under the 1940 Act requires that the finance subsidiary be a corporation, although the SEC staff has permitted limited liability companies, partnerships and business trusts meeting certain requirements and issuing certain types of non-voting securities to rely on the rule. See, *e.g.*, SEC No-Action Letters Inco Limited, available Mar. 4, 1994; Lehman Brothers, Inc., available Mar. 8, 1994

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(1) any debt or preferred stock issued to or held by the public must be unconditionally guaranteed by its parent;[5,6,7]

(2) at least 85% of the funds raised by the finance subsidiary must be advanced as soon as practicable, but in any event within six months, to its parent or to another company controlled by its parent;[8]

(relating to limited liability companies); Andrews & Kurth L.L.P., available Apr. 5, 1994 (relating to partnerships); Goldman, Sachs & Co., available Apr. 27, 1995; Merrill Lynch & Co., available May 25, 1995; and Lehman Brothers, Inc., available May 26, 1995 (relating to Delaware business trusts).

5 The term "parent company" is defined in Rule 3a-5(b)(2) under the 1940 Act as an entity that is not an investment company under Section 3(a) of the 1940 Act or that is excepted or exempted by order from the definition of investment company by Section 3(b) of the 1940 Act or by rules adopted by the SEC under Section 3(a). Thus, the parent must be analyzed separately under the 1940 Act. Entities whose parents must rely upon an exemption from the 1940 Act under Section 3(c) (such as U.S. insurance companies, sales finance companies, broker-dealers and similar companies) may not be able to utilize Rule 3a-5, although exemptions from this aspect of Rule 3a-5 are often granted. See, *e.g.*, MBIA Global Funding, LLC (SEC Release No. IC-26751, File No. 812-12987 (Feb. 8, 2005) (notice); SEC Release No. IC-26785 (Mar. 17, 2005) (order)); LaSalle Funding LLC (SEC Release No. IC-25457, File No. 812-12706 (Mar. 11, 2002) (notice); SEC Release No. IC-25514 (Apr. 9, 2002) (order)); BHF Finance (Delaware) Inc. (SEC Release No. 25151, File No. 812-12596 (Sept. 6, 2001) (notice); SEC Release No. IC-25202 (Sept. 28, 2001) (order)); American International Group, Inc. et al. (SEC Release No. IC-24284, File No. 812-11714 (Feb. 10, 2000) (notice); SEC Release No. IC-24331 (Mar. 7, 2000) (order)); The Toronto-Dominion Bank, et al. (SEC Release No. IC-24258, File No. 812-11306 (Jan. 20, 2000) (notice); SEC Release No. IC-24289, File No. 812-11306 (Feb. 15, 2000) (order)). Non-U.S. banks and non-U.S. insurance companies (unlike their U.S. counterparts) may be able to establish finance subsidiaries qualifying under Rule 3a-5. See Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume. In addition, the parent company must be a private issuer, not a governmental entity. See Rule 3a-5(b)(2)(ii).

6 Under certain circumstances, the 85% requirement may be interpreted on a cumulative rather than an offering-by-offering basis. See SEC No-Action Letter KDSM, Inc. and Sinclair Capital, available Mar. 17, 1997.

7 The staff of the SEC has acknowledged that neither privately placed securities nor securities sold under Regulation S require a guarantee, even if the securities are eligible for resale pursuant to Rule 144A under the 1933 Act. See SEC No-Action Letters Societe Generale and SGA Societe Generale Acceptance, available Feb. 14, 1992; PSEG Capital Corporation, available July 13, 1988; Sony Capital Corporation, available Apr. 27, 1992; and MEC Finance USA Inc., available Oct. 25, 1991. In addition, the parent's requirements in the case of preferred stock are solely that it unconditionally guarantee payment of declared dividends and, in the event of liquidation, unconditionally guarantee the payment of the lesser of the full liquidation preference plus accumulated and unpaid dividends, or the amount of the subsidiary's assets remaining after the satisfaction of other parties having claims which, as a matter of law, are prior to those of the preferred stockholders. SEC No-Action Letters Cleary, Gottlieb, Steen & Hamilton, available Dec. 23, 1985; Chieftain International Funding Corp., available Nov. 3, 1992. For further explanation of the requirement of a guarantee of preferred stock, see SEC No-Action Letter KDSM, Inc. and Sinclair Capital, available Mar. 17, 1997.

8 The term "company controlled by a parent company" is defined in Rule 3a-5(b)(3) under the 1940 Act as any company that is more than 25% owned by the parent and, like the parent, is not an investment company under Section 3(a) or is excepted or exempted by order or by Section 3(b) or rules adopted by the SEC under Section 3(a). Entities which invest in or make loans to companies controlled by their parent company which fall within an exemption from the 1940 Act under Section 3(c) may not be able to utilize Rule 3a-5, although exemptions from this aspect of the rule are often granted. See, *e.g.*, J.P. Morgan Index Funding Company I, et al. (SEC Release Nos. 22713, 812-10572 (June 17, 1997) (notice); SEC Release

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(3) the subsidiary's assets must be limited to U.S. government securities, securities of its parent company or an issuer controlled by its parent company, commercial paper exempt under Section 3(a)(3) of the 1933 Act, and loans to related companies;[9]

(4) all of its common stock and other voting stock (other than directors' qualifying shares) must be owned, directly or indirectly, by an eligible parent company;[10]

(5) the primary purpose of the subsidiary must be to finance the business operations of its parent or companies controlled by its parent;[11]

(6) the parent company's guarantee must provide that in the event of a default in payment, the holders of the securities may proceed directly against the parent company; and

(7) any securities issued by the finance subsidiary which are convertible or exchangeable are convertible or exchangeable only for securities issued by the parent company or for debt securities or non-voting preferred stock issued by the finance subsidiary meeting applicable requirements of Rule 3a-5.

Some issuers are unable to take advantage of Rule 3a-5 because they have not used guarantees to enhance the credit of securities issued by their finance subsidiaries. For example, in lieu of guarantees, Japanese issuers have in the past either entered into a support or "keepwell" agreement with the finance subsidiary (discussed below) or entered into a reimbursement agreement with a bank that issues a letter of credit that backs the securities of the finance subsidiary. Although generally neither of the foregoing currently qualifies as a guarantee for purposes of Rule 3a-5, the rule provides that a letter of credit meeting certain prescribed

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No. 22750 (July 15, 1997) (order)); American International Group, Inc. et al. (SEC Release Nos. 24284, 812-11714 (Feb. 10, 2000) (notice); SEC Release No. 24331 (Mar. 7, 2000) (order)); LaSalle Funding LLC (SEC Release Nos. 25457, 812-12706 (Mar. 11, 2002) (notice); SEC Release No 25514 (Apr. 9, 2002) (order)).

9 The SEC staff has also permitted certain limited investments in demand and time deposits. See SEC No-Action Letter Hewlett-Packard Finance Company, available Oct. 7, 1992; see also IBM International Finance, N.V., et al (SEC Release No. 19548 (June 29, 1993) (notice); SEC Release No. 19602 (July 28, 1993) (order)). The SEC staff has also permitted certain limited investments in shares of money market mutual funds. See SEC No-Action Letter Hewlett-Packard Finance Company, available July 17, 1996.

10 The SEC, however, has permitted a Netherlands Antilles entity to hold all of a finance subsidiary's common stock for the benefit of a charity. See Cellco Finance N.V. (SEC Release Nos. 23118, 82-11108 (Apr. 20, 1998) (notice); SEC Release No. 23180 (May 12, 1998) (order)). The SEC staff stated that in certain limited circumstances a finance subsidiary would be permitted to have only one class of securities which would not be owned initially, or possibly ever, by the parent or a company controlled by the parent. See SEC No-Action Letter Brown & Wood, available Feb. 24, 2000 (although the parent would not own any securities of the business trust, it would control the entity in all material respects).

11 Under Rule 3a-5 under the 1940 Act, a finance subsidiary may have business operations as long as such operations are subsidiary to its primary purpose of financing its parent. See SEC No-Action Letter KDSM, Inc. and Sinclair Capital, available Mar. 17, 1997.

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conditions and issued by a parent that is a "foreign bank" under Rule 3a-6 under the 1940 Act may be used in lieu of a guarantee.[12]

Rule 3a-3

A finance subsidiary may issue short-term paper (as defined in the 1940 Act) without a parent guarantee in reliance upon Rule 3a-3 under the 1940 Act. The commercial paper need not be privately placed (as is the case of commercial paper issued by a Rule 3a-5 finance subsidiary which does not have a parent guarantee), but the exemption limits the fund-raising options of the finance subsidiary to commercial paper. The pertinent conditions of Rule 3a-3 are generally as follows:

(1) all the issuer's outstanding securities (other than short-term paper, directors' qualifying shares and debt securities owned by the U.S. Small Business Administration) must be directly or indirectly owned by its parent; and

(2) the parent and its wholly-owned subsidiaries may have no more than 45% of their consolidated assets invested in, and receive no more than 45% of their consolidated net income after taxes from, investment securities.[13]

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12 See Rule 3a-5(a)(7) under the 1940 Act. The SEC has also issued exemptive orders permitting alternatives to a guarantee. See, *e.g.*, FSA Capital Management Services LLC (SEC Release Nos. 25986, 812-12704 (Mar. 28, 2003) (notice); SEC Release No. 26009 (Apr. 27, 2003) (order)); Cellco Finance N.V. (SEC Release No. 23118, 812-11108 (Apr. 20, 1998) (notice); SEC Release No. 23180 (May 12, 1998) (order)); Bayerische Vereinsbank Aktiengesellschaft Vereinsbank Finance (SEC Release No. 21041 (May 4, 1995) (notice); SEC Release No. 21102 (May 31, 1995) (order)); Berliner Handels-und Frankfurter Bank (SEC Release No. 19603 (July 28, 1993) (notice); SEC Release No. 19649 (Aug. 24, 1993) (order)); WestLB Finance USA Inc. (SEC Release No. 18958 (Sept. 16, 1992) (notice); SEC Release No. 19014 (Oct. 14, 1992) (order)); Berliner Handels-und Frankfurter Bank (SEC Release No. 15188 (July 2, 1986) (notice); SEC Release No. 15230 (July 29, 1986) (order)) (where the subsidiaries' obligations were backed by a third party arrangement with a Cayman Islands branch of the parent bank; the third party branch, and hence the parent itself, assumed the obligations of the finance subsidiaries when the proceeds from the sale of the obligations were loaned to or deposited in the branch and assigned to the holders of the obligations as security for the obligations). See also, AMBAC Capital Management, Inc. (SEC Release No. 21115 (June 6, 1995) (notice); SEC Release No. 21182 (July 3, 1995) (order)) (parent corporation issued an unconditional insurance policy to back the obligations of its subsidiary; Southwestern Bell Capital Corporation (SEC Release No. 40-15388 (Oct. 31, 1986) (notice); SEC Release No. 40-15430 (Nov. 21, 1986) (order)); Pactel Capital Resources (SEC Release No. IC-14964 (Feb. 28, 1986) (notice); SEC Release No. IC-15014 (Mar. 25, 1986) (order)) (where the subsidiaries' obligations were backed by a support agreement enforceable directly by the holders of the obligation, and for regulatory reasons, the telephone companies could not guarantee subsidiary debt; the SEC viewed the support agreements as a satisfactory alternative).

13 Under the rule, the parent must be a company that, among other things, meets the requirements of Rule 3a-1(a) under the 1940 Act. Section 3(b)(3) provides an exemption similar to Rule 3a-3 for an entity whose parent is an investment company as defined in Section 3(a)(3) but that is excluded by Section 3(b). See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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Rule 3a-7

Rule 3a-7 exempts any structured finance vehicle in the business of acquiring and holding virtually any type of asset (other than equity securities) that can be securitized, provided the vehicle satisfies conditions adopted by the SEC to protect investors.[14]

Section 3(c)(1)

Section 3(c)(1) provides an exemption from the definition of "investment company" in the 1940 Act. A finance subsidiary meeting the qualifications of Section 3(c)(1) may issue securities without the restrictions that apply to private investment companies as to the type of securities offered. In order to qualify for the Section 3(c)(1) exemption, a finance subsidiary must satisfy the following conditions:

(1) its securities, other than short-term paper, may be beneficially owned by no more than 100 persons at any one time (after giving effect to the attribution provisions of the Section); and

(2) its securities must be sold in a private placement exempt from the provisions of the 1933 Act by virtue of Section 4(2) or Regulation D.[15]

Section 3(c)(5)

Sales finance companies are usually exempt from the provisions of the 1940 Act by Section 3(c)(5)(A) or (B), which exempt traditional finance companies.[16] As discussed in Chapter 9 (*1940 Act-Exempt Issuers*) of this volume, Section 3(c)(5) is available not only for operating companies but also for many types of structured financings involving mortgages and other financial assets.

Section 3(c)(7)

Section 3(c)(7) exempts from the provisions of the 1940 Act any issuer whose securities are privately offered and are beneficially owned exclusively by persons who, at the time of their acquisition, are "qualified purchasers." The definition of "qualified purchaser" is set forth in Section 2(a)(51) of the 1940 Act and the SEC rules thereunder.[17]

SUPPORT AGREEMENTS

Support or "keepwell" agreements have been used (in lieu of a parent guarantee) by issuers to enhance the credit of a finance subsidiary. A support agreement is designed to provide

[14] See Chapter 9 (*1940 Act-Exempt Issuers*) of this volume.

[15] For additional information, see Chapter 9 (*1940 Act-Exempt Issuers*) of this volume.

[16] As indicated above, traditional sales finance companies and mortgage banks that are themselves exempt from the 1940 Act by virtue of Section 3(c)(5) are generally prohibited from issuing securities through a special purpose finance subsidiary. See supra footnote 5.

[17] See Chapter 9 (*1940 Act-Exempt Issuers*) of this volume.

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comfort to investors and the rating agencies that the finance subsidiary will always have sufficient liquidity and solvency to pay its outstanding debts.

Rating Agency Requirements

In order for a finance subsidiary to obtain a rating comparable to that of its parent from an NRSRO, a support agreement should include the following:

(1) the parent should maintain, directly or indirectly, at least 51% of the voting control over the finance subsidiary;

(2) the parent should cause the finance subsidiary to maintain a positive net worth;

(3) the parent should cause the finance subsidiary to maintain liquid assets at all times in an amount sufficient to pay its obligations as they become due;

(4) the support agreement should not be amended, modified or cancelled if to do so would result in a downgrade of the finance subsidiary's outstanding securities;

(5) holders of the finance subsidiary's securities should have the right, derivative (*i.e.*, through the finance subsidiary) or otherwise, to enforce the support agreement against the parent; and

(6) if the parent is a non-U.S. parent, it should consent to personal and subject matter jurisdiction of U.S. courts in connection with its obligations under the support agreement.

1933 Act and 1934 Act Registration and Reporting Issues

If the parent of a finance subsidiary is not a reporting company under the 1934 Act, the SEC has generally required disclosure about the entities providing financial support. The SEC has not generally required such disclosure where the party providing the support files periodic information with or to the satisfaction of the SEC under the 1934 Act (other than providing information pursuant to Rule 12g3-2(b)) because such information is publicly available to investors in the U.S. capital markets.

In connection with a proposed registration of investment grade non-convertible debt securities by a U.S. finance subsidiary of a non-U.S. parent, the SEC has advised us that the following analysis applies to such securities if the non-U.S. parent is eligible to use Form F-3:

(1) The support agreement will not constitute a guarantee of the U.S. finance subsidiary's debt securities and therefore will not constitute a separate security of the parent requiring registration under the 1933 Act.

(2) The SEC will permit the U.S. finance subsidiary to register investment grade debt securities under the 1933 Act on Form S-3 pursuant to General Instruction 1.C.2.

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(3) The U.S. finance subsidiary's registration statement on Form S-3 can incorporate by reference a registration statement for the subsidiary filed under the 1934 Act on Form 10. The Form 10 registration statement should be filed prior to the registration statement on Form S-3 and should register the common stock of the U.S. finance subsidiary rather than any debt securities it may issue. In preparing the 1934 Act registration statement on Form 10, the U.S. finance subsidiary can rely, by analogy, on Instruction I to Form 10-K in omitting certain information otherwise required by Form 10, namely the information called for by Form 10-K in Item 6 (Selected Financial Data), Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations), Item 4 (Submission of Matters to a Vote of Security Holders), Item 10 (Directors and Executive Officers of the Registrant), Item 11 (Executive Compensation), Item 12 (Security Ownership of Certain Beneficial Owners and Management) and Item 13 (Certain Relationships and Related Transactions). The U.S. finance subsidiary's ability to rely on Instruction I will be contingent upon the satisfaction of the conditions set forth in Instruction I(1), *i.e.*, all of the U.S. finance subsidiary's equity securities must be owned by the ultimate non-U.S. parent or another reporting company under the 1934 Act that is current in its filing obligations and that has not, during the preceding 36 calendar months, defaulted on any indebtedness of such company or its subsidiaries or in the payment of rentals under material long-term leases.

(4) The sole registrant with respect to the 1934 Act and 1933 Act registration statements will be the U.S. finance subsidiary, and the only securities requiring registration under the 1933 Act will be the debt securities issued by the U.S. finance subsidiary. Full financial statements of the U.S. finance subsidiary audited in accordance with U.S. generally accepted accounting principles will be required to be included as part of the Form 10 registration statement. The non-U.S. parent will not be required to sign either the Form 10 or the Form S-3 registration statement. The staff of the SEC has an unofficial policy, however, of requiring certain financial statement disclosure by entities that provide credit enhancement for registered securities if the staff is of the opinion that the credit enhancement would be material to an investment decision regarding the securities being registered. Accordingly, pursuant to this policy, the staff of the SEC may require the U.S. finance subsidiary to incorporate by reference into its registration statement on Form S-3 the full financial statements of its non-U.S. parent, as filed annually on the parent's Form 20-F. No further disclosure, other than its annual financial statements, will be required. The non-U.S. parent will not be required to file financial statements (audited or unaudited) more frequently than annually.

(5) With respect to the U.S. finance subsidiary's ongoing reporting requirements under the 1934 Act, it will be required to file reports on Forms 10-K, 10-Q and 8-K as would any other U.S. issuer. Regarding the scope of disclosure in the U.S. finance subsidiary's annual report on Form 10-K, the staff of the SEC will not object to the U.S. finance subsidiary omitting disclosure in reliance upon Instruction I to Form 10-K (see (3) above) so long as the non-U.S. parent files its annual report on Form 20-F within 90 days of the end of its fiscal year. As a

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non-U.S. issuer, the non-U.S. parent is normally subject to a six-month standard for the filing of its annual report rather than the ninety-day standard applicable to U.S. issuers.[18] If the non-U.S. parent is unable to file its annual report within the shorter ninety-day period, the U.S. finance subsidiary may omit all disclosure permitted to be omitted under Instruction I except for that covered by Instruction I(2)(a), *i.e.*, the information called for by Form 10-K in Item 6 (Selected Financial Data), and Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations). In addition, consistent with the SEC staff's position in no-action letters, General Electric Financial Services, Inc., available June 25, 1986, Discover Credit Corp., available August 28, 1989, NationsBank Corporation, Nations Financial Holdings Corporation, available September 19, 1995, and Duke Capital Corp., available December 29, 1997, if common stock of the U.S. finance subsidiary is registered on Form 10, so long as the U.S. finance subsidiary is wholly-owned, directly or indirectly, by the non-U.S. parent, (1) the U.S. finance subsidiary will not be required to file proxy or information statements pursuant to Section 14 of the 1934 Act, (2) the U.S. finance subsidiary's officers, directors and shareholders will not be required to file reports with respect to its common stock under Section 16(a) of the 1934 Act, (3) the U.S. finance subsidiary's shareholders will not be required to file reports under Section 13(d) or (g) of the 1934 Act with respect to their holdings and (4) the filing requirements under Section 13(e) of the 1934 Act will be inapplicable with respect to transactions involving the common stock of the U.S. finance subsidiary.

In the case of a non-U.S. parent that enters into a support agreement for the benefit of an operating sales finance subsidiary that registers securities under the 1933 Act, the SEC will require disclosure of some nominal financial information on the non-U.S. parent if the parent is not a reporting company under the 1934 Act. Several years were spent negotiating the extent of the required disclosure with the SEC, with the result that the provider of the support agreement is not required to disclose its financial statements but is required to disclose some brief financial data. This information generally includes only the parent's total revenues and ratio of earnings to fixed charges for the last three years, as well as its total assets, net worth and a statement that net income in each of the last three years exceeded a stated level.

The SEC has exempted finance subsidiaries formed to issue debt securities or preferred stock from the periodic and current reporting requirements of the 1934 Act when the parent is a reporting company under the 1934 Act, the finance subsidiary is wholly-owned by the parent and has no independent operations, the parent has fully and unconditionally guaranteed all of the finance subsidiary's obligations under the outstanding securities and the holders of the securities may proceed directly against the non-U.S. parent to enforce the finance subsidiary's obligations.[19] The SEC has adopted Rule 12h-5 under the 1934 Act to exempt certain subsidiary issuers and subsidiary guarantors from the 1934 Act periodic reporting in cases where Rule 3-10

[18] See SEC Release No. 33-8959 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf). Foreign private issuers will be required to file their annual report on Form 20-F within four months after their fiscal year-end for fiscal years ending on or after December 15, 2011.

[19] However, as a condition to this position, the parent must include certain disclosure in its 1934 Act reports. See Rule 3-10 under Regulation S-X.

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of Regulation S-X permits certain financial information relating to such subsidiary issuers and subsidiary guarantors to be omitted from registration statements or reports filed with the SEC.[20]

TAXATION ISSUES

Thin capitalization, withholding tax, earnings stripping and other issues to be considered by non-U.S. issuers using U.S. finance subsidiaries are discussed in *Accessing the U.S. Capital Markets – Securities Products*.

[20] See SEC Release No. 33-7878 (Aug. 4, 2000) (http://www.sec.gov/rules/final/33-7878.htm).

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CHAPTER 11

REITS

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BACKGROUND AND HISTORY OF REITS

Real Estate Investment Trusts ("REITs") were first authorized in the United States by the adoption of the Real Estate Investment Trust Act of 1960.[1] Prior to that time, most commercial real estate in the United States was held primarily in partnership form. By adopting the REIT legislation, Congress sought to bolster the many parts of the economy dependent on real estate by encouraging broader investor participation in real estate. The early REITs were similar to closed-end investment companies in that they were pools of assets advised by professional, third-party managers and did not pay corporate level taxes. Many of the earlier REITs, however, were plagued by conflicts of interest and other problems that resulted in a general lack of confidence in them by the investment community. As a result of the enactment of the Tax Reform Act of 1986, REITs were permitted to operate and manage most types of income-producing properties. This development permitted REITs to internalize their property management and development activities and eliminate some of the structural conflicts of interest that had undermined the confidence of the investment community.

In 1991, Kimco Realty Corporation completed an initial public offering and listed its shares on the NYSE. This was a watershed event for the REIT market since Kimco did not fit the general profile of REITs that had previously gone public. Kimco was a large, fully-integrated private real estate organization that operated as a "real" business and not as an entity created to hold a portfolio of properties managed by an external manager. Through its initial public offering, Kimco was able to establish a platform for ongoing access to the capital markets, pay down existing indebtedness, and provide liquidity for its existing investors. (Sidley Austin acted as underwriters' counsel on the Kimco initial public offering.) Other real estate organizations quickly followed Kimco by transforming themselves into REITs through initial public offerings. These REITs varied by property type and geographic focus. Investors' confidence in the REIT format was bolstered by the willingness of these new REITs to adopt conservative debt policies and by the presence of a majority of independent members on boards of directors of REITs. REIT formation was further accelerated by the advent of the umbrella partnership REIT or "UPREIT," which is discussed below.

Since 2003, "qualifying dividends" paid by corporations that are themselves subject to taxation have been eligible to be taxed at reduced, capital gains rates. Because REITs receive a dividends paid deduction that enables them to regularly bypass the corporate tax, a majority of

[1] U.S. Internal Revenue Code Sections 856 through 859.

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REIT dividends (the most important exception being REIT dividends that are attributable to dividends the REIT receives from any "taxable REIT subsidiary") are generally ineligible for the reduced dividend rate. However, even on an after-tax basis at the maximum tax rates, REIT dividends on average continue to significantly exceed dividend levels of non-REITs. The reduced rate currently imposed on regular corporate dividends is scheduled to "sunset" after December 31, 2010, and the prospects for a legislative extension are uncertain as of the date of publication of this volume.

U.S. INTERNAL REVENUE CODE PROVISIONS

REITs are creatures of the U.S. Internal Revenue Code ("tax code") and are governed by a complex set of tax code provisions. In order to qualify as a REIT, among other requirements, a company must be formed as a corporation, business trust or similar vehicle, be managed by a board of directors or trustees and have at least 100 holders. In addition, shares of a REIT must be fully transferable and not more than 50% of a REIT's capital stock may be held by five or fewer individuals during the last half of the REIT's taxable year. For purposes of this "five-fifty" test, individuals include natural persons and certain entities, such as private foundations. REITs must also satisfy other tests, including:

- at least 90% of REIT taxable income must be distributed annually to holders;
- at least 75% of assets must be comprised of real estate assets (*e.g.*, real property, mortgage loans secured by interests in real property, etc.);
- at least 75% of REIT gross income must be comprised of rents from real property, interest on mortgage loans and certain other types of passive real estate-related income; and
- at least 95% of REIT gross income must be derived from the same items as the 75% income test and from passive investment sources such as dividends, interest and gain from the sale of securities.

A REIT must also satisfy certain other limitations on its assets. Ordinarily, a REIT cannot (1) invest more than 25% of its total assets in the securities of any one issuer, (2) invest more than 25% of its total assets in the securities of taxable REIT subsidiaries ("TRSs") or (3) own more than 10% (by vote or value) of any one issuer's securities (other than (i) wholly-owned entities treated as "qualified REIT subsidiaries" ("QRSs"), which are disregarded for federal income tax purposes and treated as part of the REIT that owns them and (ii) TRSs, subject to exceptions for certain debt instruments, notably including those that qualify as "straight debt" securities and any security issued by another REIT.

The use of TRSs by REITs has become commonplace in REIT structures since laws permitting their use were adopted in 1999. A TRS can provide services (such as third-party management and development consulting) and hold assets (for example, oil and gas properties) without regard to the strict asset and income limitations placed upon REITs. A TRS is a corporation that is taxable as an ordinary corporation (that is, the TRS is subject to an entity-level income tax and its shareholders are subject to income tax on the dividends distributed by the TRS). In order for a corporation to qualify for TRS status, both the REIT and

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the corporation must file a joint election to treat the corporation as a TRS; a TRS need not be wholly-owned by a REIT.

One particularly notable type of TRS is one that leases a lodging facility or a health care facility from its parent REIT. The rent paid by the TRS to its parent REIT is deductible by the TRS in determining its corporate taxable income and is treated as "good" REIT income by the parent REIT, provided that the lodging facility or health care facility is managed on behalf of the TRS by an independent contractor that is also actively engaged in managing those types of facilities for parties unrelated to the REIT. The income derived directly from hotels and health care facilities is generally not treated as "rent" for REIT purposes but as business income. This type of TRS allows hotel REITs and health care REITs greater flexibility in their operations in that they do not have to lease those properties to an independent operator, but can merely hire one as a manager through a TRS.

UPREITS AND DOWNREITS

From inception through the early 1990s, REITs were formed as corporations or business trusts which then acquired properties or had properties contributed to them. In the latter case, this generally resulted in a taxable event for the parties contributing the properties, which was a significant impediment to REIT formation. In the early 1990s, the UPREIT structure was first employed. In this construct, a property owner contributes its assets to a newly-formed limited partnership (the operating partnership) in exchange for limited partnership interests in a tax-free exchange. The limited partnership's general partner is typically a REIT or wholly-owned subsidiary thereof. In one variation, a REIT may conduct an initial public offering and contribute the proceeds therefrom, either directly or through such a wholly-owned subsidiary, to the limited partnership in exchange for an interest in the limited partnership. The REIT lists its common stock on a national securities exchange (typically the NYSE) and the limited partnership interests held by parties that contributed real property are redeemable at the option of the holder for cash or, if the general partner so elects, exchanged for shares of common stock in the REIT. Since the exchange of properties for limited partnership interests is not a taxable event under the tax code, the UPREIT structure allows REITs to offer a significant tax deferral option to contributors who hold properties with substantial built-in gain.

Following the lead of the UPREITs, REITs that have not employed the UPREIT structure may utilize limited partnerships formed beneath the REIT in order to offer the same tax deferral benefits to a contributor and similar redemption and exchange rights as an UPREIT. This structure is sometimes referred to as a DOWNREIT.

In UPREIT and DOWNREIT transactions, the party contributing the property remains liable for the tax on the gain that was "built-in" to the property at the time it was contributed to the UPREIT or the DOWNREIT. Consequently, there is usually a "tax protection agreement" entered between the REIT and the property contributor at the time the property is contributed, in which the REIT agrees not to allow the UPREIT or the DOWNREIT to sell the contributed property for some contractually agreed period and to pay the property contributor's tax on the built-in gain if such a sale is made before the expiration of the agreed period. In addition, to avoid any taxable, deemed distributions to the contributor, the REIT may agree not to refinance the property except under certain circumstances.

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REIT DEBT OFFERINGS

In attempting to access the debt capital markets, REITs have faced significant challenges in obtaining investment grade credit ratings. The rating agencies and the investment community have not forgotten the credit problems that highly leveraged REITs and other real estate vehicles experienced in the past. As a result, REITs have generally had to agree to a set of financial covenants in issuing debt securities in the public markets, even where their debt is rated investment grade. These covenants vary among REITs, but often include the following:

- limits on the incurrence of indebtedness as a percentage of the total assets of the REIT (including more stringent limits on the incurrence of secured debt);
- limits on the ratio of net income or funds from operations to the REIT's annual debt service payments;
- limits on distributions beyond those required by the tax code; and
- requirements regarding the maintenance of unencumbered assets.

MORTGAGE OR SPECIALTY FINANCE REITS VS. EQUITY REITS

Some REITs hold mortgage-related debt investments as opposed to real property or a combination of mortgage-related debts and real property (so-called "hybrid REITs"). In addition to commercial or residential mortgage loans, mortgage or specialty finance REITs may hold a variety of other mortgage-related debt investments, such as mortgage-backed securities, mezzanine loans secured by pledges of all of the equity interest in the owners of real property, and debt securities issued by real estate companies or REITs. Many mortgage and specialty finance REITs are externally managed through a management agreement, similar to the way investment company funds are managed. The management agreement may contain provisions limiting the manager from managing similar vehicles and detailing the manner in which investment opportunities are allocated among affiliates of the manager and the REIT, and typically provides for a base management fee (*e.g.*, 1.75% of the REIT's equity per annum) and incentive compensation (*e.g.*, 20% of the REIT's net income or funds from operations over a specified return on the average price at which common shares have been sold in offerings by the REIT). UPREITs and DOWNREITs can be advantageous in this regard by having managers receive partnership interests that entitle them to the economic equivalent of incentive compensation in the form of a partnership profits interest, sometimes referred to as a "promote" or a "carried interest." In addition to potentially deferring their recognition of income, such an arrangement also may result in an allocation of partnership profits that are treated as capital gains.

Mortgage and specialty finance REITs generally seek to avoid registration under the 1940 Act, often by structuring themselves as holding companies that fall outside of the definition of "investment company" contained in Section 3(a)(1)(C) of the 1940 Act. Section 3(a)(1)(C) defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis.

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Excluded from the term "investment securities," among other things, are U.S. government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or 3(c)(7) of the 1940 Act. As a result, a mortgage or specialty finance REIT organized as a holding company may not own securities issued by subsidiaries that are excepted from the definition of "investment company" by Section 3(c)(1) or 3(c)(7) of the 1940 Act that, together with any investment securities, have a combined value in excess of 40% of the value of its total assets on an unconsolidated basis.

Mortgage or specialty finance REITs operating through holding companies typically have one or more subsidiaries that are exempt from the 1940 Act by virtue of Section 3(c)(5)(C), which provides an exemption for entities "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." For this purpose, the SEC has taken the view that, in order to qualify for this exemption, at least 55% of an entity's assets must consist of mortgage loans (or the functional equivalent) and other interests in real estate, commonly referred to as "Qualifying Real Estate Assets," and at least an additional 25% of the entity' other assets must be other qualifying real estate-related assets, or "Real Estate-Related Assets."

As a result of a May 2007 SEC no-action letter, "Tier 1 mezzanine loans" may be treated as Qualifying Real Estate Assets where, except for the lack of a mortgage loan against the property, the mezzanine loan is the "functional equivalent" of, and provides the holder with the same economic position as a second mortgage (including providing the right to foreclose on the collateral and, thereby, through 100% ownership of the property-owning entity, ownership of the underlying real estate). Other mezzanine loans are generally classified as Real Estate-Related Assets. Similarly, the Internal Revenue Service has ruled that mezzanine loans meeting certain requirements may be treated as loans secured by real property even though they are technically not so secured, being secured instead by ownership interests in an entity (typically a limited liability company) that owns real estate.

The SEC has not expressed a view concerning whether other types of mortgage related securities are Qualifying Real Estate Assets, Real Estate-Related Assets or neither, although certain mortgage and specialty finance REITs have disclosed their views on how they consider these securities in analyzing the availability of the exemption contained in Section 3(c)(5)(C). For example, the staff of the SEC has not provided any guidance on the treatment of B-Notes. B-Notes are loans secured by a first mortgage and subordinated to a senior interest, referred to as an A-Note. Mortgage and specialty finance REITs, however, have taken the position that B-Notes are Qualifying Real Estate Assets where the REIT has the unilateral right to (i) instruct the servicer to foreclose on a defaulted mortgage loan, (ii) replace the servicer in the event the servicer, in its discretion, elects not to foreclose on such a loan and (iii) purchase the A-Note in the event of a default on the mortgage loan. Other B-Notes are generally treated as Real Estate-Related Assets.

FUNDS FROM OPERATIONS

When reporting financial results, many equity REITs report not only their net income but also their funds from operations, or "FFO." FFO is a measure that begins with net income

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calculated in accordance with GAAP and makes certain adjustments in an attempt to provide a more accurate measure of a REIT's performance. Historical cost accounting for real properties assumes that the value of such properties diminishes evenly over time and includes depreciation expense in calculating net income. Many analysts view net income as an insufficient measure of performance since real property values have risen or fallen with market conditions over time and the deduction for depreciation expense bears very little or no relationship to those values.

It should be noted that FFO is a performance measure and not a measure of a REIT's cash flow. FFO is defined by the National Association of Real Estate Investment Trusts ("NAREIT") as "net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships and joint ventures are calculated to reflect funds from operations on the same basis." However, since FFO is a non-GAAP measure, some REITs have varied from the NAREIT definition. The SEC staff has indicated its intention to challenge such variations in the future.

In light of the SEC's rules concerning the use of non-GAAP financial information, when disclosing FFO, REITs are required, among other things, to provide a reconciliation of FFO to net income and, for any document being filed with the SEC, to give equal or greater prominence to GAAP net income. SEC staff policy at one time strictly prohibited REITs from disclosing FFO per share in prospectuses and, as a result, press releases often disclose FFO on a per share basis while prospectuses (particularly those that are subject to SEC review such as prospectuses for IPOs) typically do not disclose FFO per share.

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CHAPTER 12

BANK ISSUERS

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GENERAL

In this chapter, we address the issuance of securities in the U.S. capital markets by U.S. banks and U.S. branches and agencies of non-U.S. banks, which we collectively call "bank securities" and "bank issuers," respectively. As discussed below, bank securities issued by bank issuers are exempt from 1933 Act registration by virtue of Section 3(a)(2) of the 1933 Act, as discussed in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

These issuances have taken the form of bank securities that include senior or subordinated bank-level debt securities ("bank notes"), certificates of deposit structured to resemble debt securities ("deposit notes") and institutional certificates of deposit (which are certificates of deposit sold institutionally, generally through the intermediary of a deposit broker).

U.S. banks also access the U.S. capital markets at the holding company level and non-U.S. banks also access the U.S. capital markets directly and not through a U.S. branch or agency. In each case, the securities offerings are subject to the registration requirements of the 1933 Act and, if not registered with the SEC, are usually made pursuant to Section 4(2) of and Rule 144A or Regulation S under the 1933 Act or, if commercial paper, Section 3(a)(3) or 4(2) of the 1933 Act.

As further discussed below, since the promulgation by the Federal Deposit Insurance Corporation ("FDIC") of its final regulation regarding the Temporary Liquidity Guarantee Program ("TLG Program") on November 21, 2008, U.S. depository institutions and eligible U.S. bank and thrift holding companies which have elected not to opt out of the TLG Program have issued senior debt securities guaranteed by the FDIC under the TLG Program. Under the TLG Program, the FDIC guarantees principal and interest on senior unsecured debt issued between October 14, 2008 and June 30, 2009 by entities participating in the program. On November 24, 2008, the SEC staff issued a letter to the FDIC concurring with the view that such debt maturing on or before June 30, 2012 and guaranteed under the TLG Program would be considered guaranteed by an instrumentality of the United States and therefore exempt from 1933 Act registration by virtue of Section 3(a)(2) of the 1933 Act.

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As discussed in this chapter below, non-U.S. banks and U.S. branches and agencies of non-U.S. banks are not eligible to participate in the TLG Program. Also, the foreign government guarantees of bank securities offered in the U.S. capital markets would have to be registered on Schedule B, as described in Chapter 14 (*Foreign Governmental Issuers*) of this volume, unless the transaction or bank security was except from registration as discussed in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

Both U.S. and non-U.S. banks are also frequent issuers of asset-backed securities and structured hybrid capital securities in the U.S. capital markets. However, such securities are usually issued by banks through trusts or other special-purpose vehicles, and are therefore not generally treated as "securities issued by a bank" for purposes of the federal securities laws. As a result, their issuance is subject to different considerations.[1]

For an overview of the U.S. regulations that apply to the activities of non-U.S. banks in the United States, see Appendix D (*U.S. Regulation of Activities of Non-U.S. Banks in the United States*) of this volume.

Characteristics of Bank Securities

Bank notes are general debt obligations of the issuing bank and may be issued as either senior debt ("senior bank notes") or subordinated debt ("subordinated bank notes") of the issuing bank. Senior bank notes are generally issued as either "short-term bank notes," with maturities from seven days to and including one year from the date of issuance, or "medium-term bank notes," with maturities of over one year. Short-term bank notes typically pay interest on a money market (actual/360) basis and, like commercial paper, are payable only at maturity. Medium-term bank notes typically pay interest at fixed or floating rates, using normal medium-term note interest conventions.

Although denominated "senior indebtedness," as a result of the depositor preference provisions of the Federal Deposit Insurance Act, as amended ("FDI Act"), senior bank notes issued by U.S. banks are subordinate in right of payment upon liquidation of the issuing bank to the U.S. deposit liabilities of such bank (including to the rights of the FDIC as subrogee of insured depositors of the bank).[2]

Subordinated bank notes rank subordinate in right of payment upon liquidation of the issuing bank to deposits and senior debt of the issuing bank, including senior bank notes. Subordinated bank notes are typically structured to qualify as Tier 2 capital under applicable bank capital regulations (*e.g.*, in the United States, five-year minimum maturity, minimal covenants, and acceleration only in the event a receiver is appointed for the bank).

Because bank notes are not deposits, they are not insured as deposits by the FDIC or any other governmental agency. As a result, U.S. bank issuers of bank notes are not required to include bank note liabilities in their assessment base when calculating the deposit insurance

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[1] For a general discussion of asset-backed securities, see *Accessing the U.S. Capital Markets – Securities Products*.

[2] 12 U.S.C. Section 1821(d)(11).

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premiums, if any, payable to the FDIC on deposits. As further discussed below, senior bank notes, if guaranteed under the TLG Program, are assessed a fee under that program.

Institutional Certificates of Deposit and Deposit Notes

Institutional certificates of deposit are deposit liabilities of the issuing bank and, accordingly, as a result of the depositor preference provisions of the FDI Act discussed above, in the case of U.S. banks, rank senior in right of payment upon liquidation of the issuing bank to such bank's senior bank notes and subordinated bank notes. Although they are insured deposits, and therefore subject to inclusion in an insured bank's FDIC insurance assessment base, they are typically sold in denominations significantly in excess of the FDIC insurance limit (U.S.$250,000 per beneficial owner[3]) with the result that investors rely on the credit of the issuing bank, not the availability of FDIC insurance, in making their decision to invest in such instruments.

Under applicable provisions of the FDI Act and the FDIC's regulations thereunder, only "well capitalized" U.S. depository institutions and "adequately capitalized" U.S. depository institutions that have received the prior approval of the FDIC may issue brokered deposits.[4]

Under the IBA (subject to certain limited exceptions), non-U.S. banks may accept deposits having balances of less than the standard maximum deposit insurance amount (as determined in accordance with the FDI Act) only through FDIC-insured U.S. banking subsidiaries or U.S. branches that were FDIC-insured on December 19, 1991 and remain FDIC-insured.

The TLG Program

On November 21, 2008, the FDIC issued its final regulation ("TLGP Rule") for the TLG Program. Pursuant to the TLGP Rule, the FDIC will guarantee all "senior unsecured debt" issued by "eligible entities" from October 14, 2008 through June 30, 2009, subject to a cap discussed below.[5] The FDIC has concluded that the guarantee is backed by the full faith and credit of the United States. The expiration of the guarantee is the earlier of the maturity date of the debt and June 30, 2012.[6]

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[3] On October 3, 2008, the FDIC announced that deposits of FDIC-insured institutions may be issued up to U.S.$250,000 per depositor until December 31, 2009. It is planned and currently expected that on January 1, 2010 FDIC deposit insurance for all deposit accounts (with the exception of certain retirement accounts) will return to U.S.$100,000 per depositor. See http://www.fdic.gov/deposit/deposits/changes.html.

[4] 12 U.S.C. Section 1831f and 12 C.F.R. Section 337.6.

[5] 73 Fed. Reg. 72244 (Nov. 26, 2008; to be codified at 12 C.F.R. Part 370). The TLG Program also provides for a Transaction Account Guarantee Program under which the FDIC guarantees the totality of certain non-interest-bearing transaction accounts.

[6] On January 16, 2009, the FDIC board announced that it would soon propose rule changes to the TLG Program to extend the maturity of the guarantee up to ten years where the debt is supported by collateral and the issuance supports new customer lending.

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An "eligible entity" is (i) an FDIC-insured depository institution, (ii) a U.S. bank holding company, (ii) certain U.S. savings and loan holding companies and (iii) affiliates of FDIC-insured depository institutions which the FDIC, upon written request, has agreed to treat as eligible entities. FDIC-insured depository institution subsidiaries of foreign banks are eligible entities; U.S. branches (even if FDIC-insured) and agencies of non-U.S. banks are not.

The cap on the amount of senior unsecured debt that the FDIC guarantees under the TLG Program for each eligible entity participating in the program is 125% of the participant's senior unsecured debt outstanding at the close of business on September 30, 2008 and maturing on or before June 30, 2009. For FDIC-insured depository institution participants that had no senior unsecured debt outstanding or had only federal funds purchased at September 30, 2008, the cap is 2% of such participant's consolidated liabilities as of September 30, 2008. For participants that are not FDIC-insured depository institutions and that did not have any senior unsecured debt outstanding at September 30 2008, the FDIC decides, on a case-by-case basis, whether such entity may participate and what its cap is. The cap is generally calculated separately for each participant within a holding company structure. However, if a participating entity is both an FDIC-insured depository institution and a direct or indirect subsidiary of a parent participating entity, it may, absent direction from the FDIC to the contrary, increase its limit above the established cap by using an amount not to exceed the limit of one or more of its parent participating entities. In addition, the FDIC may adjust the 125% cap for a participant, allowing it to exceed the limit or subjecting it to a lower limit.

Eligible entities wishing to opt out of the TLG Program were required to do so before midnight on December 5, 2008; their failure to do so constituted an irrevocable election to continue to participate in the TLG Program. All eligible entities within the same holding company structure were required to make the same election. The FDIC has published a list of eligible entities that opted out of the TLG Program.[7] If an eligible entity did not opt out, it cannot issue senior unsecured debt maturing prior to June 30, 2012 without the FDIC's guarantee until it exceeds its cap. The only exception is that such an eligible entity wishing to issue non-guaranteed debt with a maturity date after June 30, 2012 was given this option if it paid a special fee.

"Senior unsecured debt" eligible to be covered by the FDIC guarantee under the TLG Program is unsecured borrowing (including borrowing in a foreign currency) that (i) is evidenced by a written agreement or a trade conformation, (ii) has a specified and fixed principal amount, (iii) is noncontingent and does not contain any embedded derivatives, (iv) is not by its terms subordinated to any other liability and (v) after December 5, 2008, has a term of more than 30 days. "Senior unsecured debt" may include, for example, the following debt (provided it has a term of more than 30 days): federal funds purchased, promissory notes, commercial paper, unsubordinated unsecured notes, including zero-coupon bonds, U.S. dollar denominated certificates of deposit owed to an insured depository institution, an insured credit union as defined in the Federal Credit Union Act, or a foreign bank, U.S. dollar denominated deposits in an international banking facility (IBF) of an insured depository institution owed to an insured depository institution or a foreign bank, and U.S. dollar denominated deposits on the books and records of foreign branches of U.S. insured depository institutions that are owed to an insured

[7] The list is available at http://www.fdic.gov/regulations/resources/TLGP/optout.html.

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depository institution or a foreign bank.[8] "Senior unsecured debt" excludes, for example, any obligation that has a stated maturity of "one month," obligations from guarantees or other contingent liabilities, derivatives, derivative-linked products, debts that are paired or bundled with other securities, convertible debt, capital notes, the unsecured portion of otherwise secured debt, negotiable certificates of deposit, deposits denominated in a foreign currency or other foreign deposits (except as allowed under the TLGP Rule), revolving credit agreements, structured notes, instruments that are used for trade credit, retail debt securities, and any funds regardless of form that are swept from individual, partnership, or corporate accounts held at depository institutions. Also excluded are loans from affiliates, including parents and subsidiaries, and institution-affiliated parties.

The FDIC's payment obligation under the TLG Program is triggered by the issuing entity's uncured failure to make a timely payment of principal of or interest on the senior unsecured debt (a "payment default"). Under the TLG Program, a payment default obligates the FDIC to make such payment following prescribed notification to the FDIC of such payment failure and timely demand for payment under the FDIC's guarantee. The failure of the issuer to pay any principal of or interest on the senior unsecured debt that is then paid by the FDIC on a timely basis cannot constitute an event of default under the senior unsecured debt which would permit holders of the debt to accelerate the maturity of the debt during any period when the FDIC is making timely payment of principal and interest on the debt. The full details of the FDIC guarantee are provided in the TLGP Rule and at the FDIC's web site at http://www.fdic.gov/tlgp.

The TLGP Rule requires entities participating in the TLG Program to execute and file with the FDIC a Master Agreement. Among the terms of the Master Agreement, the issuing entity agrees to pay to the FDIC any amounts the FDIC pays to the holders of the senior unsecured debt under the FDIC guarantee. In addition, the issuing entity agrees not to amend or waive any provisions of the unsecured senior debt required by the Master Agreement with regard to principal, interest payment, default or ranking without the express written consent of the FDIC.

The assessment applicable to all guaranteed debt is determined by multiplying the amount of the debt by the term of the debt (June 30, 2012 applies as the maximum maturity date for any issuance with a longer maturity) by an amount equal to: (i) 50 basis points for debt with a maturity of 180 days or less; (ii) 75 basis points for debt with a maturity of 181 days through 364 days; or (iii) 100 basis points for debt with a maturity of 365 days or more. The amount is increased by 10 basis points for a participating entity that is not an insured depository institution but that controls, directly or indirectly, or is otherwise affiliated with at least one insured depository institution, if the combined assets of all insured depository institutions affiliated with such entity constitutes less than 50% of the consolidated holding company assets.

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[8] The term "foreign bank" does not include a foreign central bank or other similar foreign government entity that performs central bank functions or a quasi-governmental international financial institution such as the International Monetary Fund or the World Bank. References to debt owned to an insured depository institution, an insured credit union, or a foreign bank mean owed to the institution solely in its own capacity and not as agent.

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Regulation Q

Bank notes, deposit notes and institutional certificates of deposit, if not payable solely outside the United States, are generally subject to Regulation Q[9] and Regulation D[10] of the Federal Reserve Board. Under the Federal Reserve Board's Regulation Q, depository institutions, including all FDIC-insured banks, and all branches and agencies of non-U.S. banks that have total worldwide consolidated assets in excess of U.S.$1 billion dollars, are prohibited from paying interest on demand deposits, which are defined to include liabilities with an original maturity or required notice of withdrawal period of less than seven days. The effect of Regulation Q is to prohibit bank issuers from issuing bank notes, deposit notes and institutional certificates of deposit with original maturities of less than seven days. The Federal Reserve Board's Regulation D imposes reserve requirements on any liability (whether or not it is classified as a deposit for FDIC insurance purposes), including any liability evidenced by a bank note, deposit note or institutional certificate of deposit, that is a non-personal time deposit, transaction account or eurocurrency liability.[11] However, the reserve requirement for non-personal time deposits and eurocurrency liabilities is currently set at zero.

Equity-Linked and Credit-Linked Securities

The issuance of equity-linked and credit-linked bank notes, deposit notes and certificates of deposit and other "structured" bank notes, deposit notes and certificates of deposit present unique issues under U.S. securities, banking and commodities laws, which should be considered by any bank that is contemplating issuing such instruments.

STATUS UNDER U.S. FEDERAL SECURITIES LAWS

The initial consideration under U.S. federal securities laws is whether the instrument being issued constitutes a "security." The 1933 Act and the 1934 Act define a "security" to include any note, bond or debenture, evidence of indebtedness and any certificate of deposit for a security.

Bank notes would clearly constitute "securities" under this definition. The status of deposit notes and institutional and other certificates of deposit under these definitions is less clear. In Marine Bank v. Weaver, 455 U.S. 551 (1982), the U.S. Supreme Court held that that the certificate of deposit considered in that case was not a security for purposes of the anti-fraud provisions of the 1934 Act. The court based its holding on its conclusion that holders of the certificate of deposit were "abundantly" protected by the comprehensive set of regulations governing the banking industry and therefore did not need the protection of the federal securities laws. The court, however, acknowledged that certificates of deposit could be considered securities in certain cases, noting that each transaction must be analyzed "on the basis of the

9 12 C.F.R. Part 217.

10 12 C.F.R. Part 204.

11 It should be noted, however, under recent revisions to the Federal Reserve Board's Regulation D, and as originally authorized by the Financial Services Regulatory Relief Act of 2006, as of October 1, 2008, the Federal Reserve Board has begun paying interest on balances held by or on behalf of depositary institutions. See http://www.federalreserve.gov for more information.

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content of the instruments in question, the purposes intended to be served, and the factual setting as a whole."

Subsequent to Marine Bank, several courts have ruled that certificates of deposit issued by non-U.S. banks were not "securities" for 1933 Act purposes.[12] The primary determinant in each of these cases was the courts' finding that home country regulation reduced the risk of the certificate of deposit so as to render the protections of the U.S. securities laws unnecessary. These cases suggest that whether non-U.S. bank certificates of deposit are considered "securities" for federal securities law purposes will be highly dependent on the nature of banking regulation in the bank's home country.

In Gary Plastic Packaging Corporation v. Merrill Lynch, Pierce, Fenner & Smith Inc., 756 F. 2d 230 (2d Cir. 1985), the U.S. Court of Appeals for the Second Circuit upheld and refused to grant a motion to dismiss a claim that brokered deposits considered in that case would be "securities" within the meaning of the 1934 Act. At issue in Gary Plastic was a program developed by Merrill Lynch to sell bank certificates of deposit to the public (the "program"). The certificates of deposit were in denominations of U.S.$100,000, the then-maximum denomination for which FDIC insurance had been available. Under the program, Merrill Lynch chose the banks in which to place customer monies, based upon its assessment of the creditworthiness of the bank and the yield of the certificate of deposit. Merrill Lynch also monitored the banks for continuing creditworthiness on a regular basis, marketed the certificates of deposit, and maintained a secondary market in the certificates of deposit. No other secondary market for the certificates of deposit existed at that time; a holder of certificates of deposit requiring liquidity before the stated maturity date would be required to pay an early withdrawal fee to the issuing bank. The plaintiffs brought suit on the basis of, among other things, Sections 5(a) and 17 of the 1933 Act, Section 10(b) of the 1934 Act and Rule 10b-5 under the 1934 Act, asserting that the certificates of deposit were created especially for Merrill Lynch customers, that the rates on the certificates of deposit were lower than the rates on certificates of deposit ordinarily offered by the banks, and that Merrill Lynch retained the difference between the rates as an undisclosed commission.

The Second Circuit upheld the refusal to grant a motion to dismiss and, based upon the plaintiff's allegations (which, on a motion to dismiss, are assumed to be true), found the certificates of deposit were securities for purposes of the anti-fraud provisions of the 1933 Act and the 1934 Act. The Second Circuit concluded that the certificates of deposit were securities because (i) plaintiffs invested money in the certificates of deposit, (ii) "[b]y investigating issuers, marketing the [certificates of deposit], and creating a secondary market, Merrill Lynch was engaged in a common enterprise," and (iii) plaintiffs' investments in the certificates of deposit were based on an expectation of a return of cash investment, potential price appreciation, and the liquidity of the certificates of deposit, all of which would be derived from the efforts (and continued solvency) of Merrill Lynch. The court also observed that the certificates of deposit constituted investment contracts and that Merrill Lynch's role in the program was significantly greater than that of an ordinary broker in that, in addition to the other elements of a common

12 See, *e.g.*, Wolf v. Banco Nacionale de Mexico, S.A., 739 F.2d 1458 (9th Cir. 1984), cert. denied, 469 U.S. 1108 (1985); West v. Multibanco Comermex, S.A., 807 F.2d 820 (9th Cir. 1987), cert. denied, 482 U.S. 906 (1987).

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enterprise, Merrill Lynch negotiated rates of interest with the issuing banks (which, as stated above, allegedly were lower than the rates paid directly by such banks).

Consideration needs to be given to Gary Plastic in determining whether a broker-placed certificate of deposit or deposit note is a "security" under the federal securities laws. However, as further discussed below, even if a certificate of deposit or deposit note is deemed to be a "security," it should, if issued by a U.S. bank or a U.S. branch or agency of a non-U.S. bank, generally be exempt from the registration requirements of the 1933 Act.

1933 ACT CONSIDERATIONS

U.S. Banks

Section 3(a)(2) of the 1933 Act exempts from the registration and prospectus delivery requirements of the 1933 Act "any security issued or guaranteed by a bank."[13] Accordingly, bank notes, deposit notes and institutional certificates of deposit of national and state-chartered banks are generally exempt from the registration and prospectus delivery requirements of the 1933 Act.

U.S. Branches and Agencies of Non-U.S. Banks

The 1933 Act does not specifically address the availability of the Section 3(a)(2) exemption in the case of a branch or agency of a non-U.S. bank. However, in 1986, the SEC issued a release (the "1986 Release") formalizing its position, previously taken in a series of no-action letters, that "for purposes of the exemption from registration provided by Section 3(a)(2) of the 1933 Act, the SEC deems a branch or agency of a non-U.S. bank located in the U.S. to be a 'national bank' or a 'banking institution organized under the laws of any State, Territory, or the District of Columbia,' provided that the nature and extent of Federal and/or State regulation and supervision of the particular branch or agency is substantially equivalent to that applicable to Federal or State chartered domestic banks doing business in the same jurisdiction."[14] As a result of the 1986 Release and its own analysis of the regulation of non-U.S. branches and agencies in the United States, counsel for issuing U.S. branches and agencies of non-U.S. banks are generally able to conclude that securities of such branches and agencies are exempt from the registration requirements of the 1933 Act.

Direct Issuances by Bank Holding Companies and Non-U.S. Banks or their Non-U.S. Bank Subsidiaries

Securities issued by a bank holding company, directly by a non-U.S. bank, or though a non-U.S. bank subsidiary, are generally subject to registration under the 1933 Act, unless an exemption (such as the exemption set forth in Section 4(2) of the 1933 Act for privately-placed securities, in Section 3(a)(3) for commercial paper, or in the case of securities guaranteed by the

[13] For purposes of the 1933 Act, "bank" is defined to include "any national bank, or any banking institution organized under the laws of any state, territory or the District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial banking commission or similar official."

[14] SEC Release No. 33-6661, 1 Fed Sec. L. Rep (CCH) 2024A (Sept. 23, 1986).

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FDIC under the TLG Program, Section 3(a)(2) of the 1933 Act) is available. The private placement and commercial paper exemptions to the 1933 Act are further discussed in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

APPLICATION OF SECURITIES OFFERING REGULATIONS OF THE BANK REGULATORY AGENCIES

Although exempt from registration under the 1933 Act, securities issued by bank issuers are potentially subject to the registration and prospectus delivery requirements of the applicable U.S. federal and state bank regulatory agencies.

OCC Regulations

Under the Securities Offering Disclosure Rules of the Comptroller of the Currency,[15] U.S. national banks and federally-licensed branches and agencies of non-U.S. banks are subject to the registration and prospectus delivery requirements of the Office of the Comptroller of the Currency ("OCC") unless an exemption from such requirements applies. The exemptions from registration generally mirror those contained in the 1933 Act (including the private placement and commercial paper exemptions), with the exception that the 3(a)(2) exemption for bank-issued securities is not available (although, as discussed below, it may be available if the securities are guaranteed under the TLG Program).

The OCC's Securities Offering Disclosure Rules generally require that a bank subject to the rules register securities with the OCC on the same form that it would use if it were required to register securities under the 1933 Act. In recognition of the fact that most banks that are subsidiaries of bank holding companies do not compile, on a bank-level basis, the information that would be required to comply with comparable SEC registration statement forms, the OCC Securities Offering Disclosure Rules provide an alternative abbreviated registration procedure for sales of non-convertible debt securities. In order to qualify for use of the abbreviated registration procedure, the issuing bank must be a subsidiary of a bank holding company that has securities registered under the 1934 Act, or have securities registered under the 1934 Act, and the non-convertible debt security being offered must be rated investment grade by at least one NRSRO and by each other NRSRO that has rated the security. The debt securities must be offered and sold only to accredited investors in minimum denominations of U.S.$250,000. If the offering so qualifies, then the offering circular can be limited to a description of the terms of the debt security and the use of proceeds, and can incorporate by reference the bank's latest call reports and the bank's or the bank holding company's Forms 10-K, 10-Q and 8-K filed under the 1934 Act.

In order to use the abbreviated registration procedure, federally-licensed branches and agencies of non-U.S. banks are not required to have securities registered under the 1934 Act or be subsidiaries of reporting companies under the 1934 Act to use the abbreviated registration procedure if the federal branch or agency provides the OCC with the information specified by Rule 12g3-2(b) under the 1934 Act and provides purchasers with the information specified in Rule 144A(d)(4)(i) under the 1933 Act.

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15 12 C.F.R. Part 16.

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In contrast to registration statements generally filed under the OCC Securities Offering Disclosure Rules, there is no requirement that the offering circular used under the abbreviated registration procedure be formally declared effective by the OCC. It is sufficient that the offering circular and any amendments be filed with the OCC no later than the fifth business day after first use.

Although the OCC's Securities Offering Disclosure Rules purport to require registration of any instrument that is a "security" as defined in the 1933 Act, the preamble of the regulations states that "the OCC does not intend the definition to cover insured and uninsured deposit products or other traditional bank products, including letters of credit, bankers' acceptances and repurchase agreements."[16] The OCC staff has opined that certain "deposit notes" would not be considered "securities" subject to registration under the Securities Offering Disclosure Rules.[17]

Federal Reserve Board

The Federal Reserve Board does not have comparable securities offering regulations for state-chartered banks that are members of the Federal Reserve System. However, some states require banks that they charter to register their securities with the applicable state banking regulator. In addition, the FDIC has issued a "Statement of Policy on the Use of Offering Circulars" with respect to securities of state-chartered banks that are not members of the Federal Reserve System (the "Statement of Policy").[18] The Statement of Policy generally requires that state non-member banks use an offering circular containing the information set forth in the Statement of Policy when offering their securities. However, it does not require that such offering circular be filed with or declared effective by the FDIC.

Treatment of Securities Guaranteed by the FDIC under the TLG Program

In addition to exempting from the registration and prospectus delivery requirements of the 1933 Act "any security issued or guaranteed by a bank," Section 3(a)(2) of the 1933 Act exempts from such requirements any security guaranteed by an instrumentality of the United States. Traditionally, the SEC has taken the position that a security would not be exempt pursuant to this provision of Section 3(a)(2) unless the guarantee of the U.S. government instrumentality was "full and unconditional." In a November 24, 2008 letter to the SEC, the FDIC stated that, under the TLG Program, the FDIC is providing a full and unconditional guarantee of the payment obligation on qualifying senior unsecured debt issued between October 14, 2008 and June 30, 2009 by eligible entities.[19] Accordingly, the FDIC concluded that such debt issued under the TLG Program and maturing on or before June 30, 2012 would be exempt from the registration and prospectus delivery requirement of the 1933 Act by virtue of Section 3(a)(2). In a letter dated the same date, the Chief Counsel and Associate Director of the SEC's Division of Corporation Finance confirmed that the Division concurred in such view.[20] In view

16 59 Fed. Reg. 54789, 54791 (Nov. 2, 1994).

17 OCC Interpretive Letter No. 922 (Dec. 13, 2001).

18 61 Fed. Reg. 46807 (Sept. 5, 1996).

19 See http://www.sec.gov/divisions/corpfin/cf-noaction/2008/fdic112408-incoming.pdf.

20 See http://www.sec.gov/divisions/corpfin/cf-noaction/2008/fdic112408.htm.

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of the Division's position, senior unsecured debt securities issued by entities participating in the TLG Program (including by bank holding companies whose securities would not be exempt under Section 3(a)(2) if not guaranteed under such program) may be issued and sold without having to be registered under the 1933 Act. This may permit such issuers to offer their securities more easily than if they had to be offered in a registered offering.

As mentioned above, the exemptions from registration in the OCC's Securities Offering Disclosure Rules generally mirror those contained in the 1933 Act (including the private placement and commercial paper exemptions), with the exception that the 3(a)(2) exemption for bank-issued securities is not available. In a January 26, 2009 interpretive letter, the OCC clarified that debt guaranteed under the TLG Program and maturing on or before June 30, 2012 would be exempt from the OCC's Securities Offering Disclosure Rules by virtue of the fact that such debt is exempt under Section 3(a)(2) because it is guaranteed by an instrumentality of the United States (and not because it is debt issued by a bank). Debt that is not guaranteed under the TLG Program or matures after June 30, 2012 would not benefit from this exemption from the Securities Offering Disclosure Rules.[21]

1934 ACT CONSIDERATIONS

It is important for potential issuers to recognize that even if a bank security is exempt from registration under the 1933 Act, sales of such a security are generally subject to the anti-fraud provisions of Section 10(b) of the 1934 Act and Rule 10b-5 thereunder, which make it unlawful for any person, in connection with the sale of a security, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading. Furthermore, sales of bank securities are generally subject to state anti-fraud provisions. As a result, detailed offering circulars for bank note and deposit note programs are normally prepared, even when such preparation is not explicitly required by applicable federal or state banking regulation. In the case of U.S. banks, such offering materials tend to mimic the disclosure used by national banks under the OCC's Securities Offering Disclosure Rules. Offering circulars of state-licensed branches and agencies of non-U.S. banks, particularly non-U.S. banks accessing the U.S. capital markets for the first time, tend to be more fulsome. Such offering circulars frequently contain or incorporate by reference to 1934 Act filings of the non-U.S. bank a full description of the non-U.S. bank, as well as financial statements and statistical information similar to that required in 1933 Act registration statements by Industry Guide 3 (Statistical Disclosure by Bank Holding Companies).[22]

In addition, because underwriters and placement agents of bank securities are also subject to liability, even when such securities are exempt from registration under the 1933 Act, they will generally conduct "due diligence" of the issuing bank in order to avoid liability and often require accountants' comfort letters or agreed upon procedures letters and 10b-5 statements of counsel to support due diligence.

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[21] See http://www.occ.treas.gov/interp/jan09/int1108.pdf.

[22] See http://www.sec.gov/about/forms/industryguides.pdf.

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In the case of securities guaranteed by the FDIC under the TLG Program, disclosure and diligence practices may be modified in light of the guarantee.

1939 ACT CONSIDERATIONS

The 1939 Act requires that publicly-offered debt securities be issued under an indenture with an independent trustee to enforce the rights of securityholders. Under Section 304(a)(4)(A) of the 1939 Act, no indenture need be qualified with respect to any security that is exempt from registration under Section 3(a)(2) of the 1933 Act. The securities offering regulations of the federal bank regulatory agencies generally do not impose a requirement for a trust indenture. Accordingly, it is generally not necessary to qualify an indenture under the 1939 Act or applicable federal regulations with respect to bank debt securities that are exempt from registration under the 1933 Act. Although, for market-driven reasons, such securities are sometimes issued under indentures whose provisions resemble those of 1939 Act-qualified indentures, they are more often issued under issuing and paying agency agreements that do not contain the detailed covenants normally contained in a 1939 Act-qualified indenture and that require each holder to act independently with respect to matters affecting such holder's interests, including giving written notice of default on the notes and accelerating the note's maturity following an event of default. Many banks act as their own issuing and paying agent under such agreements, while others prefer for ease of administration to retain other institutions to perform this function.

Similarly, it is not generally necessary to qualify an indenture under the 1939 Act with respect to securities of bank holding companies or other eligible entities exempt from registration under Section 3(a)(2) of the 1933 Act as a result of being guaranteed by the FDIC under the TLG Program.

1940 ACT CONSIDERATIONS

The 1940 Act imposes registration requirements on entities deemed to be "investment companies." Because of the SEC's position that loans are "securities" under the 1940 Act, banks must find an exemption from the 1940 Act before issuing bank notes, deposit notes or other securities in the United States.

U.S. banks are generally excepted from the definition of "investment companies" under the 1940 Act by Section 3(c)(3) of the 1940 Act. Section 2(a)(5) of the 1940 Act defines the term "bank" to include "(A) a depository institution (as defined in Section 3 of the FDI Act) or a branch or agency of a foreign bank (as such terms are defined in Section 1(b) of the International Banking Act of 1978 ("IBA")), (B) a member bank of the Federal Reserve System, (C) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by State or Federal authority having supervision over banks and which is not operated for the purpose of evading the provisions of … [the 1940 Act]…."

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While Section 3(c)(3) of the 1940 Act does not by its terms exempt non-U.S. banks (as distinct from their U.S. branches and agencies) from registration as investment companies, the SEC has issued Rule 3a-6 under the 1940 Act, which exempts "foreign banks" as defined in the rule from being considered as investment companies under the 1940 Act.

Rule 3a-6 generally defines a "foreign bank," which we refer to as a non-U.S. bank, as a banking institution incorporated or organized under the laws of a country other than the United States, or a political subdivision of a country other than the United States, that is (A) regulated as such by that country's or subdivision's government or any agency thereof; (B) engaged substantially in commercial banking activity; and (C) not operated for the purposes of evading the 1940 Act. A non-U.S. bank is generally considered to be "engaged substantially in commercial banking activity" if it engages regularly in, and derives a substantial portion of its business from, extending commercial credit and other types of credit, and accepting demand and other types of deposits, that are customary for commercial banks located in the country in which the head office of the banking institution is located. Rule 3a-6 also includes in the definition of "foreign bank" Canadian trust companies and loan companies and United Kingdom building societies.

A non-U.S. bank that does not meet the above definition may seek an order from the SEC exempting it from being considered an investment company pursuant to Section 6(c) of the 1940 Act, although such orders tend to be time-consuming and difficult to obtain.

BLUE SKY LAWS

If the securities of a bank issuer are deemed to be "securities" under the 1933 Act and therefore exempt from registration by reason of Section 3(a)(2), such securities will be deemed to constitute "covered securities" pursuant to Section 18(b)(4)(C) of the 1933 Act ("18(b)(4)(C) Covered Securities"). As such, the securities registration requirements under the blue sky laws of the states are preempted with respect to the offer and sale of such securities. As a result, state requirements regarding securities registration, merit review, and the imposition of disclosure requirements on any offering document that is prepared by "or on behalf of the issuer" of the securities in question are preempted with respect to the offer and sale of covered securities, including 18(b)(4)(C) Covered Securities.

If the bank issuer has other securities outstanding which are listed on the NYSE, NYSE Alternext US, NASDAQ Global Select Market, NASDAQ Global Market (but not the NASDAQ OTC Bulletin Board), or on certain other national securities exchanges set forth in Rule 146 under the 1933 Act, and the securities being offered are "equal in seniority" or constitute a "senior security" to such listed securities, the security being offered would also qualify as a covered security pursuant to Section 18(b)(1)(C) of the 1933 Act ("18(b)(1)(C) Covered Securities").

The states are permitted to impose a filing in respect of an offering of 18(b)(4)(C) Covered Securities "solely for notice purposes" and which notice can consist of no more than a cover letter, a limited consent to service of process of the issuer, and a filing fee (the amount of the filing fee varies from state to state). The filing is generally required to be perfected prior to the commencement of the offering in the applicable state. In many states, a filing is not required

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if the issuer can rely on a self-executing exemption from securities registration that would be available to the offering under such state's blue sky law if such state's securities registration requirement were not preempted. Under many states' blue sky laws, a self-executing exemption is available in respect of securities issued by U.S. national or state banks, although it is not clear if these exemptions would necessarily include securities issued by U.S. branches of non-U.S. banks, even if the U.S. branch is subject to federal or state regulation similar to that of a U.S. national or state bank.

The states are not permitted to impose any filing in respect of an offering of 18(b)(1)(C) Covered Securities.

FINRA CONSIDERATIONS

If the bank securities are being offered and sold through broker-dealers that are members of FINRA, and such instruments constitute "securities" under the 1933 Act, the offering would be subject to the requirements of FINRA Rule 5110, including a substantial filing thereunder prior to the commencement of the offering. Pursuant to FINRA Rule 5110(b)(9)(F), securities offered by a bank are subject to FINRA Rule 5110, including the filing requirement thereof, even though such securities may be exempt from registration under the 1933 Act.

FINRA Rule 5110 generally requires that the terms of an offering in which FINRA members are participating as underwriters or selling agents, as well as the compensation paid to such FINRA members, be "fair and reasonable," as more fully set forth in such rule.

If (i) the instruments in question are rated by an NRSRO (such as Standard & Poor's, Moody's or Fitch) in one of its four highest generic rating categories or (ii) the issuer (a) has unsecured, non-convertible debt with a term of issue of at least four years or (b) has unsecured, non-convertible preferred securities, in each case, rated by an NRSRO in one of its four highest generic rating categories, the offering will be exempt from having to be filed with FINRA under FINRA Rule 5110, although the other requirements of such rule will still be applicable.[23]

If an exemption from filing is not available, copies of the offering materials, selling agreements, and certain other information must be filed with, and approved by, FINRA prior to the commencement of the offering together with a filing fee of U.S.$500 plus 0.01% of the aggregate dollar amount of the securities being offering, with a maximum filing fee of U.S.$75,500; the maximum filing fee triggers at an offering amount of U.S.$750 million.

If one of the FINRA member-selling agents is an "affiliate" of the issuer, as defined in NASD Rule 2720(b)(1), a filing will be required under FINRA Rule 5110 by reason of NASD Rule 2720(m) notwithstanding that an exemption from filing might otherwise be available under FINRA Rule 5110. In addition, pursuant to NASD Rule 2720(l), no FINRA member-selling agent, including unaffiliated selling agents, would be permitted to confirm sales of the securities to discretionary accounts without the prior specific written approval of the customer. And, unless the securities are rated in one of the four highest generic rating categories by an NRSRO, the offering would have to be priced by a "qualified independent underwriter" (a "QIU"), as

[23] See FINRA Rules 5110(b)(7)(B) and (A).

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defined in NASD Rule 2720(b)(15). The QIU would also be responsible for participating in the preparation of the applicable offering circular pertaining to the securities and must exercise the "usual standards of 'due diligence' in respect thereto."

If the instruments in question do not constitute "securities" under the 1933 Act, FINRA Rule 5110 and NASD Rule 2720 should not be applicable. Notwithstanding the foregoing, however, FINRA has stated that FINRA members involved in the marketing of bank-issued certificates of deposit should understand the characteristics and risk factors associated with such instruments before soliciting customers to purchase such instruments. As such, FINRA recommends that members review their compliance programs, supervisory procedures, and continuing education programs to ensure that their registered persons are properly trained and educated about such instruments. See NASD Notice to Members ("NTM") Number 02-69. In addition, NASD NTM 02-69 sets forth certain disclosures that should be provided to prospective investors "sufficiently in advance" of the transaction date.

If the issuer proposes to market its instruments directly to investors without using a 1934 Act-registered broker-dealer, there could be broker-dealer registration issues for the issuer's employees/agents/representatives under the 1934 Act as well as broker-dealer and issuer-agent/salesman registration issues for the issuer and its employees/agents/representatives, respectively, under the various states' blue sky laws.

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CHAPTER 13

CANADIAN ISSUERS

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In order to facilitate certain securities transactions between the United States and Canada, the SEC and the Canadian Securities Administrators ("CSA") adopted a multi-jurisdictional disclosure system (the "MJDS") for use by the United States and each of the provinces and territories of Canada. The MJDS was adopted in June 1991 and became effective in the United States and throughout Canada on July 1, 1991.[1] The MJDS was developed to allow qualified companies in the United States and Canada to make public offerings and file periodic reports in both countries in accordance with only their home country disclosure requirements. Underlying the MJDS is the SEC's decision to rely upon Canadian disclosure requirements and the review of disclosure documents by Canadian regulators. As adopted, the MJDS comprises two distinct but complementary systems. The system implemented in the United States relates to Canadian issuers. As implemented in Canada, the system relates to U.S. issuers.

REGISTRATION UNDER THE 1933 ACT

The MJDS allows Canadian issuers to register securities under the 1933 Act and publicly offer those securities in the United States by means of a Canadian prospectus (with certain additional U.S. disclosures) using a "wrap-around" 1933 Act registration form. These public offerings may be made in conjunction with a contemporaneous Canadian public offering or the public offering may be made only in the United States. Under the MJDS, many of the specific 1933 Act provisions with respect to the preparation and the form of a prospectus discussed elsewhere in this volume do not apply. However, the MJDS makes clear that other provisions of the 1933 Act regarding the public sale of securities in the United States do apply unless specifically exempted. For example, the safe harbor provisions relating to advertisements and other notices regarding a securities offering discussed elsewhere in this volume apply to an MJDS offering in the United States. In addition, the civil liability and anti-fraud provisions of the 1933 Act, 1934 Act and state securities laws also apply to an MJDS offering in the United States.

The MJDS is available to qualified Canadian private issuers and crown corporations.[2] Among other eligibility requirements, a Canadian private issuer must qualify as a "foreign

[1] See SEC Release No. 33-6902 (June 21, 1991); National Policy Statement No. 45 – Multi-jurisdictional Disclosure System, 14 OSC Bull. 2889 (June 28, 1991), subsequently replaced by Canada's National Instrument 71-101, 1 CCH Canadian Securities Law Reports 7101.

[2] A "crown corporation" is defined as a corporation "all of whose common shares or comparable equity is owned directly or indirectly by the government of Canada or a Province or Territory of Canada." Because all a crown corporation's stock is owned by the government, crown corporations may offer only non-

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private issuer" and must not be registered or required to be registered as an investment company under the 1940 Act.

Unlike Forms F-1 or (in respect of certain issuers) F-3, the staff of the SEC will not review registration statements filed under the 1933 Act pursuant to the MJDS. Absent special circumstances, MJDS registration statements can be effective immediately upon filing, except that registration statements registering U.S.-only offerings on Form F-9 or F-10 will become effective at a later date as specified by the Canadian issuer, subject to certain constraints. Form F-3 shelf registration statements and amendments thereto filed by a WKSI (as discussed in Chapter 5 (*Shelf Registration*) of this volume) also are not subject to SEC review and are immediately effective, but a Canadian issuer choosing to file under the 1934 Act using the MJDS cannot be a WKSI. The principal jurisdiction in Canada designated by the issuer is responsible for conducting any review of the filings. However, the MJDS offering remains subject to the SEC's authority to issue a "stop order" if the SEC believes such an order is in the public interest and necessary for the protection of investors.

Eligibility Requirements for Forms F-7, F-8, F-9, F-10 and F-80

Forms F-9 and F-10 are the most frequently used forms in the MJDS. These forms allow Canadian issuers to register investment grade debt securities (Form F-9) or any type (excluding certain derivatives) of debt or equity securities (Form F-10). Form F-10 is the most flexible form and also may be used by qualified Canadian issuers to register exchange offers and business combinations; however, the eligibility requirements for use of Form F-10 are the most stringent.

Form F-7 (rights offerings) and Forms F-8 and F-80 (exchange offers or business combinations) are used less frequently due to the specific types of transactions to which the forms relate. Forms F-7, F-8, F-9, F-10 and F-80 are all recognized by the IDEA system.

Discussed below are the eligibility requirements for 1933 Act registration statements on Forms F-9, F-10, F-7, F-8 and F-80.

Form F-9

Form F-9 is available for 1933 Act registration by Canadian issuers publicly offering investment grade debt securities or investment grade preferred securities, in either case that are offered for cash or in connection with an exchange offer and are not convertible or not convertible for at least one year from the date of issuance and thereafter only convertible into securities of another class of the same Canadian issuer (or, for majority-owned subsidiaries, into securities of the parent). At the time the securities are sold, the debt securities or preferred securities must be rated investment grade (typically, the four highest ratings categories) by a NRSRO or a Canadian "rating organization" in order to qualify.[3] Form F-9 is a "wrap-around"

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convertible, investment grade debt or preferred stock under the MJDS, since such companies would not be able to satisfy the public float requirement for using most of the MJDS forms.

[3] Investment grade ratings by securities rating organizations approved by Canadian securities regulators are recognized for filings on Forms F-9 and 40-F. SEC Release No. 33-7040 (Dec. 27, 1993) (hyperlink unavailable).

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form for the Canadian offering document, and reconciliation to U.S. GAAP is not required for any financial statements included in the form.

Form F-9 is available to Canadian issuers that satisfy the following eligibility requirements:

(1) the issuer is incorporated or organized under the laws of Canada or any Canadian province or territory and qualifies as a foreign private issuer or a crown corporation;

(2) the issuer is not registered or required to be registered as an investment company under the 1940 Act;

(3) during the 12 months immediately preceding the filing, the issuer (including a crown corporation) has been subject to the reporting requirements of a Canadian securities regulatory authority;

(4) the issuer is currently in compliance with the reporting obligations referred to in (3) above; and

(5) the issuer has a public float of its equity securities (aggregate market value held by non-affiliates) of at least U.S.$75 million, unless the securities being registered are not convertible.

Form F-10

Form F-10 is available for 1933 Act registration of public offerings by Canadian issuers of any securities, including debt and equity, but excluding certain derivative securities. Similar to Form F-9 and the other forms discussed below, Form F-10 is a "wrap-around" form for the Canadian offering document; however, unlike Form F-9, reconciliation to U.S. GAAP, as specified in Item 18 of Form 20-F, is required for financial statements included or incorporated by reference in the form for issuers whose financial statements are not prepared in accordance with IFRS as issued by the IASB.[4]

Form F-10 is available to Canadian issuers that satisfy the following eligibility requirements:

(1) the issuer is incorporated or organized under the laws of Canada or any Canadian province or territory and qualifies as a foreign private issuer;[5]

(2) the issuer is not registered or required to be registered as an investment company under the 1940 Act;

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4 IFRS will apply in Canada for annual periods beginning on or after January 1, 2011.

5 "Foreign private issuer" is defined in Rule 3(b)-4 under the 1934 Act and Rule 405 under the 1933 Act, and is discussed further in *An Overview of U.S. Securities Regulators and Laws* in this volume.

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(3) during the 12 months immediately preceding the filing, the issuer has been subject to the reporting requirements of a Canadian securities regulatory authority;

(4) the issuer is currently in compliance with the reporting obligations referred to in (3) above; and

(5) the issuer has a public float of its equity securities (aggregate market value held by non-affiliates) of at least U.S.$75 million.

Derivative securities may not be registered on Form F-10 except (1) warrants, options and rights, provided that such securities and the underlying securities to which they relate are issued by the Canadian issuer, its parent or a person directly or indirectly controlling either of them or (2) convertible securities, provided that such securities are convertible only into securities of the Canadian issuer, its parent or a person directly or indirectly controlling either of them. Other derivative securities such as stock index warrants, currency warrants or securities the value of or return of which is based upon the market price, value or return of one or more underlying affiliates' securities, one or more underlying commodities, or on the level of one or more financial benchmarks, such as interest rates, foreign exchange rates or stock market indices, are not permitted to be registered on Form F-10 or any of the other MJDS forms.

As noted below with respect to Form F-8 and F-80, the registration of securities by Canadian issuers in connection with certain specified exchange offers is specifically accommodated in Forms F-9 and F-10, and registration of securities in connection with certain specified business combinations is accommodated in Form F-10. With respect to business combinations using Form F-10, issuers are required to be subject to the reporting requirements of a Canadian securities regulatory authority only for the preceding 12 months, rather than the 36 months required for Form F-8.

Forms F-9 and F-10 contain specific provisions for public offerings made under the Canadian shelf registration and post-receipt pricing ("PREP") provisions adopted by the CSA shortly before the adoption of the MJDS. The Canadian shelf and PREP provisions may be used by Canadian issuers making a public offering under the MJDS, including U.S.-only public offerings. The Canadian shelf provisions allow for unallocated shelf registration.[6] The Canadian shelf provisions also permit public offerings on a continuous or delayed basis, similar to the U.S. shelf registration rules discussed in Chapter 5 (*Shelf Registration*) of this volume, after final receipt has been issued to a "base" prospectus. In this manner, Canadian issuers may respond to market conditions as they arise without undue delay. Prospectus supplements prepared under the Canadian shelf or PREP provisions are filed with the SEC no later than one business day after they are filed in the Canadian issuer's principal jurisdiction in Canada.

The Canadian shelf rules and the MJDS permit Canadian issuers to establish medium-term note programs in which debt securities are continuously offered with terms and conditions tailored to meet the specific needs of the issuer. Thus, a Canadian issuer with a Form F-9 or F-10 registration statement under the MJDS would be able to access both the United

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[6] See Section 3 of Canada's National Instrument 44-102, 1 CCH Canadian Securities Law Reports 4402.

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States and the Canadian capital markets as the issuer's financing needs arose and without costly regulatory delays.

Form F-7

Form F-7 is available for 1933 Act registration in connection with qualified rights offerings. Form F-7 acts as a "wrap-around" form for the applicable Canadian offering document, and no reconciliation to U.S. GAAP is required for financial statements included or incorporated by reference as part of the prospectus.

Form F-7 is available to Canadian issuers that satisfy the following eligibility requirements:

(1) the issuer is incorporated or organized under the laws of Canada or any Canadian province or territory and qualifies as a foreign private issuer;

(2) the issuer is not registered or required to be registered as an investment company under the 1940 Act;

(3) during the 36 months immediately preceding the filing, the issuer has been subject to the continuous disclosure requirements of a Canadian securities regulatory authority;

(4) during the 12 months immediately preceding the filing, the issuer's securities must have been listed on The Toronto Stock Exchange; and

(5) the issuer is currently in compliance with its obligations arising from reporting and listing requirements referred to in (3) and (4) above.

In addition to the above eligibility requirements, the rights granted to U.S. holders must not be transferable except outside the United States in accordance with Regulation S. Also, the rights granted to U.S. holders of the underlying security must be on terms and conditions no less favorable than those extended to any other holder of the same class of securities.

Forms F-8 and F-80

Forms F-8 and F-80 are available in specified circumstances for 1933 Act registration by a Canadian issuer of securities issued in an exchange offer or in connection with a statutory amalgamation, merger, arrangement or other reorganization requiring the vote of securityholders of the participating companies (a "business combination"). The securities may be the sole consideration offered in the exchange or business combination or may be offered in conjunction with cash. (Form F-9 or F-10 also may be used where the eligibility requirements of those forms are satisfied.) In the case of exchange offers and business combinations, the forms consist primarily of the applicable Canadian offering document or information circular, and no reconciliation to U.S. GAAP is required for financial statements included in these forms.

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Forms F-8 and F-80 are available to Canadian issuers that satisfy the following eligibility requirements, which are applicable to both exchange offers and business combinations:

(1) the issuer is incorporated or organized under the laws of Canada or any Canadian province or territory and qualifies as a foreign private issuer;

(2) the issuer is not registered or required to be registered as an investment company under the 1940 Act;

(3) during the 36 months immediately preceding the filing, the issuer (or for business combinations, each predecessor participant but not the successor registrant) has been subject to the reporting requirements of a Canadian securities regulatory authority;

(4) during the 12 months immediately preceding the filing, the issuer's securities (or for business combinations, each predecessor participant but not the successor registrant) must have been listed on The Toronto Stock Exchange;

(5) the issuer is currently in compliance with its obligations arising from the reporting and listing requirements referred to in (3) and (4) above; and

(6) the issuer (or for business combinations, each predecessor participant but not the successor registrant) has a public float of its equity securities (aggregate market value held by non-affiliates) of at least C.$75 million, unless the issuer is making the exchange offer for its own securities.

In addition to the eligibility requirements set forth above, the following conditions also must be satisfied:

(1) the company that is the subject of the exchange offer (or for business combinations, each predecessor participant and the successor registrant) is incorporated or organized under the laws of Canada or any other Canadian province or territory and qualifies as a foreign private issuer;

(2) the company that is the subject of the exchange offer is not registered or required to be registered as an investment company under the 1940 Act;

(3) less than 25% (in the case of Form F-8) or 40% (in the case of Form F-80) of the class of securities that are the subject of the exchange offer or business combination are held by U.S. holders. A conclusive presumption as to the percentage of U.S. holders is provided for in the forms in the case of a third-party exchange offer, unless there is knowledge to the contrary;[7]

[7] The presumption that the threshold has not been exceeded is effective unless: (a) the most recent annual report or annual information form filed or submitted by the issuer to Canadian securities regulators or with the SEC indicates that 25% or more (40% or more for Form F-80) of the securities are held by U.S. holders, (b) the aggregate reported trading volume indicates that more of the relevant securities were traded in the

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(4) the securities being issued in the exchange offer or business combination are offered to U.S. holders on terms and conditions no less favorable than those offered to any other holder of the same class of securities; and

(5) derivative securities may not be registered on Forms F-8 or F-80 except (A) warrants, options and rights, provided that such securities and the underlying securities to which they relate are issued by the registrant, its parent or an affiliate of either, or (B) convertible securities, provided that such securities are only convertible into securities of the registrant, its parent or a person directly or indirectly controller either of them.

Also see certain further conditions to using the MJDS for tenders and exchange offers as discussed below in this chapter under "—Application of Certain SEC Rules and Forms to all Canadian Issuers—Tender Offer Regulation."

Disclosure Requirements of Forms F-7, F-8, F-9, F-10 and F-80

Forms F-7, F-8, F-9, F-10 and F-80 are each divided into a cover page, General Instructions and three parts. The cover page and the three parts for each form are discussed below.

Cover Page

The cover page contains basic information relating to the Canadian issuer, including its name, its jurisdiction of incorporation or organization, the address of its principal executive offices, and the name and address of the Canadian issuer's agent for service of process in the United States. The cover page must also set forth a calculation of the registration fee, and Canadian issuers must check a box if the securities being registered are offered on a delayed or continuous basis pursuant to the home jurisdiction's shelf prospectus offering procedures. For Forms F-9 and F-10, the Canadian issuer must determine when the filing should be declared effective by the SEC, subject to certain constraints.

Part I

Part I contains information required to be delivered to prospective purchasers of the securities, which consists of the home jurisdiction prospectus that is used to publicly offer the securities. Except for certain requirements discussed below, the prospectus is prepared in accordance with the disclosure requirements of the home jurisdiction. The prospectus used in the United States is not required to contain documents incorporated by reference into the prospectus which are not required to be delivered by any home jurisdiction rule or regulation to the purchasers of the securities. In addition, the prospectus used in the United States is not required to include disclosure that is applicable solely to Canadian purchasers and is not material to U.S. purchasers. For instance, the prospectus is not required to include any (1) Canadian "red herring" legend, (2) discussion of Canadian tax considerations, other than those material to a

United States than in Canada over the 12 months prior to the commencement of the relevant offer or (c) the offeror has actual knowledge that the 25% (40% for Form F-80) limit has been equalled or exceeded.

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U.S. purchaser, (3) names of any Canadian underwriters not acting as an underwriter in the United States, (4) description of the Canadian plan of distribution, except as necessary to explain the material elements of the U.S. plan of distribution, (5) discussion of certain statutory rights applicable under Canadian provincial or territorial securities rules, unless applicable to a U.S. purchaser, or (6) description of certain certificates of the issuer or any underwriter.

Part I also requires the placement of certain informational legends on the outside front cover page of the prospectus. The first informational legend explains (1) that the offering of the securities is made pursuant to a multi-jurisdictional disclosure system whereby a foreign issuer is permitted to prepare the prospectus according to the disclosure requirements of its home jurisdiction; (2) that the foreign disclosure requirements may differ from those in the United States; and (3) that the financial statements are prepared in accordance with foreign generally accepted accounting principles, and are subject to foreign auditing and auditor independence standards, and that the financial statements may not be comparable to the financial statements of a U.S. company. Also required are legends regarding the enforceability of the civil liability provisions of the federal securities laws by investors, the potential tax consequences to investors (both in the U.S. and in the issuer's home country) upon an acquisition of the securities and the warning that the SEC has not approved or disapproved the securities or passed upon the disclosure.

Forms F-8, F-9, F-10 and F-80 require the inclusion of a legend regarding certain market activities in an exchange offer during the period the Canadian issuer is distributing the securities in the United States. Since Forms F-9 and F-10 may be used prior to the registration statement being declared effective by the SEC, the U.S. "red herring" legend required on Forms F-1, F-2 and F-3 also is required.

Forms F-7, F-8, F-9, F-10 and F-80 permit Canadian issuers to incorporate by reference documents previously filed with the SEC pursuant to the 1934 Act or submitted to the SEC pursuant to Rule 12g3-2(b) under the 1934 Act.[8] All of the above forms also require that a list of all documents filed with the SEC as part of the registration statement be attached to or included in the prospectus.

Form F-10 also requires that financial statements included in the prospectus be reconciled to U.S. GAAP for issuers whose financial statements are not prepared in accordance with IFRS as issued by the IASB,[9] as required by Item 18 of Form 20-F under the 1934 Act.

Part II

Part II of the 1933 Act registration statements on Forms F-7, F-8, F-9, F-10 and F-80 contains information and documents that need not be furnished to purchasers but are available for public inspection and copying at the SEC (including any reports or information that are

8 As a result of the 2008 revisions to Rule 12g3-2(b), documents will no longer be "submitted" to the SEC pursuant to Rule 12g3-2(b). In the instructions to the MJDS forms there was no corresponding change made to expressly permit documents "published" under revised Rule 12g3-2(b) to be incorporated by reference in the MJDS forms.

9 See supra footnote 4.

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required to be made publicly available in connection with the transaction, any agreements relating to a proposed acquisition or business combination (except for Form F-7), copies of any documents incorporated by reference into the registration statement and any publicly available documents filed with any Canadian regulatory authority concurrently with the prospectus.) If any accountant, engineer, appraiser or other "expert" is named in the registration statement as having prepared or certified any part of the prospectus, Part II requires the written consent of such person for inclusion in the registration statement. Finally, a copy of any indenture must be included.

Forms F-8, F-9, F-10 and F-80 require inclusion of a brief statement regarding indemnification provisions under which indemnification against liabilities arising under the 1933 Act may be available to directors, officers or controlling persons of the Canadian issuer (including any provisions included in an underwriting agreement relating to the indemnification of an underwriter or controlling persons which may benefit persons who are directors, officers or controlling persons of the issuer). The registration statement must also contain a statement that, with respect to the indemnification of directors, officers or controlling persons, the SEC is of the view that such indemnification is against public policy and, therefore, unenforceable.

Part III

Part III (with the exception of Form F-7) requires a Canadian issuer to undertake to make available to the staff of the SEC a representative of the issuer who will respond to questions or inquiries, and to undertake to furnish information relating to the registration statement to the staff of the SEC when requested. With regard to exchange offers, a Canadian issuer using Forms F-8 and F-80 also must undertake that it will disclose in the United States, on the same basis it may be required to do so by Canadian regulation, information regarding purchases of the Canadian issuer's securities or the subject issuer's securities.

Part III also requires Canadian issuers, and any non-U.S. person acting as trustee with respect to the securities, to file with the SEC an irrevocable consent and power of attorney on Form F-X.

Investment Companies

The MJDS forms are not available for investment companies that are registered or required to be registered under the 1940 Act. However, they are available to investment companies exempt from registration under the 1940 Act. For instance, Canadian banks, insurance companies and similar institutions that issue securities in the United States would be permitted to use the MJDS. In addition, Rule 3a-7 under the 1940 Act, discussed above, permits structured financing vehicles that comply with the terms of Rule 3a-7, and that meet the eligibility requirements of the applicable form, to use the MJDS.

Auditor Independence

Financial statements included in Forms F-7, F-8, F-9, F-10 and F-80 may be audited in accordance with Canadian generally accepted auditing standards. However, except in the case of a rights offering on Form F-7, all MJDS Forms require compliance by auditors with U.S. independence requirements for the most recent full fiscal year included in an initial registration

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statement on these forms and for each report thereafter. Compliance with Canadian ethics and independence standards is permitted for earlier periods, unless the Canadian issuer previously filed with the SEC a report or registration statement containing an audit report on financial statements for the prior period as to which the U.S. auditor independence standards otherwise applied.

The 1939 Act

Public offerings of debt securities are generally subject to the 1939 Act. The 1939 Act requires, among other things, the qualification of indentures under which debt securities are issued, establishes eligibility requirements for the indenture trustee, imposes strict standards of conduct on the indenture trustee, requires certain reports and notices by the trustee, and regulates the impairment of certain rights of holders of debt securities. The 1939 Act also requires the trustee to be a U.S. institution authorized to exercise corporate trust powers and subject to supervision or examination by a regulatory authority in the United States.

The SEC adopted two rules in connection with MJDS offerings to facilitate the offering of debt securities under the MJDS by Canadian issuers. Rule 10a-5 under the 1939 Act permits Canadian trust companies subject to supervision or examination by Canadian federal authorities under the Trust Companies Act (Canada) or the Canada Deposit Insurance Corporation Act to act as sole indenture trustees for debt offerings under the MJDS. Rule 4d-9 under the 1939 Act exempts Canadian trust indentures used to issue debt securities under the MJDS from virtually all substantive requirements of the 1939 Act provided that the indentures are subject to the Canada Business Corporations Act, the Business Corporations Act (Ontario) or the Bank Act.

Form F-X

A Canadian issuer must, at the time it files a registration statement on Form F-7, F-8, F-9, F-10 or F-80, file with the SEC a Form F-X, which contains an irrevocable consent to service of process for SEC proceedings or civil actions arising out of, or relating to, the public offering or the securities being offered. In addition, Form F-X contains an appointment of a U.S. person as agent for service of process. Form F-X also must be filed by the Canadian trustee where debt securities are being registered.

Form F-X contains no limitation on venue, resulting in the ability of aggrieved investors in civil actions relating to an offering of securities under the MJDS to bring suit in any federal or state court in the United States.

REGISTRATION AND REPORTING UNDER THE 1934 ACT

Registration

As noted elsewhere in this volume, before a foreign private issuer can list securities or ADRs on a U.S. national securities exchange, the securities must be registered under the 1934 Act. Also, a foreign private issuer must register its equity securities under the 1934 Act if it exceeds the Section 12(g) thresholds for the number of record holders of its equity securities and the number of U.S. holders of those equity securities. For most foreign private issuers, Form 20-F can be used to register the securities under the 1934 Act. MJDS Form 40-F is available for

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use by certain Canadian issuers to register securities under Section 12(b) or 12(g) of the 1934 Act. A Canadian issuer that has securities listed on a U.S. national securities exchange, or that exceeds the Section 12(g) thresholds of equity securities held of record and of equity securities held by U.S. holders, is eligible to use Form 40-F to satisfy its registration obligations if (1) the Canadian issuer is eligible to use Form F-10 or (2) the Canadian issuer is eligible to use Form F-9 and the securities could be registered on Form F-9.

Reporting

As discussed in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume, when a foreign private issuer has listed securities on a U.S. national securities exchange, or has registered a public offering of securities under the 1933 Act, it must thereafter file periodic reports in order to keep the information on file with the SEC (and therefore available to the market place) "reasonably current." The MJDS provides certain accommodations for Canadian issuers who become subject to the 1934 Act, whether as a result of (1) making a registered public offering in the United States, (2) having a specified number of record holders of their equity securities and a specified number of U.S. holders of those equity securities or (3) having their securities listed on a U.S. national securities exchange.

Under the MJDS, Canadian issuers that have an obligation under the 1934 Act solely as the result of an MJDS offering registered on Form F-7, F-8, F-9, F-10 or F-80 may satisfy their reporting requirements under the 1934 Act by filing Canadian continuous disclosure documents with the SEC under the cover of Form 40-F (annual report)[10] or 6-K (interim reports). In addition, under exemptive provision Rule 12h-4 under the 1934 Act, Canadian issuers that have an obligation under the 1934 Act arising solely as a result of an MJDS offering registered on Form F-7, F-8 or F-80 are exempt from the 1934 Act reporting obligations provided that they comply with Rule 12g3-2(b), as discussed in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

A Canadian issuer eligible to use Form F-10 may use Canadian disclosure documents to satisfy its 1934 Act reporting obligations with respect to any security, whether the offering was made pursuant to the MJDS or otherwise. This permits a Canadian issuer who previously made a registered offering of securities in the United States to switch to Canadian disclosure documents to satisfy its U.S. continuous reporting obligations under the 1934 Act using MJDS forms, or it may choose to use non-MJDS forms. However, if MJDS forms are used, then the annual filing (using Form 40-F) requires that financial statements included in the Canadian disclosures that are not prepared in accordance with IFRS as issued by the IASB must be reconciled to U.S. GAAP pursuant to Item 17 of Form 20-F, subject to certain exceptions discussed below under "Form 40-F."

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[10] Recently, the SEC adopted amendments to Form 40-F requiring a Canadian issuer that files pursuant to MJDS to test its status as a foreign private issuer only as of the last business day of its second fiscal quarter. Currently, a Canadian issuer that is eligible to file a Form 40-F annual report at the end of the fiscal year is presumed to be eligible to use Form 40-F, as well as Form 6-K, from the date of filing to the end of the next fiscal year. See SEC Release No. 33-8959 (Sept. 23, 2008) (http://www.sec.gov/rules/final/2008/33-8959.pdf).

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The Form F-10 eligibility tests are applied continuously for these purposes. Thus, issuers that no longer meet the eligibility criteria (*e.g.*, the "size" tests) are not entitled to use Canadian disclosures and must therefore switch to using the SEC's disclosure scheme for foreign private issuers or the U.S. domestic scheme.

A Canadian issuer eligible to use Form F-9 may use Canadian disclosure documents to satisfy its 1934 Act reporting obligations only with respect to securities that could be offered on Form F-9 (*i.e.*, investment grade debt or preferred securities that are not convertible or are not convertible for at least one year). Financial statements included in the Canadian disclosure documents are not required to be reconciled to U.S. GAAP even if they are not prepared in accordance with IFRS as issued by the IASB. Similar to Form F-10, the eligibility tests are applied continuously.

Historically, MJDS filings (under the 1933 Act or under the 1934 Act) have not been reviewed by the SEC, which instead defers to home jurisdiction review in Canada. However, Section 408 of Sarbanes-Oxley now requires that the SEC review, at least every three years, the periodic filings under the 1934 Act of all registrants listed on a U.S. exchange, and no exceptions are provided for MJDS filers. Therefore, the SEC has extended this mandated review to periodic filings by MJDS issuers listed on a U.S. exchange and has given comments to some MJDS filers with respect to their filings under the 1934 Act, apparently primarily with respect to U.S. GAAP reconciliation. The SEC requires an issuer to report unresolved staff comments received more than 180 days prior to fiscal year end in the Form 10-K or 20-F with respect to that fiscal year, but this disclosure of unresolved staff comments is not required for MJDS filers under the 1934 Act, who use Form 40-F.

Form 40-F

Information filed on Form 40-F includes the Canadian issuer's annual information form, audited annual financial statements, and (in connection with its periodic filings) the annual management's discussion and analysis, as prepared in accordance with Canadian requirements. Reconciliation as specified in Item 17 of Form 20-F is required in connection with Form 40-F for issuers whose financial statements are not prepared in accordance with IFRS as issued by the IASB unless the obligation to file arises as a result of registration on Form F-7, F-8, F-9 or F-80 or the Form 40-F is filed with respect to securities that could have been registered under the MJDS on Form F-9. A Form 40-F must be filed with the SEC on the same day that the annual information form is required to be filed with any securities commission in Canada. Certain exhibits, including copies of materials incorporated by reference in the relevant Canadian documents and executed experts' consents, must be filed with the Form 40-F. In addition, a consent to service of process on Form F-X must be filed with the annual report on Form 40-F, unless Form F-X was previously filed. Annual reports on Form 40-F must be in English.

In response to Sarbanes-Oxley, the SEC amended Form 40-F to require certifications from each principal executive officer and principal financial officer and certain other disclosures regarding the Form 40-F, including information with respect to disclosure controls and procedures, internal control over financial reporting, audit committee financial experts, code of ethics, audit and related fees and off-balance sheet arrangements. See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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Form 6-K

Canadian issuers are required to furnish, under cover of Form 6-K, information the issuer has made public or is required to make public in its home jurisdiction, has filed or is required to file with a stock exchange where its securities are traded, or has distributed or is required to distribute to its shareholders. Documents furnished under the cover of Form 6-K must be filed "promptly" after the information has been made public in the home jurisdiction.

APPLICATION OF CERTAIN SEC RULES AND FORMS TO ALL CANADIAN ISSUERS

Rule 3a12-3

Under Rule 3a12-3 under the 1934 Act, foreign private issuers (including Canadian foreign private issuers) are exempt from the U.S. proxy rules and U.S. insider trading/short swing profit recovery rules. Since Canadian issuers are exempt from the U.S. proxy rules, the SEC's shareholder communications provisions are not applicable to Canadian issuers.

Canadian issuers that use the U.S. disclosure forms (rather than the MJDS forms or foreign private issuer forms) are not prevented from relying on Rule 3a12-3. However, a Canadian issuer is required to set forth all information normally incorporated by reference to the U.S. proxy statement in the Form 10-K.

1933 Act and 1934 Act Forms

All rules and forms discussed in this volume with respect to foreign private issuers are also available to Canadian foreign private issuers. For instance, Form 20-F is available for all Canadian private issuers for the registration of securities and annual reports under the 1934 Act. In addition, Canadian foreign private issuers are permitted to use Forms F-1 and F-3.

Tender Offer Regulation

Under the MJDS, a bidder making a cash tender offer or an exchange offer in Canada and the United States for securities of a Canadian issuer may comply with the provisions of the 1934 Act by complying with the applicable Canadian tender offer regulation if U.S. holders own less than 40% of the class of securities of the Canadian target company subject to the tender or exchange offer and if, in the case of an issuer tender or exchange, the issuer is not registered or required to be registered as an investment company under the 1940 Act.

In a tender or exchange offer under the MJDS, Schedules 13E-4F (Canadian issuer tender offer), 14D-1F (Canadian third-party tender offer) and 14D-9F (recommendation by a Canadian issuer, or director or officer of the Canadian issuer, that is the target of a tender offer filed on Schedule 14D-1F) may be filed with the SEC in lieu of the counterpart U.S. tender offer forms, and compliance with applicable Canadian tender offer regulation is deemed to satisfy certain U.S. tender offer rules. In addition, a bidder may be able to satisfy the registration requirements under the 1933 Act in respect of securities to be issued in an exchange offer by preparing exchange offer documents in accordance with Canadian disclosure requirements and filing those documents with the SEC on Form F-8 (where U.S. holders own less than 25%), Form F-80

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(where U.S. holders own less than 40%) or, if those forms are unavailable, Form F-9 or F-10, provided that the eligibility requirements for the use of those forms are met as discussed in this chapter above.

A condition to the use of the MJDS to effect cross-border tender and exchange offers is that the transaction be subject to a Canadian regulatory scheme governing the conduct of tender offers. Consequently, tender or exchange offers that are not subject to Canadian tender offer regulation, such as tender offers for non-convertible debt securities and non-convertible, non-voting preferred stock, are not eligible for the MJDS. Also, offers exempted from Canadian tender offer regulation likewise would not qualify.

Where the MJDS applies with respect to a Canadian target company, Canadian regulatory authorities are primarily responsible for establishing the applicable disclosure standards for both tender and exchange offers. The principal jurisdiction designated as responsible for conducting any review of the disclosure documents required for a tender or exchange offer filed in Canada and the United States will be that customary in Canada. Nevertheless, certain U.S. tender offer rules will continue to apply to MJDS tender and exchange offers, including various general anti-fraud and insider trading provisions. In addition, if the MJDS tender or exchange offer is being made in connection with a "going private" transaction, a Schedule 13E-3 will need to be prepared and filed with the SEC in accordance with U.S. requirements.[11]

The eligibility requirements for conducting a concurrent tender or exchange offer in Canada and the United States under the MJDS are as follows:

(1) the tender or exchange offer is covered by and not exempt from provisions of Canadian law governing the terms and conditions of the tender or exchange offer;

(2) offers are extended to all holders of the class of securities in the United States upon terms no less favorable than those extended to any other holder of the same class of securities;

(3) U.S. holders must hold less than 40% of the securities of the class subject to the tender or exchange offer, as determined in accordance with specific rules under the MJDS;

(4) in order to use Form F-8 or F-80 to register the securities to be issued in an exchange offer (in lieu of the appropriate non-MJDS form), U.S. holders must hold less than 25% (in the case of Form F-8) or 40% (in the case of Form F-80) of the securities of the class subject to the exchange offer, among the other conditions required to be satisfied for use of such forms as discussed in this chapter above; and

(5) as with Forms F-8 and F-80, third-party bidders, whether solicited or unsolicited, are permitted to rely upon a conclusive presumption that less than the threshold

[11] See Chapter 16 (*Repurchasing, Exchanging and Amending an Issuer's Outstanding Securities*) of this volume.

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percentage of securities is held by U.S. holders and that the target of the tender or exchange offer is a Canadian issuer, provided that there is a primary trading market outside the United States and absent published trading volume data, disclosure in public filings or actual knowledge to the contrary.

Although offers exempted from Canadian tender offer regulation would not qualify for MJDS treatment, a limited grant of exemptive relief by Canadian securities regulators from certain Canadian tender offer regulations would not likely preclude a tender or exchange offer in the United States from qualifying under the MJDS. However, the MJDS would not be available if such relief were granted from Canadian provisions mandating tender offer protections that are called for by the 1934 Act and SEC regulation such that the tender or exchange offer is not subject to these protections pursuant to a Canadian regulatory scheme.

Persons seeking to use the MJDS despite the receipt of such an exemptive order may seek relief from the SEC to allow the tender or exchange offer to proceed under the MJDS conditioned upon compliance with the relevant 1934 Act regulation with respect to U.S. holders or unconditionally. The SEC must be provided with a copy of all requests for relief from Canadian securities authorities at the time the request is made in Canada, and any orders granting such relief should be filed as an exhibit to Schedule 13E-4F or 14D-1F.

To the extent the class of securities subject to the tender or exchange offer is not registered under the 1934 Act, many of the provisions of the 1934 Act will not apply to such tender or exchange offer. In addition, the issuance of securities in an exchange offer may qualify for an exemption from registration under Section 3(a)(10) of the 1933 Act if the exchange offer is conducted pursuant to a court approved "plan of arrangement" as is often the case with Canadian companies, provided that certain requirements are satisfied.

Schedules 13D and 13G

The requirement to file Schedule 13D or, in certain cases, a short form statement under Schedule 13G, under the 1934 Act upon acquisition directly or indirectly of beneficial ownership in excess of 5% of a class of equity securities registered under the 1934 Act within ten calendar days of such acquisition still applies and is not affected by the MJDS.[12]

REQUIREMENTS UNDER SARBANES-OXLEY

Canadian issuers, like other foreign private issuers, that file reports with the SEC under the 1934 Act are currently subject to Sarbanes-Oxley's requirements and prohibitions. See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume. This includes Canadian issuers that have entered the SEC's reporting system by listing their securities on the NYSE, NYSE Alternext US or NASDAQ or by registering an offering of their securities under the 1933 Act or that are required to file reports under Section 12(g) of the 1934 Act because they exceed the specified thresholds of holders of record of equity securities and of U.S. holders of those equity securities. This does not include Canadian issuers that use the exemption provided by

[12] See Chapter 19 (*Acquisitions by Non-U.S. Entities*) of this volume.

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Rule 12g3-2(b).[13] Certain provisions of Sarbanes-Oxley apply to Canadian issuers that are not yet required to file reports with the SEC but that have filed a registration statement under the 1933 Act that has not yet become effective.

13 See Chapter 15 (*Home Country Matters*) of this volume.

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CHAPTER 14

FOREIGN GOVERNMENTAL ISSUERS

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GENERAL

This chapter describes the eligibility and disclosure requirements for the registration of securities by foreign governmental issuers under the 1933 Act. Schedule A to the 1933 Act prescribes information that must be furnished by corporate and other non-governmental issuers. Schedule A has been effectively superseded through the adoption by the SEC of various forms, such as Forms S-1, S-3, F-1 and F-3, which provide more detailed disclosure requirements for such issuers. Because the SEC has never adopted comparable forms for foreign governmental issuers, such issuers continue to be guided by the statutory disclosure requirements applicable to foreign governmental issuers found in Schedule B to the 1933 Act. This chapter discusses the Schedule B eligibility and disclosure requirements, other disclosure that has come to be expected from foreign governmental issuers, and the procedures necessary to conduct a delayed or continuous offering of securities registered pursuant to a registration statement complying with Schedule B.

SCHEDULE B ELIGIBILITY REQUIREMENTS

General

Section 7 of the 1933 Act requires any "foreign government, or political subdivision thereof" registering securities under the 1933 Act to file with the SEC a registration statement containing the information specified in Schedule B to the 1933 Act. The SEC has permitted issuers other than foreign central governments, provinces, states and cities to register securities on a Schedule B registration statement.

The term "political subdivision" is not defined in the 1933 Act, and the SEC has not developed express criteria for determining whether or not a particular issuer is a "political subdivision" of a foreign government for purposes of Schedule B. However, the staff of the SEC has acknowledged that transnational organizations, sovereign nations, provinces, municipalities, development banks, school districts are among the various types of entities that have filed Schedule B registration statements. The staff has also issued no-action letters to foreign issuers on a case-by-case basis, and provided informal advice to foreign issuers as to their eligibility to register securities pursuant to Schedule B. The no-action letters state, without deciding whether the particular issuer is a "political subdivision" within the meaning of Section 7 of the 1933 Act, that the staff of the SEC will not object to the issuer registering securities on a Schedule B registration statement. These no-action letters provide some guidance for determining whether or not the SEC would allow a particular issuer to register securities on a Schedule B registration statement.

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If there is any question as to whether an issuer is eligible to register securities on a Schedule B registration statement, the matter is normally discussed with the staff of the SEC in a pre-filing conference. At such a conference, the issuer should be prepared to provide the staff with detailed information concerning the issuer and its relationship to a government.

The staff of the SEC is more likely to allow a foreign issuer to register securities on a Schedule B registration statement if the issuer is formed by governmental action for the purpose of performing delegated governmental functions, or if the foreign issuer is formed pursuant to an agreement among countries in order to serve their joint economic interests. However, the staff of the SEC may require the government or governments for which the foreign issuer is performing such functions to co-sign the issuer's Schedule B registration statement.

The staff of the SEC has issued no-action letters only to foreign issuers that have had the credit support of a government by operation of law or pursuant to (1) an unconditional guarantee,[1] (2) call provisions applicable to sovereign shareholders for the subscribed but unpaid capital of such issuers or (3) back-to-back lending arrangements with a government pursuant to which the government undertakes to make payments of principal and interest upon the same terms as the initial borrowing.[2] If a government guarantees securities, the guarantee may have to be registered on the Schedule B registration statement as a separate security, and the government will then become a co-registrant on such registration statement.

Each of the issuers in the no-action letters possessed legal immunities and exemptions commonly associated with governmental bodies, agencies and instrumentalities.

Selected No-Action Letters

The following no-action letters illustrate the types of issuers that, in addition to governments, may be eligible to file a Schedule B registration statement.

CABEI No-Action Letter. On March 14, 1973, the staff of the SEC issued a no-action letter to Central American Bank for Economic Integration ("CABEI") in which it accepted counsel's opinion that CABEI was eligible to register securities pursuant to Schedule B. CABEI was established pursuant to an international agreement among several Latin American countries ("Latin American Countries") in order to promote the economic integration and balanced economic development of such countries. CABEI's activities included the following:

(1) infrastructure projects to complete existing regional systems or to balance disparities in basic sectors that were creating difficulties for balanced economic development;

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1 The SEC has issued several no-action letters to Canadian electrical utilities wishing to register securities guaranteed by a province of Canada.

2 See the discussion of the no-action letter issued to the Bank of Greece in 1993 in this chapter below under the heading "—Schedule B Eligibility Requirements—Selected No-Action Letters—Bank of Greece No-Action Letter."

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(2) long-term investment projects in industries to increase goods available for trade among the Latin American Countries or for export;

(3) coordination of agricultural projects to improve, expand or replace existing food production operations and establish food production on a regional basis;

(4) projects to finance enterprises needing to expand operations, modernize plants or change the structure of production to improve efficiency and competitive capacity in order to facilitate regional free trade;

(5) projects to finance services indispensable to the functioning of the Central American Common Market; and

(6) other projects to create complementary economies among the Latin American Countries and increase trade within the region.

At the time of CABEI's no-action request, each of the Latin American Countries had subscribed a proportionate amount of CABEI's ordinary capital and guarantee capital, the latter being subject to call only to the extent deemed necessary for the fulfillment of CABEI's debt obligations. In addition, CABEI was immune from all taxes and customs duties, and from any obligation relating to the payment, withholding or collection of any tax or duty, in the Latin American Countries. Further, the property and other assets of CABEI were immune from all forms of attachment and seizure.

NIB No-Action Letter. On December 30, 1981, the staff of the SEC issued a no-action letter to Nordiska Investeringsbanken ("NIB") in which it accepted counsel's opinion that NIB was eligible to register securities pursuant to Schedule B. NIB was established pursuant to an international agreement among several Nordic countries ("Nordic Countries") to make loans and give guarantees in accordance with regular banking practice in order to encourage investment projects and promote exports of common interest to the Nordic Countries. At the time of NIB's no-action request, the authorized capital stock of NIB was 400 million special drawing rights, and the subscribed but unpaid capital stock of NIB was subject to call upon the Nordic Countries only to the extent deemed necessary for the fulfillment of NIB's debt obligations. In addition, NIB was exempt from many of the regulations of the Nordic Countries (*e.g.*, regulatory supervision, payment restrictions and credit policy measures, direct taxation, stamp duties and other official charges on loan agreements, and requirements to register as a commercial company or bank).

KfW No-Action Letter. On August 20, 1987, the staff of the SEC issued a no-action letter to Kreditanstalt für Wiederaufbau ("KfW") in which it accepted counsel's opinion that KfW was eligible to register securities pursuant to Schedule B. KfW was organized as a direct federal corporation under the laws of the Federal Republic of Germany ("Germany") in order to perform certain federal administrative functions. Specifically, KfW's purposes were (1) to grant and guarantee loans, insofar as other credit institutions were unable to raise the necessary funds, for projects serving the reconstruction or the promotion of the German economy and in connection with the export transactions of domestic enterprises and (2) to grant loans to finance projects deserving of assistance in foreign countries, especially in connection with development

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aid, or loans necessary for funding foreign debtors' liabilities to creditors in Germany, or loans of special governmental or economic interest to Germany. The loans in clause (2) above were funded directly from the German government's federal budget.

At the time of KfW's no-action request, 80% of KfW was owned by Germany and 20% was owned by the German states. By operation of German law, Germany was obligated to provide KfW with any and all funds required to enable KfW to meet its obligations. Accordingly, the credit of Germany, including its taxing power, was fully engaged for the benefit of the holders of debt securities issued by KfW. In addition, KfW was exempt from taxation, from the registration provisions of the German Commercial Code and from the principal provisions of the German Banking Law. Finally, in issuing its no-action letter to KfW, the staff of the SEC emphasized the fact that Germany had agreed to sign KfW's registration statement.

Bank of Greece No-Action Letter. On June 2, 1993, the staff of the SEC issued a no-action letter to the Bank of Greece in which it accepted counsel's opinion that the bank was eligible to register securities pursuant to Schedule B despite (1) the absence of a guarantee of the Bank of Greece's borrowings by the Greek government; (2) the fact that the Greek government only owned 10% of the Bank of Greece's shares; and (3) the fact that the bank was originally created to be independent of the Greek government.

Critical to the SEC staff's assessment of the Bank of Greece's eligibility was its status as the central bank of the Republic of Greece and the fact that the Greek government would sign the registration statement. For example, the Bank of Greece: (1) had the exclusive privilege to issue bank notes; (2) served as the exclusive depository for the Greek government's deposits and reserves; (3) controlled and managed the Greek government's gold and foreign currency reserves; (4) implemented foreign exchange policy and conducted monetary and credit policy; (5) supervised the operations and financial conditions of other Greek banks; and (6) otherwise acted as banker to the Greek government. In addition, the Bank of Greece's charter had the force of law and could only be amended if the amendment was approved by parliament by means of the adoption of a new law. Finally, like previous issuers permitted to register securities pursuant to Schedule B, the Bank of Greece was exempt from all taxes and duties.

Moreover, based upon arguments raised in the letter of inquiry, market perceptions of the Bank of Greece's centrality to the Greek government may have weighed heavily in the decision of the staff of the SEC to issue the no-action letter. Moody's Investors Service rated the Bank of Greece's securities rather than those of the Greek government. Offering and registration documents used by the Bank of Greece and international governmental accounting statistics demonstrated that it was the Bank of Greece and not the Greek government that was the recognized borrower in the international securities markets. In addition, the Bank of Greece entered into back-to-back lending arrangements with the Greek government pursuant to which the Greek government undertook to make payments of principal and interest on the loan upon the same terms as the initial borrowing.

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DISCLOSURE REQUIREMENTS FOR SCHEDULE B FILERS

Registration under the 1933 Act

Schedule B Disclosure Requirements

Foreign governmental issuers must register securities by filing a registration statement containing the information specified in Schedule B. Schedule B requires the disclosure of certain information about the issuer (and, in the case of securities guaranteed by the government, similar information about the government), the offering and the underwriters. If a foreign government guarantees the securities of one of its agencies or instrumentalities, both the agency or instrumentality and the government as guarantor are required to sign the registration statement.

Specifically, Schedule B requires disclosure of the following:

(1) name of the foreign government or its subdivision, as issuer or co-registrant;

(2) specific purposes and the approximate amounts to be devoted to such purposes, so far as determinable, of the offering;[3]

(3) the amount of the funded (long-term) debt and the estimated amount of the floating (short-term) debt outstanding and to be created by the security to be offered, excluding intergovernmental debt, and a brief description of the date, maturity, character of such debt, rate of interest, character of amortization provisions, and the security, if any, for such debt;[4]

(4) whether or not the issuer or its predecessor has, within a period of twenty years prior to the filing of the registration statement, defaulted on the principal or interest of any external security, excluding intergovernmental debt, and, if so, the date, amount, and circumstances of such default, and the terms of the succeeding arrangement, if any;

(5) the receipts, classified by source, and the expenditures, classified by purpose, for the latest fiscal year for which such information is available and the two preceding fiscal years, year by year;

(6) the names and addresses of the underwriters;

(7) the name and address of the issuer's authorized agent, if any, in the United States;

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[3] If the funds are to be raised in part from other sources, the amounts thereof and the sources thereof must also be disclosed.

[4] If substitution for any security is permissible, a statement of the conditions under which such substitution is permitted must be disclosed; and if substitution is permissible without notice, this fact must be specifically stated. The SEC generally requires that debt tables included in the Schedule B registration statement reflect information as of a date no more than 90 days prior to the date the registration statement becomes effective.

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(8) the estimated net proceeds to be derived from the sale in the United States of the security to be offered;

(9) the price at which the security is proposed to be offered in the United States to the public or the method by which such price is computed;[5]

(10) all commissions[6] paid or to be paid, directly or indirectly, by the issuer to the underwriters in respect of the sale of the security to be offered;

(11) the amounts or estimated amounts, itemized in reasonable detail, of expenses, other than the commissions specified in paragraph (10) above, incurred or borne by or for the account of the issuer in connection with the sale of the security to be offered, including legal, engineering, certification and other charges;

(12) the names and addresses of counsel who have passed upon the legality of the issue;

(13) a copy of any agreement or agreements made with any underwriter governing the sale of the security within the United States; and

(14) an agreement of the issuer to furnish a copy of the opinion or opinions of counsel in respect to the legality of the issue, with a translation, where necessary, into the English language. Such opinion should set out in full all laws, decrees, ordinances, or other acts of government under which the issue of such security has been authorized.

Rules 490 through 493 under the 1933 Act modify the disclosure requirements of Schedule B. Rule 490 allows an issuer to omit detailed disclosure (as required by paragraph (3) of Schedule B) with respect to issues of outstanding funded debt if the aggregate amount of such debt is less than 5% of the total of the funded debt outstanding and the debt to be created by the securities to be offered. However, the issuer must include the amount of such debt issues in the statement of the total amount of funded debt outstanding, and the issuer must disclose the title, amount outstanding, rate of interest, and date of maturity with respect to each such issue.

Rule 491 clarifies the requirements of paragraph (6) of Schedule B by requiring a Schedule B issuer to disclose only the names and addresses of the principal underwriters and a brief statement regarding the discounts and commissions to be received by sub-underwriters or dealers. The principal underwriters are typically those that sign the underwriting agreement between the issuer and the underwriters.

[5] A variation in price may be proposed prior to the date of the public offering of the security, but the SEC must be notified immediately of such variation.

[6] Commissions include all cash, securities, contracts, or anything else of value paid, to be set aside or disposed of, or understandings reached with or for the benefit of any other persons in which the underwriter is interested, in connection with the sale of such securities. Where any such commission is paid, the amount of such commission paid to each underwriter must be disclosed.

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Rule 492 allows the issuer to omit certain information required by Schedule B from the prospectus (Part I of the registration statement) provided such information is disclosed in Part II of the registration statement (which is filed with the SEC but not included in the prospectus). Rule 492 provides that the prospectus does not need to include, among other things, the information with respect to the amortization and retirement provisions of debt (other than the securities being registered), the substitution of security for such debt, the addresses of the underwriters and legal counsel and a copy of the agreement between the issuer and the underwriters.

Rule 493 provides, among other things, that the opinion or opinions of counsel required by paragraph (14) of Schedule B may be filed either as part of the registration statement as originally filed or as an amendment to the Schedule B registration statement.

Rule 493 also requires that a Schedule B registration statement must (i) be filed on the SEC's IDEA system (unless a hardship exemption has been obtained), (ii) disclose that the SEC maintains a web site that contains reports and other information regarding issuers that file electronically and (iii) contain the address for the SEC web site (http://www.sec.gov). Schedule B registrants are encouraged to give their Internet address, if available.

Rule 494 permits a foreign national government with which the United States maintains diplomatic relations to publish a "newspaper prospectus" in newspapers, magazines, or other periodicals distributed via second-class mail. This rule was adopted in 1951 to accommodate the then common practice of advertising in newspapers securities issued by foreign national governments. Although this practice is less popular today, this rule remains available.

Financial Statements

Schedule B does not require audited financial statements to be included in a registration statement. In practice, however, the SEC usually requires an issuer filing a registration statement pursuant to Schedule B to include any financial statements it otherwise publishes. A Schedule B issuer is not required to have its financial statements reconciled to U.S. GAAP, but instead may provide its most recent available financial statements in their ordinarily prepared and presented form (in English). The SEC may require disclosure explaining the financial statements if U.S. investors would have difficulty understanding them.

Other Disclosure Requirements and Practices

Further disclosure is required by other provisions of the 1933 Act, which apply to registration statements generally. Section 12 of the 1933 Act, and Rule 408 thereunder, require an issuer to provide any information necessary to make the statements contained in the prospectus, in light of the circumstances under which they are made, not misleading. Thus, it is generally not sufficient for an issuer to provide only the information specifically required by Schedule B. Other disclosure, although not specifically required, has become customary and therefore expected by U.S. investors and the staff of the SEC. A prospectus for a foreign governmental issuer will usually include disclosures (including statistics) regarding the country (*e.g.*, its geography, population and political system), its economy, monetary system, foreign trade and balance of payments, foreign exchange, public finance, public debt and other relevant

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matters. Schedule B issuers such as development banks and enterprises eligible to register securities pursuant to Schedule B should provide additional information concerning their business, financial condition and results of operations.

Registration and Periodic Reporting under the 1934 Act

The 1934 Act requires issuers that have filed a registration statement that has become effective under the 1933 Act to file periodic reports with the SEC. Schedule B issuers, however, are exempt from this requirement. However, a foreign governmental issuer is subject to these registration and reporting requirements under the 1934 Act if it lists its securities on a U.S. national securities exchange (including NASDAQ). In practice, securities of foreign governmental issuers are rarely listed.

Even if the periodic reporting requirements of the 1934 Act are applicable to a foreign governmental issuer, such an issuer is exempt from many of the normal filing requirements that apply to other issuers. A foreign governmental issuer must, however, file a registration statement on Form 18 in connection with its listing application and, thereafter, it must file an annual report on Form 18-K. Interim amendments to Form 18 or Form 18-K are filed and designated as Form 18A or Form 18-K/A filings, as the case may be. Form 18 requires essentially the same disclosure required by Schedule B of the 1933 Act. Form 18-K also sets forth the disclosure that is used under the SEC's integrated disclosure system in connection with a delayed or continuous offering. Otherwise, annual reports on Form 18-K typically provide more abbreviated disclosure.[7]

Requirements under Sarbanes-Oxley

Sarbanes-Oxley should not apply to foreign governmental issuers. Although, as a technical matter, a foreign governmental issuer could be construed to be encompassed within the definition of "issuer" under Section 2(a)(7) of Sarbanes-Oxley and therefore be subject to its requirements and prohibitions. As a practical matter, it is unlikely that the U.S. Congress intended to apply Sarbanes-Oxley to such issuers.[8]

DELAYED OR CONTINUOUS OFFERING PROCEDURES

In 1980, the SEC adopted a procedure by which certain issuers eligible to register securities pursuant to Schedule B could conduct "delayed" or "continuous" offerings of securities. This procedure, typically referred to as "shelf registration," allows "seasoned" foreign governmental issuers[9] to register securities to be offered at a later time in one or more offerings

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[7] If the issuer is a national government, Form 18 and Form 18-K also require disclosure regarding (i) the gold reserves of the central bank of the issuer and any further gold stocks held by the issuer, (ii) imports and exports of merchandise for the last fiscal year of the issuer and (iii) if published, the balance of international payments for the last fiscal year.

[8] See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

[9] An otherwise "non-seasoned" foreign governmental issuer wishing to conduct a delayed or continuous shelf registration offering may satisfy the seasoning requirement by first filing a registration statement for a discrete offering of securities. The issuer may then file the shelf registration statement immediately following completion of the first offering.

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according to market conditions and the capital needs of the issuer. The SEC has defined foreign governmental issuers that have registered their securities (or guarantees of the securities of another issuer) under the 1933 Act within five years and have not defaulted on any payment of principal or interest as "seasoned" foreign governmental issuers. In 1982, the SEC issued another release designed to conform the shelf registration procedures of foreign governmental issuers to those provided by Rule 415 for non-governmental (or private) issuers.[10]

The current procedure for shelf registration by a foreign governmental issuer is outlined below. It should be noted that the SEC's liberalization of shelf offering procedures under Securities Offering Reform to the registered offering process does not extend to Schedule B issuers. Adopting the reforms, the SEC stated that it expects the SEC staff "will continue to consider disclosure and other shelf issues affecting Schedule B issuers in the same manner they do today."

Initially, a seasoned foreign governmental issuer wishing to conduct a delayed or continuous offering should file a shelf registration statement in order to register an amount of debt securities (of undetermined maturities, redemption provisions, interest rates and other terms) that, at the effective date, it reasonably expects will be offered and sold within two years from the initial effective date. The registration statement should contain a base prospectus ("base prospectus") disclosing the standard general political, economic and statistical information with regard to the country as well as the specific information required by Schedule B.

The filing of a shelf registration statement imposes no additional obligations on the Schedule B issuer, which may simply de-register the securities in the event a decision is made not to use the shelf in the future. Alternatively, the issuer may adopt procedures to keep the shelf updated as discussed in this chapter below under the heading "—Delayed or Continuous Offering Procedures—Incorporation by Reference," which in turn allows the issuer to access more easily the U.S. capital markets through shelf "takedowns."

Under the current procedure for shelf takedowns, foreign governmental issuers do not have to file post-effective amendments to the initial shelf registration in connection with each offering. Instead, the issuer may include in the base prospectus all the information previously included in prospectus supplements except price, maturity and related information that must be furnished by a Rule 424(c) pricing sticker. The only condition to using this procedure is that the base prospectus must be adequately disseminated to the public a reasonable period before the offering. In addition, the issuer must ensure that, at the time of each sale of securities, the base prospectus and supplements thereto contain or incorporate by reference all current information that might be material to an investor.

Incorporation by Reference

The staff of the SEC has consistently issued no-action letters to many seasoned Schedule B issuers, in which the staff has allowed these issuers to update their shelf registration statements

[10] See Chapter 5 (*Shelf Registration*) of this volume.

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and to comply with the disclosure requirements of the 1933 Act by incorporating disclosures by reference to their filings on Forms 18-K and 18-K/A.[11]

The annual report on Form 18-K includes all information required by the form (with certain exceptions) and any additional information required to be included in a Schedule B registration statement together with any other information deemed material to investors. The Form 18-K/A amendments are filed as necessary and include, for example, such information as the interim financial reports of the Schedule B issuer, its annual budget (if a foreign governmental issuer) and any additional information deemed necessary or appropriate for disclosure purposes.

When a shelf registration statement is filed under Schedule B, the base prospectus contained therein incorporates by reference the most recently filed Form 18-K, including all amendments. Incorporation of the filed Form 18-K and any Form 18-K/A effectively relieves the issuer of the need to file annual post-effective amendments to its shelf registration statement. By incorporating by reference to Forms 18-K and 18-K/A, foreign governmental issuers are able to regularize the due diligence process and facilitate ready market access when making an offering from a shelf registration statement. Other benefits of incorporating by reference to Forms 18-K and 18-K/A include: (1) greater confidentiality for the proposed launch of specific transactions due to shorter time periods between the decision to make an offering and the actual launch of the offering, and the fact that work surrounding the regularly scheduled updating of the disclosure would not necessarily signal the launch of a new offering; (2) an indication to investors of the Schedule B issuer's continuing commitment to maintaining a presence in the U.S. capital markets; and (3) better disclosure as regular updating permits the issuer's team to focus on the disclosure process without necessarily simultaneously focusing on the marketing requirements of a particular transaction.

[11] See, for example, SEC No-Action Letters Republic of Hungary, available Sept. 28, 2007; Oesterreichische Kontrollbank Aktiengesellschaft and Republic of Austria, available July 20, 2007; Landeskreditbank Baden-Württemberg – Förderbank and State of Baden-Württemberg, available May 23, 2005; Republic of Uruguay, available Mar. 8, 2005; Bolivarian Republic of Venezuela, available Apr. 28, 2004; Landwirtschaftliche Rentenbank – Federal Republic of Germany, available Jan. 30, 2003; Financement – Quebec, available June 24, 2002; Government of Jamaica, available May 22, 2002; Republic of Italy, available Feb. 4, 2002; Province of Nova Scotia, available Nov. 1, 1999; Republic of Turkey, available Oct. 19, 1999; Republic of South Africa, available Oct. 4, 1999; Deutsche Ausgleichsbank – Federal Republic of Germany, available June 30, 1999; Republic of Panama, available Mar. 25, 1998; The Federative Republic of Brazil, available May 15, 1997; Republic of Colombia, available Feb. 3, 1997; Queensland Treasury Corporation and State of Queensland, available Oct. 24, 1996; European Investment Bank, available Aug. 29, 1996; State of Israel, available Nov. 30, 1995.

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SECTION VI: OTHER MATTERS

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CHAPTER 15

HOME COUNTRY MATTERS

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GENERAL

There are many legal and regulatory aspects of various non-U.S. jurisdictions that present disclosure issues for investors and marketing issues for securities firms. This chapter addresses some of the most common of these.

EXCHANGE CONTROLS

Among the important considerations for U.S. and other international investors are any laws, decrees, regulations and administrative orders and guidelines, including any currency or exchange controls, that could affect the ability of a non-U.S. issuer to make the required or permitted payments to nonresident securityholders, under the securities being offered. In this regard, it is important to note that securities sold and traded in the U.S. capital markets are generally denominated in U.S. dollars; where payments on the securities otherwise would be payable in local currency (*e.g.*, dividends on equity securities), these amounts are often deposited into a U.S. dollar-paying depositary facility (*e.g.*, ADRs or Global Depositary Receipts, referred to as "GDRs") or distributed to U.S. investors through a structure known as the "Black Friars" structure, under which the U.S. investor may elect to receive payments in U.S. dollars from the paying agent (which exchanges the foreign currency for U.S. dollars).

If there are substantial impediments to the ability of a non-U.S. issuer or a U.S. conversion agent (*e.g.*, the depositary bank for ADRs or the paying agent for debt securities) to make any payments on the issuer's securities outside the issuer's home jurisdiction or, if the securities are payable in U.S. dollars (or another foreign currency), to purchase U.S. dollars (or other applicable currency) with its local currency, the non-U.S. issuer will have to be able to manage its business so that it maintains or generates a sufficient amount of U.S. dollars (or other applicable currency), outside its home country if necessary, to make payments under the securities. Limitations on the ability of non-U.S. issuers to obtain the currency required to pay investors could result in risk factor disclosure about those limitations or prevent completion of an offering.

U.S. investors are also concerned about the volatility and method of determining the exchange rate when the return on securities depends upon the exchange rate between the currency of the non-U.S. issuer's home jurisdiction and the currency of the investor's jurisdiction (*e.g.*, ADRs representing equity issued by a non-U.S. issuer). While this is generally a matter of describing the exchange rate history and policy of the non-U.S. issuer's home jurisdiction in the disclosure document used to offer the securities, in the case of securities that are yield sensitive,

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securities firms may advise the non-U.S. issuer that a gross-up tied to adverse exchange rate changes is necessary to effectively market the securities.

TAXES THAT AFFECT NONRESIDENT SECURITYHOLDERS

Investors are generally concerned about their after-tax return on securities investments. Accordingly, they are concerned about, among other things, the withholding and other taxes that a non-U.S. issuer's home jurisdiction might impose on payments under its securities. The offering document for securities issued by a non-U.S. issuer should, therefore, contain a brief description of all taxes applicable to U.S. securityholders under the laws and regulations of the issuer's home jurisdiction, including withholding provisions to which U.S. securityholders are subject, and any applicable reciprocal tax treaty between the issuer's home jurisdiction and the United States.

Withholding Taxes

Many securities, sold by issuers in cross-border transactions, other than common or ordinary equity securities, contain a gross-up provision that protects investors against withholding taxes on payments made under those securities because most jurisdictions, except some well known tax havens, impose a withholding or similar tax on payments made to persons resident outside that jurisdiction on specified types of securities. It is often the task of the lawyers to structure a transaction in such a way as to avoid or minimize withholding taxes.

Many jurisdictions provide an exemption from the general withholding requirements if certain conditions are met, which may include distribution and reporting requirements. For example, payments made to non-residents of Argentina in respect of debt securities issued by Argentine companies qualify for an exemption from a certain withholding tax if the securities qualify as *obligaciones negociables* under local securities regulations and have been sold pursuant to an authorized public offering. If there is no exemption from the general withholding requirements, then the withholding tax will be that rate established by the laws of the non-U.S. issuer's home jurisdiction after taking into account applicable international treaty concessions. Where applicable, certification requirements that enable investors to take advantage of a lower treaty rate should be set in place when the securities are issued (ordinarily, failure by an investor to provide adequate certification to take advantage of a lower treaty rate following a request by the issuer is grounds for avoiding the non-U.S. issuer's gross-up obligation with respect to such investor). For example, if the normal withholding rate is 30% but a treaty with the United States reduces that rate to 10% if payments are made to a U.S. person, the non-U.S. issuer's home jurisdiction may require certain procedures to verify that a recipient is a U.S. person before withholding at the lower rate is permitted. This can be particularly problematic where the securities are book-entry securities lodged in one country (*e.g.*, the United States), but are offered and sold in many countries with levels of withholding with respect to the non-U.S. issuer's home jurisdiction that differ from those where the securities are held in book-entry form.

Other Taxes

Other taxes relevant to investors include capital gains tax, stamp duty, gift tax and inheritance tax. Payment of these taxes (other than any stamp duty payable upon the original

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issuance of securities) is normally left up to the investor. There is no historic practice of issuers compensating U.S. investors in the event that a country imposes such taxes, although they could negatively impact marketability. Descriptions of these other taxes are ordinarily included in the disclosure document. It may be possible to avoid stamp duty, capital gains and other transfer-based taxes by, among other things, immobilizing an issuer's securities in an offshore facility and issuing interests in that facility (*e.g.*, ADRs). Where this is not possible, so long as the taxes are not so onerous as to make it impractical to market the securities, it is ordinarily left to the investor to plan around or bear these taxes.

LIMITATIONS ON THE RIGHTS OF NONRESIDENT SECURITYHOLDERS

U.S. investors in a non-U.S. issuer's securities, particularly common or ordinary equity securities and securities convertible into common or ordinary shares, are interested in any limitations on the rights of nonresident securityholders. These limitations should be carefully described in the disclosure document used to sell the non-U.S. issuer's securities.

The most common limitation on the rights of nonresident securityholders is contained in non-U.S. investment regulations. Many countries have regulations that limit the percentage of a local issuer's securities that a U.S. or other international investor may hold generally or in the case of specified industries (*e.g.*, in order to ensure domestic control of those industries). Further, charter and related documents of a non-U.S. issuer may contain restrictions on nonresident investment that are more restrictive than those required by applicable laws and regulations.

Another possible limitation on the rights of nonresident securityholders is one that applies to their ability to vote shares. The home jurisdiction of the non-U.S. issuer may impose restrictions on the voting rights of a non-home jurisdiction securityholder. Additionally, a non-U.S. issuer's own corporate documents may limit or prohibit such voting rights. Furthermore, nonresident securityholders may not be entitled to appraisal rights in certain non-U.S. jurisdictions.

ENFORCEABILITY OF JUDGMENTS

In purchasing securities of an issuer from another part of the world, U.S. investors want to know how and where they can enforce their rights as securityholders. U.S. investors generally do not want to prosecute legal actions in a non-U.S. jurisdiction due to the expense and inconvenience. By selling securities in the United States, a non-U.S. issuer is likely to be subject to personal jurisdiction in connection with matters arising out of the securities. U.S. courts have also asserted subject matter jurisdiction in the past over disputes with extraterritorial elements where there was conduct or were effects in the United States, including disputes involving sales of securities in the United States by foreign corporations or foreign governments. While U.S. investors do not generally require non-U.S. issuers to expressly consent to legal action arising out of the securities in each U.S. jurisdiction where the securities are offered and sold, U.S. investors often expect non-U.S. issuers to consent to the jurisdiction of U.S. federal and state courts located in New York or other appropriate U.S. jurisdictions. In addition, the governing law with respect to debt securities offered in the U.S. capital markets is ordinarily the law of the State of New York or another U.S. jurisdiction so as to enable the courts of that jurisdiction to

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more easily render a judgment if the non-U.S. issuer does not comply with the terms of those securities. A non-U.S. issuer's consent to jurisdiction also gives U.S. investors comfort that legal issues will be resolved under familiar laws and a familiar legal system.

While U.S. investors typically obtain the right to pursue claims in a court which is local to them, where assets of a non-U.S. issuer are located in the issuer's home jurisdiction, these investors may have to seek enforcement of a U.S. judgment in their favor in the issuer's home jurisdiction. Accordingly, it is important that such investors be informed about the enforceability of U.S. judgments in the courts of the home jurisdiction of the non-U.S. issuer. It may be impossible, however, to confirm with sufficient legal certainty the extent of enforceability of U.S. judgments against a non-U.S. issuer if there is no treaty or other arrangement pursuant to which its home country recognizes judgments obtained in the investor's jurisdiction or the primary jurisdiction in which the securities are offered. For example, the PRC, Singapore and Indonesia do not have such a treaty or other arrangement with the United States. The extent to which U.S. judgments may not be enforceable in a non-U.S. issuer's jurisdiction must be described in the disclosure document used to offer and sell the securities.

The enforceability of a U.S. judgment against a non-U.S. issuer in the non-U.S. issuer's home jurisdiction often depends upon whether the U.S. judgment is predicated on the securities laws that apply to the securities purchased by the investor, or instead relates to the non-U.S. issuer's charter and related documents and the laws of its home jurisdiction that regulate its activities generally or to the terms of the security. It is generally understood by investors in the U.S. capital markets that judgments based on U.S. securities laws, like judgments based on tax laws, are generally not enforceable internationally. In addition, U.S. investors understand that, for reasons of expense and the availability of evidence, they may have to prosecute an action in a non-U.S. issuer's home jurisdiction if the action is solely or primarily based upon a non-U.S. issuer's noncompliance with its charter or related documents, the laws of its home jurisdiction or the terms of securities (*e.g.*, preference shares) which are governed by the laws of its home jurisdiction.

Claims based on the terms of securities or other agreements governed by New York law or the law of another U.S. jurisdiction pose a potentially difficult problem. While courts in the United States would be the logical choice to pursue a contract claim based on the laws of a U.S. jurisdiction and non-U.S. jurisdictions may respect a choice of U.S. law to govern such agreements, courts outside the United States may nevertheless require a re-hearing on the merits of claims that have already yielded a U.S. judgment in the investor's favor. In addition, public policy and other considerations may prevent enforcement outside the United States of the judgment of a court in the United States. For example, some U.S. offerings of sub-investment grade-rated unsecured debt securities by Indonesian businesses have borrowed from the international bank lending practice in Indonesia and included an arbitration provision to address a perceived marketing problem arising out of the inability of investors to enforce U.S. judgments in Indonesia. In that case, an investor holding securities could arbitrate a complaint. Because the Indonesian issuers consented to be bound by the arbitration and given that Indonesia is a signatory to the International Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the resulting arbitration award should then be enforceable in Indonesia.

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CHAPTER 16

REPURCHASING, EXCHANGING AND AMENDING AN ISSUER'S OUTSTANDING SECURITIES

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PRIMARY SEC RULES AND REGULATIONS GOVERNING DEBT SELF TENDER OFFERS 327
EXCHANGE OFFERS 330
CONSENT SOLICITATIONS 331

GENERAL

Issuers repurchase, exchange or alter the terms of outstanding securities to, among other things, change their capital structure, reduce the amount of outstanding equity, eliminate high coupon debt securities, reduce the amount of their outstanding debt or eliminate burdensome indenture covenants.

These transactions may offset the dilutive effects of acquisitions or stock option, dividend reinvestment, stock purchase or similar plans, increase earnings per share, return capital to shareholders or eliminate smaller holdings and thus reduce servicing costs. Public companies may also seek to purchase a sufficient amount of stock in order to "go private" because they have concluded that the cost associated with being a public company (*e.g.*, those costs associated with compliance with Sarbanes-Oxley) outweigh the benefits.

An issuer can accomplish the foregoing by means of open market purchases, privately negotiated transactions, tender offers, exchange offers and consent solicitations. The method utilized by the issuer will be influenced by a variety of factors including the terms of the securities,[1] the time period available to the issuer to accomplish its goal and the funds available to the issuer.

Rule 10b-5 Considerations

In each instance where an issuer purchases its securities, it must be sure that it does not purchase securities at a time when it is in possession of material non-public information in violation of Rule 10b-5 under the 1934 Act.[2] Some issuers impose "blackout periods" on their purchase activity at times when that information might exist.

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[1] Some securities contain call provisions or require super majority approval to adopt certain amendments to the instruments pursuant to which they were issued.

[2] *Employment of Manipulative and Deceptive Devices*. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commence, or of the mails, or of any facility of any national securities exchange: (1) to employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. See 17 C.F.R. Section 240.10b-5 (2007).

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Purchases in the Open Market and Privately Negotiated Transactions

Open market purchases may be the most economical method available to an issuer to purchase its securities, especially when it is not seeking to purchase a large percentage of the outstanding securities. Purchases of securities from time to time in the open market have an advantage over a tender offer (discussed below) in that they may be engaged in opportunistically, do not require the issuer to pay a premium over the current market price and generally do not require compliance with particular rules and regulations.[3] Accordingly, the costs associated with such purchases are generally *de minimis*. The purchase activity, however, must be structured in such a manner as not to be classified as a "tender offer." If the purchase program is a tender offer, then in addition to the premium usually associated with such activity, the issuer will be subject to additional requirements and the additional transaction costs may be material to the issuer.

Privately negotiated transactions may be the most effective method available to an issuer if the security that the issuer is seeking to purchase is in the hands of a limited number of holders. In that instance, the issuer can negotiate directly with the holders. However, unlike open market purchases, in the case of privately negotiated transactions, the issuer will probably pay a premium over the prevailing market price.

Tender Offers

While the 1934 Act does not contain a definition of what types of purchases constitute a "tender offer," it does set forth specific rules applicable to transactions that are tender offers.[4] The determination of whether a particular purchase program constitutes a tender offer is made by applying a series of subjective factors that have evolved from elements suggested by the SEC and court decisions. The SEC has suggested that courts look to the following eight factors in determining the existence of a tender offer:

(i) whether there is an active and widespread solicitation of securityholders;

(ii) whether the solicitation is for a substantial percentage of the issuer's securities;

(iii) whether the offer to purchase is made at a premium over the prevailing market price;

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[3] In addition to the rules and regulations discussed in this chapter below, the issuer should consider if the proposed purchases could be viewed as manipulative. The increased demand for an issuer's stock created by a stock purchase program may result in an increase in the market price. There is nothing wrong with an issuer purchase that has the effect of shoring up the price of its stock as long as the purchases are not made to manipulate the price of the stock. Rule 10b-18 (17 C.F.R. Section 240.10b-18 (2007)) provides all issuers with a safe harbor in which to conduct stock purchase programs without fear of being accused of manipulation. If the rule's conditions are met, Rule 10b-18 purchases will not be deemed to violate the anti-manipulation provisions of Section 9(a)(2) of the 1934 Act (15 U.S.C. 78i(a)(2)) or Section 10(b) (17 C.F.R. Section 240.10b (2007)) or Rule 10b-5 "solely by reason of the time, price or amount of such purchases or the number of broker-dealers used to effect such purchases."

[4] Certain of these rules are discussed in this chapter below.

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(iv) whether the terms of the offer are firm rather than negotiable;

(v) whether the offer is contingent upon the tender of a fixed minimum number of securities and perhaps subject to a ceiling of a fixed maximum number of securities to be purchased;

(vi) whether the offer is open for only a limited period of time;

(vii) whether the offerees are pressured to respond and sell into the offer; and

(viii) whether public announcements of a purchasing program precede or accompany a rapid accumulation of large amounts of the subject securities.[5]

Due to the absence of a statutory definition of a tender offer, numerous court cases have been brought alleging that certain open market and privately negotiated purchases constitute a tender offer, requiring the protections of the applicable rules under the 1934 Act.[6]

As a result of these court cases, it has become clear that large open market or privately negotiated transactions do not constitute tender offers solely as a result of the percentage of securities acquired or the number of persons from whom the acquisitions are made. What is less clear, however, is exactly how the eight factor test is to be applied in determining whether a particular purchase transaction or series of transactions, not constituting a conventional tender offer, should be treated as a tender offer. The SEC has not articulated any specific guidance on how the test should be applied.

If the purchase activity is classified as a tender offer, compliance with certain provisions of the federal securities laws, and the rules and regulations thereunder, is required.[7] If those provisions are not complied with, either during a tender offer or an open market purchase program preceding or following a tender offer, the issuer may be subject to complaints initiated by the SEC or securityholders alleging that:

(i) some aspect of the tender offer constitutes a fraudulent, deceptive or manipulative act as a result of noncompliance with applicable rules and regulations;

(ii) an open market purchase program prior to a tender offer constitutes a "creeping" tender offer in violation of the tender offer rules and regulations; or

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5 The SEC's eight factor test was first set forth and adopted by a court in Wellman v. Dickinson, 475 F. Supp. 783 (S.D.N.Y. 1979), aff'd, 682 F.2d 355 (2d Cir. 1982), cert. denied, 460 U.S. 1069 (1985).

6 See Securities and Exchange Commission v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985) and Hanson Trust PLC v. SCM Corporation, 774 F.2d 47 (2nd Cir. 1985).

7 See 17 C.F.R. Section 240.14e (2007) (Regulation 14E) (applicable to all tender offers except those for "exempted securities") and 17 C.F.R. Section 240.13e-4 (2007) (Rule 13e-4) (for issuer equity tender offers) and 17 C.F.R. Section 240.14d (2007) (Regulation 14D) (for certain third-party equity tender offers).

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(iii) an open market purchase program following a tender offer constitutes a *de facto* extension of the tender offer not in compliance with applicable rules and regulations.

PRIMARY SEC RULES AND REGULATIONS GOVERNING EQUITY SELF TENDER OFFERS[8]

A cash tender offer may be the most efficient way for an issuer to acquire a large block of its own securities in a relatively brief time. Tender offers, unlike open market purchases or privately negotiated transactions, are strictly regulated under the 1934 Act.

Regulatory Framework

Issuer tender offers for equity securities[9] are regulated by Section 13(e) and Rule 13e-4 under the 1934 Act. In addition, issuer equity tender offers, like all other tender offers, are subject to the general anti-fraud and anti-manipulative provisions of Regulation 14E under the 1934 Act.[10]

Section 13(e)(1) of the 1934 Act makes it unlawful for an issuer that has any class of equity securities registered under Section 12 of the 1934 Act, or which is a closed-end investment company registered under the 1940 Act, to purchase any of its equity securities (not just those registered under Section 12) in contravention of the rules and regulations of the SEC.

Rule 13e-4 under the 1934 Act regulates tender offers for equity securities made by an issuer that (i) has a class of equity securities registered pursuant to Section 12 of the 1934 Act, (ii) is required to file periodic reports pursuant to Section 15(d) of the 1934 Act or (iii) is a

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8 In addition to the rules and regulations discussed below, the issuer should consider if the proposed purchases could be viewed as manipulative. The increased demand for an issuer's stock created by a stock purchase program may result in an increase in the market price. There is nothing wrong with an issuer purchase that has the effect of shoring up the price of its stock as long as the purchases are not made to manipulate the price of the stock. Rule 10b-18 (17 C.F.R. Section 240.10b-18 (2007)) provides all issuers with a safe harbor in which to conduct stock purchase programs without fear of being accused of manipulation. If the rule's conditions are met, Rule 10b-18 purchases will not be deemed to violate the anti-manipulation provisions of Section 9(a)(2) of the 1934 Act (15 U.S.C. 78i(a)(2)) or Section 10(b) (17 C.F.R. Section 240.10b (2007)) or Rule 10b-5 "solely by reason of the time, price or amount of such purchases or the number of broker-dealers used to effect such purchases."

9 Section 3(a)(11) of the 1934 Act defines an "equity security" as any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the SEC shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security. See 17 C.F.R. Section 240.3a-11 (2007).

10 Regulation 14E consists of Rules 14e-1 (unlawful/tender offer practices), 14e-2 (position of subject company with respect to tender offer), 14e-3 (transactions in securities on the basis of material, non-public information in the context of tender offers), 14e-4 (prohibited transactions in connection with partial tender offers), 14e-5 (prohibiting purchases outside of a tender offer), 14e-6 (repurchase offers by certain closed-end registered investment companies), 14e-7 (unlawful tender offer practices in connection with roll-ups) and 14e-8 (prohibited conduct in connection with pre-commencement communications). See 17 C.F.R. Section 240.14e (2007).

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closed-end investment company registered under the 1940 Act.[11] Pursuant to Section 3(a)(11) of the 1934 Act, equity securities include those securities that are convertible into equity securities. Rule 13e-4 applies to tender offers for any equity securities of the issuer (not just those registered under the 1934 Act) as long as the issuer making the tender offer fits within any of the three categories described in the previous sentence.

Timing

An issuer tender offer must remain open until the expiration of (i) at least 20 business days[12] from its commencement[13] (if it is a business day, the date of the commencement is included in the business day count regardless of the time commenced on that day)[14] and (ii) at least ten business days from the date that a notice is first published, sent or given to shareholders of an increase or decrease in the percentage of the class of securities being sought or the consideration offered or the dealer's soliciting fees.[15] However, this requirement does not apply

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[11] The SEC, by the adoption of its "Cross-Border Offer Tender Offer Rules" (see 17 C.F.R. Section 240.13e(h)(8) (2007) (Rule 13e-4(h)(8)), 17 C.F.R. Section 240.14d-1(c) and (d) (2007) (Rule 14d-1(c), (d)) and 17 C.F.R. Section 240.14e-5(b)(10) (2007) (Rule 14e-5(b)(10)) and 17 C.F.R. Section 230.802 (2007)(Rule 802)) provided relief from certain of the disclosure and procedure requirements of the 1934 Act and 1933 Act. See also Chapter 19 (*Acquisitions by Non-U.S. Entities*) of this volume. These exemptions do not provide relief from the general anti-fraud and anti-manipulation provisions of the federal securities laws. These rules were amended, eight years after they were originally adopted because the SEC recognized that the exemptions did not operate as well as hoped and did not address the practical difficulties of various timing and logistical issues faced when determining U.S. ownership. Eligibility is based principally on the level of U.S. interest in a transaction, measured by the percentage of securities of a foreign company held by U.S. investors. The objectives of the exemptions as originally adopted and as amended is to encourage offerors and issuers in cross-border transactions to permit U.S. securityholders to participate in the same manner as other securityholders. These rules make available certain exemptions from the application of many of the provisions of the 1934 Act and from the registration requirements of the 1933 Act. These exemptions are available in those circumstances in which U.S. securityholders do not hold more than a certain percentage of the target company stock. The so-called "Tier I" exemption applies where U.S. securityholders hold 10% or less of the target stock. The so-called "Tier II" exemption applies where U.S. securityholders hold 40% or less of the target stock. The Tier I and Tier II exemptions are only available if the securities are issued by a "foreign private issuer" as defined in 1934 Act Rule 3b-4 and the U.S. ownership is limited as described above. The rules provide detailed provisions intended to make clear when and how U.S. ownership is determined. If available, the Tier I exemption exempts a bidder from substantially all U.S. tender offer regulation while the Tier II exemption provides somewhat more limited relief from the U.S. tender offer rules. Rule 802 under the 1933 Act provides certain relief from the registration requirement of the 1933 Act if criteria similar to the Tier I criteria discussed above are met.

[12] Rule 14d-1(g)(3) defines a business day as any day, other than Saturday, Sunday or a federal holiday, and shall consist of the time period from 12:01 a.m. through 12:00 midnight Eastern time. See 17 C.F.R. Section 240.14d-1(6)(3) (2007).

[13] The rule defines commencement as the date on which the "means to tender" (*i.e.*, a transmittal form or a statement regarding how the transmittal form may be obtained) is "just published, sent or given" to securityholders.

[14] See 17 C.F.R. Section 240.13e-4(f)(i) (2007) (Rule 13e-4(f)(i)).

[15] See 17 C.F.R. Section 240.13e-4(f)(ii) (2007) (Rule 13e-4(f)(ii)).

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to the acceptance for payment of an additional amount of securities not in excess of 2% of the class of securities that is the subject of the tender offer.[16]

Procedures

As soon as practicable on the date of commencement of the issuer tender offer, the issuer must: (i) file with the SEC a Schedule TO, including all exhibits thereto; and (ii) publish, send or give to shareholders a summary term sheet of the transaction (as discussed in this chapter below) and the information required by Schedule TO (except the exhibits) or a fair and adequate summary of such information by means of either: (A) a long-form publication;[17] (B) promptly mailing or otherwise furnishing the offer to purchase to each shareholder whose name appears on the most recent shareholder list of the issuer,[18] or (C) (I) short-form publication (tombstone)[19] and (II) if the tender offer is not subject to the SEC's "going private rule," Rule 13e-3, promptly mailing the offer to purchase and a letter of transmittal to each requesting shareholder.[20]

In addition to mailing or otherwise furnishing an offer to purchase to shareholders (see (ii)(B) above), the issuer must also (i) contact each participant on the most recent security position listing of any clearing agency within the possession or access of the issuer and inquire as to the approximate number of beneficial owners of the securities,[21] (ii) furnish such participant with a sufficient number of copies of the offer to purchase[22] and (iii) agree to reimburse such participant promptly for the cost of forwarding the offer to purchase to the beneficial owners.[23]

The issuer must file with the SEC an amendment to the Schedule TO reporting promptly any material changes in the information previously filed, as well as a final amendment reporting promptly the final results of the tender offer.[24] If a material change occurs in the information previously published, sent or given to shareholders, the issuer must disseminate promptly disclosure of the change in a manner reasonably calculated to inform shareholders of such change.[25]

Any pre-commencement communication made in connection with or relating to the tender offer (such as the announcement by press release prior to commencement of the tender offer of an intention to commence the tender offer) must be filed on a Schedule TO on the date of first use. The SEC has adopted a rule that, among other things, makes it a fraudulent,

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[16] Id.

[17] See 17 C.F.R. Section 240.13e-4(e)(1)(i) (2007) (Rule 13e-4(e)(1)(i)).

[18] See 17 C.F.R. Section 240.13e-4(e)(1)(ii)(A) (2007) (Rule 13e-4(e)(1)(ii)(A)).

[19] See 17 C.F.R. Section 240.13e-4(e)(1)(iii)(A) (2007) (Rule 13e-4(e)(1)(iii)(A)).

[20] See 17 C.F.R. Section 240.13e-4(e)(1)(iii)(B) (2007) (Rule 13e-4(e)(1)(iii)(B)).

[21] See 17 C.F.R. Section 240.13e-4(e)(1)(ii)(B) (2007) (Rule 13e-4(e)(1)(ii)(B)).

[22] See 17 C.F.R. Section 240.13e-4(e)(1)(ii)(C) (2007) (Rule 13e-4(e)(ii)(C)).

[23] See 17 C.F.R. Section 240.13e-4(e)(1)(ii)(D) (2007) (Rule 13e-4(e)(ii)(D)).

[24] See 17 C.F.R. Section 240.13e-4(d)(2) (2007) (Rule 13e-4(d)(2)).

[25] See 17 C.F.R. Section 240.13e-4(e)(3) (2007) (Rule 13e-4(e)(3)).

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deceptive or manipulative practice for a person to publicly announce plans to make a tender offer that has not yet commenced if that person does not intend to commence such offer within a reasonable period of time and complete the offer.[26]

Withdrawal Rights

Securities tendered pursuant to an issuer tender offer may be withdrawn: (i) at any time during which the tender offer remains open[27] and (ii) if not yet accepted for payment, after the expiration of 40 business days from the commencement of the tender offer (regardless of any extension).

Proration

If the tender offer is made for less than all the outstanding equity securities of a class and if a greater number is tendered, then the securities shall be taken up and paid for as nearly as may be prorated disregarding fractions, according to the number of securities deposited by each depositor provided that the issuer may (i) accept all securities tendered by "odd-lot" holders (persons who own beneficially or of record less than 100 shares) before prorating securities tendered by others[28] and (ii) accept by lot (if the issuer accepts all securities tendered by shareholders) securities tendered by shareholders who tender all securities held by them and who tender those securities conditionally (*i.e.*, when tendering, elect to have either all or none or at least a minimum amount or none accepted).[29] These "conditional tenders" are sometimes provided for because the numbers of shares to be purchased from a particular shareholder may affect the tax treatment of the purchase to the shareholder and the shareholder's decision whether to tender.

Prompt Payment

The issuer must pay the consideration offered or return the tendered securities promptly after termination or withdrawal of the tender offer.

Purchases Outside the Tender Offer

From the time the issuer tender offer is first publicly announced until the expiration of at least ten business days after the date of termination of the issuer tender offer, the issuer may not purchase the security that is the subject of the issuer tender offer other than pursuant to the tender offer.[30] This restriction also applies to any security of the same class and series or any right to

[26] See 17 C.F.R. Section 240.14e-8 (2007) (Rule 14e-8).

[27] See 17 C.F.R. Section 240.14e-7(a)(1) (2007) (Rule 14d-7(a)(1)).

[28] See 17 C.F.R. Section 240.13e-4 (f)(3)(i) (2007) (Rule 13e-4(f)(3)(i)).

[29] See 17 C.F.R. Section 240.13e-4 (f)(3)(ii) (2007) (Rule 13e-4(f)(3)(ii)).

[30] See 17 C.F.R. Section 240.13e-4 (f)(6) (2007) (Rule 13e-4(f)(6)).

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purchase any such securities.[31] This restriction generally includes purchases by the dealer manager.

All Holders; Best Price

No issuer or affiliate shall make a tender offer unless: (i) the tender offer is open to any shareholder of the class of securities subject to the tender offer (other than shareholders in states where the issuer is prohibited from making the tender offer)[32] and (ii) the consideration paid to any shareholder pursuant to the tender offer is the highest consideration paid to any other shareholder during the tender offer.[33] If the consideration offered is increased during the issuer tender offer, then all securities that are acquired pursuant to the issuer tender offer must be acquired at the highest consideration offered.[34]

Pricing of Equity Tender Offers

Fixed Price Tender Offer

The issuer sets a price per share fixed at commencement of the tender offer.

Modified "Dutch Auction" Tender Offer

A modified "Dutch auction" tender offer is a tender offer where the issuer specifies the number of shares that it will purchase ("x shares") or the total consideration that it will pay ("consideration cap") and invites shareholders to tender their shares within a specified range of prices. An issuer making a modified "Dutch auction" tender offer must specify a reasonable price range, typically a range of 15% above the minimum price of the issuer's shares. Shareholders can usually tender shares at price increments within this price range. At the end of the tender offer, the issuer selects the lowest single purchase price ("Purchase Price") that allows it to repurchase x shares or pay the consideration cap and pays the Purchase Price to all shareholders whose shares are accepted. Only shareholders that tender their shares at prices at or below the Purchase Price will have their shares accepted for purchase. To maximize participation, issuers often give shareholders the option of electing to tender at whatever price is selected by the issuer in the tender offer. Shareholders that make this election will ensure that their shares will be purchased in the tender offer, subject to proration.

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[31] Id.

[32] See 17 C.F.R. Section 240.13e-4 (f)(8)(i) (2007) (Rule 13e-4(f)(8)(i)).

[33] See 17 C.F.R. Section 240.13e-4 (f)(8)(ii) (2007) (Rule 13e-4(f)(8)(ii)).

[34] See 17 C.F.R. Section 240.13e-4 (f)(4) (2007) (Rule 13e-4(f)(4)).

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PRIMARY SEC RULES AND REGULATIONS GOVERNING DEBT SELF TENDER OFFERS[35]

Issuer debt tender offers must comply with Regulation 14E under the 1934 Act. Unlike the rules applicable to equity tender offers, these rules do not set out any filing or specific disclosure requirements. Many of the rules related to debt tender offers have developed as a result of no-action letters issued by the staff of the SEC.

As a general rule, issuers would prefer to keep the tender offer period to a minimum in order to limit the exposure to changes in interest rates during the tender offer period. Several requests for no-action have been granted by the staff of the SEC in connection with the twenty business day tender offer period required by Rule 14e-1(a).[36] In those letters, the staff of the SEC was asked to concur with the position that such tender offers need only be held open for seven to ten calendar days. The relief requested in these letters stemmed from the increased market and interest rate risks to which an issuer seeking to purchase its debt securities in a tender offer is exposed by virtue of the longer tender period required by Rule 14e-1(a).[37] The relief granted in these no-action letters applies to situations where an issuer conducts a tender offer that:

(i) offers to purchase for cash any and all non-convertible debt of a particular class or series;[38]

(ii) is open to all record and beneficial holders of that class or series of debt;

(iii) is conducted in a manner designed to afford all record and beneficial holders of that class or series of debt a reasonable opportunity to participate in the tender offer, including the dissemination of the offer on an expedited basis in situations where the tender offer is open for a period of less than ten calendar days; and

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35 *Redemption*. If the debt contains a call provision, permitting the issuer to redeem the outstanding debt, this may be the easiest and most effective means to employ. The redemption provisions of most indentures set forth specific procedures that must be strictly followed. Failure to fully comply with these procedures may prevent the issuer from redeeming its debt in accordance with its plans. Normally, a call provision will also include a formula for determining the redemption price. Generally, the initial redemption price will be at a premium to the face amount of the debt with the premium decreasing and eventually disappearing during the term of the debt.

36 See Salomon Brothers Inc., SEC No-Action Letter, 1986 WL 65340 (Mar. 12, 1986); Goldman, Sachs & Co., SEC No-Action Letter, 1986 WL 66561 (Mar. 26, 1986); and Merrill Lynch, Pierce, Fenner & Smith Incorporated, SEC No-Action Letter, 1996 WL 67037 (July 2, 1986). These letters were submitted after Rule 14e-1 under the 1934 Act was amended to apply to all issuer tender offers, not only those conducted in circumstances where an issuer was engaged in a defensive tender offer for its equity securities, as had previously been the case.

37 It was argued in those letters that, historically, issuer debt tenders offers had been held open for a period considerably shorter than the twenty business days required by Rule 14e-1(a) under the 1934 Act, generally a period of seven to ten calendar days depending on a number of factors.

38 In the case of medium-term notes, each issuance of notes of the same interest rate and with the same maturity should, for this purpose, be considered as a separate series.

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(iv) is not made in anticipation of or in response to other tender offers for the issuer's securities.[39]

The staff of the SEC also extended its position to the period of time that issuer debt tender offers must be kept open after the announcement of an increase or decrease in the consideration offered. It is the SEC staff's position that any extension should be commensurate with the length of the original tender offer, rather than the ten business days discussed above.

Debt Tender Offer Purchase Price Determination

Fixed Spread Tender Offers

In order to avoid the interest rate risk associated with the debt tender offers, issuers have sought ways to avoid or postpone fixing the purchase price.[40] In this regard, the staff of the SEC granted no-action relief with respect to issuer debt tender offers for cash for non-convertible, investment grade debt securities at a price to be determined on each day during the tender offer period by reference to a stated fixed spread over the then-current yield on a specified benchmark U.S. Treasury security determined as of a specified time on the day of tender or the preceding day, subject to the conditions that such offer:

(i) is an offer for cash for any and all non-convertible, investment grade debt of a particular class or series;

(ii) is open to all record and beneficial holders of that class or series of debt;

(iii) is based upon a benchmark U.S. Treasury security for which information is reported each day in a daily newspaper of national circulation;

(iv) is conducted in a manner designed to afford all record and beneficial holders of that class or series of debt a reasonable opportunity to participate in the tender offer, and, in the case of an offer conducted in reliance on the 1986 no-action letter (providing for an abbreviated offer period, discussed above) dissemination of the tender offer is made on an expedited basis;

(v) provides that all tendering holders of that class or series of debt are paid promptly for their tendered securities after such securities are accepted for payment; and

(vi) is not made in anticipation of or in response to other tender offers for the issuer's securities.[41]

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[39] The SEC added an additional factor in a subsequent no-action letter when it said that, while not stated expressly therein, the no-action position contained in the 1986 No-Action Letter (Salomon Brothers Inc., SEC No-Action Letter, 1986 WL 65340 (Mar. 12, 1986)) is limited to issuer debt tender offers for "*investment grade debt securities only*." See Salomon Brothers Inc., SEC No-Action Letter, 1990 WL 286946 (Oct. 1, 1990).

[40] The premium offered in debt tender offers, unlike equity tender offers, is normally rather small.

[41] See Salomon Brothers Inc., SEC No-Action Letter, 1990 WL 286946 (Oct. 1, 1990).

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Real-Time Fixed Spread Cash Tender Offers

The staff of the SEC extended the above position with respect to tender offers for non-convertible, investment grade securities in order to permit issuers to conduct debt tender offers using a fixed spread pricing methodology in which the nominal purchase price in a debt tender offer is calculated by reference to a stated fixed spread over most current yield on a benchmark U.S. Treasury security determined at the time the securityholder tenders the debt security (a "real-time fixed spread offer") rather than by reference to the yield on a benchmark U.S. Treasury security as of a specified time on the day of tender or the preceding day as discussed in this chapter above. Real-time fixed price offers apply a fixed spread to arrive at a series of nominal purchase prices; such nominal purchase prices do not remain fixed, but change with any movement in the benchmark U.S. Treasury security.[42]

The SEC staff's no-action position is subject to the following conditions:

(i) the tender offer is for cash for any and all non-convertible, investment grade debt of a particular class or series of the issuer;

(ii) the tender offer is open to all record and beneficial holders of that class or series;

(iii) the tender offer identifies the specific benchmark U.S. Treasury security to be used and specifies the fixed spread to be added to the yield on the benchmark U.S. Treasury security;

(iv) the tender offer states the nominal purchase price that would have been payable based on the applicable reference yield immediately preceding the commencement of the tender offer;

(v) the tender offer indicates a daily newspaper of national circulation that will provide the closing yield of the benchmark U.S. Treasury security on each day of the tender offer;

(vi) the tender offer indicates the reference source to be used during the tender offer to establish the current yield on the benchmark U.S. Treasury security;

(vii) the tender offer describes the methodology used to calculate the purchase price for the tendered securities;

(viii) the tender offer indicates that the current yield on the benchmark U.S. Treasury security and the resulting nominal purchase price of the debt securities is accessible on a real-time basis by either calling the dealer manager collect or through an "800" telephone number, if established for the tender offer;

(ix) the tender offer is conducted in a manner designed to afford all record and beneficial holders of the debt securities a reasonable opportunity to participate in

[42] See Merrill Lynch, Pierce, Fenner & Smith Incorporated, SEC No-Action Letter, 1993 WL 270676 (July 19, 1993).

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the tender offer, and, in the case of an offer to be held open for less than ten calendar days, dissemination of the offer must be on an expedited basis, and in no event may an offer be open for less than seven calendar days;

(x) all tendering holders are paid promptly for their tendered securities after such securities are accepted for payment; and

(xi) the tender offer is not made in anticipation of or in response to other tender offers for the issuer's securities.

In addition to the above conditions, the staff of the SEC requires the dealer manager to:

(i) make and maintain records showing at least the following information:

   (A) the date and time of each tender;

   (B) the current yield on the benchmark U.S. Treasury security at the time of each tender; and

   (C) the purchase price of the tendered securities based on that yield.

(ii) send a confirmation of the transaction to tendering debt holders providing the specifics of the transaction (including, upon request, the time of tender) no later than the next business day after the tender.

EXCHANGE OFFERS

As an alternative to the "cash" offers discussed in this chapter above, an issuer may offer to exchange a new security for the currently outstanding security. In order to induce holders to participate in an exchange offer, the issuer will have to offer some incentive to the holder for giving up their old security for a new one with different terms.

Unlike the cash transactions discussed above, the exchange offer involves the offering of a "new security," which, in the absence of an available exemption, requires that such offer be registered pursuant to the 1933 Act. Issuers conducting exchange offers have occasionally relied on the exemption provided by Section 3(a)(9) of the 1933 Act. Section 3(a)(9) exempts from registration "any security exchanged by the issuer with its existing securityholders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." If the issuer employs a dealer manager and that dealer manager is paid a fee for soliciting exchanges, the issuer will not be able to claim the exemption from registration provided by Section 3(a)(9). The SEC has provided guidance in a series of no-action letters[43]

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[43] See Dean Witter & Co., Inc., SEC No-Action Letter, 1974 WL 11253 (Dec. 23, 1974) and Dean Witter & Co., Inc., SEC No-Action Letter, 1975 WL 11253 (Feb. 24, 1975); The Carter Organization, SEC No-Action Letter, 1975 WL 11258 (Apr. 7, 1975); Mortgage Investors of Washington, SEC No-Action Letter, 1980 WL 14902 (Oct. 7, 1980); Seaman Furniture Company, Inc., SEC No-Action Letter, 1989 WL 246436 (Oct. 10, 1989); and International Controls Corp., SEC No-Action Letter, 1990 WL 285830 (Aug. 6, 1990).

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regarding permissible activities by a dealer manager in connection with a Section 3(a)(9) exempt exchange offer. While these letters are far from exhaustive in their scope, they tend to provide guidance regarding those activities that the SEC views as acceptable and those it views as unacceptable. Issuers have also relied upon the exemption provided by Section 4(2) of the 1933 Act when the old securities have been held by a small number of holders.[44]

CONSENT SOLICITATIONS

An issuer may seek to amend the terms of the indenture pursuant to which its debt securities were issued, among other things, to remove certain restrictive covenants. Most indentures provide a mechanism allowing for their amendment upon the consent of the holders of the outstanding securities. In the case of most indentures, such amendment can be made with the consent of a majority of the holders. Some indentures provide that certain amendments require the consent of some amount greater than a majority (*i.e.*, 66⅔ of the outstanding holders). The issuer will sometimes pay a separate fee for the consents. Upon the receipt of the consent required to adopt the proposed amendments, the issuer and the trustee for the indenture will execute a supplement to the indenture pursuant to which the proposed amendment will become effective.

[44] See Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

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CHAPTER 17

LIABILITIES UNDER U.S. SECURITIES LAWS

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GENERAL

Issuers accessing the U.S. capital markets may be subject to potential liabilities under the U.S. federal securities laws arising from the public or private issuance of securities in the United States, as well as from the ensuing reporting and other obligations imposed under the 1934 Act. The following discussion is intended to identify and briefly describe some of these liabilities. See also Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume, which identifies additional potential liabilities in connection with an issuer's ongoing reporting and other requirements. These discussions do not purport to address all areas of potential liability under U.S. federal and state securities laws.[1]

The 1933 Act and the 1934 Act, and the respective rules and regulations thereunder, contain specific provisions creating potential liability for issuers and their directors and officers. The principal liability provisions of the 1933 Act and the 1934 Act are discussed below.[2] In addition, the SEC has considerable enforcement powers under the 1933 Act and the 1934 Act, and criminal sanctions may be applicable in some cases as well.

1933 ACT REGISTRATION STATEMENT LIABILITY

General

Pursuant to Section 11 of the 1933 Act, any person who acquires a security registered under the 1933 Act may bring an action if any part of the registration statement (which includes the prospectus), when that part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. A fact is "material" if there is a substantial likelihood that a reasonable investor would, under all the circumstances, consider it important in reaching an investment decision.

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1 For example, each of the 50 states of the United States has its own common law with respect to fraud or negligence that might provide for liability in connection with offerings and sales of securities and, in nearly all cases, statutes that specifically provide private rights of action with respect to securities offerings.

2 This discussion reflects certain provisions of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), the basic purpose of which is to reduce abusive securities litigation.

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The effective date of a registration statement is highly significant for purposes of Section 11 of the 1933 Act. Liability under Section 11 applies only to information within the registration statement as of its effective date. Historically, the effective date meant only the date of the SEC's order of effectiveness under Section 8(a) or 8(c). In practice under the integrated disclosure system, where incorporated 1934 Act annual reports stand in the place of post-effective amendments updating the registration statement contents, the filing date of a report on Form 10-K or 20-F also will be construed as an effective date.

The SEC, as part of Securities Offering Reform, defined "effective date" in Rule 430B under the 1933 Act to include not only the original effective date under Section 8(a) and the effective date of a required post-effective amendment, but also the earlier of the date of filing of a prospectus required under Rule 424 under the 1933 Act deemed to be a part of the registration statement or the first sale. Prospectuses of this type are generally the supplements used to supply the detailed information concerning the terms of the offering, the securities offered and the plan of distribution, whose omission from the original form of prospectus is authorized by Rules 430A and 430B. As a result of the adoption of Rule 430B, issuers may be liable for certain information for which they were not previously responsible under Section 11 and underwriters, who formerly only might have been liable for such information under Section 11, now are clearly exposed to liability for misstatements and omissions in 1934 Act reports filed after the statutory effective date. The action, however, does not extend to other prospective defendants. Officers and directors signing the registration statement and the auditors, with any other experts, are not to be affected by the additional deemed effective dates added to Rule 430B by Securities Offering Reform. Because of this exclusion, new auditors' consents will not be required at the time of the filing under Rule 424.

Scope of Liability

Liability may be imposed upon every person who signed the registration statement (including the issuer, its principal executive officer or officers, its principal financial officer, its comptroller or principal accounting officer, its board of directors or persons performing similar functions) or persons about to become directors of the issuer and, for a non-U.S. issuer, its duly authorized representative in the United States); the issuer's directors; "experts" (such as accountants) who have, with their consent, been named in the registration statement as having prepared or certified part of the registration statement or a report or valuation used in connection with the registration statement, with respect to that statement; and every underwriter. Such persons are jointly and severally liable.[3] Each person held liable may receive contribution from others held liable unless such person is guilty of fraudulent misrepresentation and the others were not.

Reliance on the registration statement need not be proved in a claim under Section 11 unless the purchaser acquired the security after the issuer had made generally available to its securityholders an earnings statement covering a period of at least one year beginning after the

[3] Outside directors are jointly and severally liable only to the extent they "knowingly" violate the securities laws.

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effective date of the registration statement. If proof of reliance is required, such reliance may be established without proof of the reading of the registration statement.[4]

The issuer's liability is absolute unless it can show that the plaintiff knew of the misstatement or omission at the time of the acquisition of the applicable security. Directors of the issuer and officers of the issuer who signed the registration statement, as well as underwriters, will not be liable if they can affirmatively establish a "due diligence" defense.

Due Diligence Defense

To establish a due diligence defense with respect to any part of the registration statement not purporting to be made on the authority of an expert ("non-expertised"), a director, an officer or an underwriter must show that "he had, after reasonable investigation, reasonable ground to believe and did believe, . . . that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . ."[5]

To establish a due diligence defense with respect to any part of the registration statement purporting to be made on the authority of an expert ("expertised"), a director, an officer or an underwriter must show that "he had no reasonable ground to believe and did not believe . . . that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert. . . ."

In determining what constitutes reasonable investigation or reasonable grounds for belief, the standard of reasonableness is that required of a prudent man in the management of his own property. The SEC, in Rule 176 under the 1933 Act, has identified the following factors affecting a determination of what constitutes reasonable investigation and reasonable grounds for belief under Section 11:

(1) the type of issuer;

(2) the type of security;

(3) the type of person;

(4) the office held when the person is an officer;

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[4] One appellate court has also held that, while reliance need not be proven in the usual Section 11 case, a plaintiff who committed to purchase shares in a merger prior to the issuance of the registration statement was barred from suit because reliance on the registration statement would have been impossible. See APA Excelsior III L.P. v. Premiere Techs., Inc., 476 F.3d 1261, 1267-77 (11th Cir. 2007).

[5] For a discussion of the due diligence defense in the context of modern securities offerings, see Committee on Federal Regulation of Securities, Report of Task Force on Sellers' Due Diligence and Similar Defenses Under the Federal Securities Laws, 48 BUS. LAW. 1185 (1993); In re WorldCom Secs. Litig., 346 F.Supp. 2d 628, 660-85 (S.D.N.Y. 2004) (underwriter due diligence). See also, Annual Review of Federal Securities Regulation, 57 BUS. LAW. 885,943-945 (2002) and In re Enron Corporation Securities Litigation, 2005 U.S. Dist. LEXIS 39927 (S.D.Texas 2005).

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(5) the presence or absence of another relationship to the issuer when the person is a director or proposed director;

(6) reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the issuer and the filing);

(7) when the person is an underwriter, the type of underwriting arrangements, the role of the particular person as an underwriter and the availability of information with respect to the registration; and

(8) whether, with respect to a fact or document incorporated by reference, the particular person had any responsibility for the fact or document at the time of the filing from which it was incorporated.

Damages

Under Section 11, a plaintiff may seek to recover damages equal to the difference between the amount paid for the security (not in excess of the public offering price) and the value of the security at the time the suit is brought. Different measures of damage apply where the plaintiff has sold the security at a loss. The defendant may reduce the damages by proving that part or all of the depreciation in the value of the security arose from a cause other than the misstatement or omission complained of.

Limitation on Actions

A private action under Section 11 of the 1933 Act must be brought within one year after the discovery of the untrue statement or omission, or after the discovery should have been made by the exercise of reasonable diligence. However, in no event may a private action under Section 11 be brought more than three years after the security was *bona fide* offered to the public. While these limitation provisions may not apply when the SEC is asking a court for an injunction, the SEC may be subject to a five-year limitation period where it seeks a civil fine or penalty.

1933 ACT REGISTRATION VIOLATIONS; PROSPECTUS LIABILITY

Registration Violations

Pursuant to Section 12(a)(1) of the 1933 Act, liability attaches to any person who offers or sells a security in violation of the registration requirements of Section 5 of the 1933 Act. Section 12(a)(1) is essentially a strict liability statute that imposes liability without regard to the seller's awareness of the violation, upon a showing by the investor of the jurisdictional use of the U.S. mails or interstate commerce, the lack of the required registration, and the sale of a security by the defendant.

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Prospectus Liability

General

Pursuant to Section 12(a)(2) of the 1933 Act, liability attaches to any person who offers or sells a security (other than certain exempted securities[6]) "by the use of any means or instruments of transportation or communications in U.S. interstate commerce or of the U.S. mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading . . . and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."

Section 12(a)(2) is applicable to public offerings by issuers or controlling shareholders. Based upon court decisions, strong arguments can be made that it does not apply to private placements[7] or to transactions in the secondary markets.[8] Section 12(a)(2) may, however, apply to public offerings made pursuant to Regulation S.[9]

Due Diligence Defense

In accordance with the terms of the statute, a "due diligence" defense is available in a suit brought under Section 12(a)(2). Factors that courts have viewed as relevant to making a determination of what constitutes "reasonable care" for purposes of Section 12(a)(2)'s due diligence defense include:

(1) the amount of planning and promotional participation, such as designing the deal and contacting and attempting to persuade potential purchasers;

(2) access to source data against which the truth or falsity of representations can be tested;

(3) relative skill in ferreting out the truth; and

(4) pecuniary interest in the transaction's completion.

As a practical matter, there is little difference between what constitutes "reasonable care" necessary to establish the due diligence defense under Section 12(a)(2) and "reasonable investigation" necessary to establish the due diligence defense under Section 11, even though in

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6 Exempted securities are discussed in Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

7 See Gustafson v. Alloyd Co., 513 U.S. 561 (1995); Glamorgan Coal Corp. v. Ratner's Group, PLC, 1995 U.S. Dist. LEXIS 9548 (S.D.N.Y. 1995); In re JWP, Inc. Sec. Litig., 928 F. Supp. 1239 (S.D.N.Y. 1996); Yung v. Lee, 432 F.3d 142 (2d Cir. 2005); and Rogers v. Sterling Foster & Co., 222 F.Supp.2d (S.D.N.Y. 2004).

8 See Saslaw v. Al Askari, 1997 U.S. Dist. LEXIS 5621 (S.D.N.Y. 1997); and Shanahan v. Vallat, 2004 U.S. Dist. LEXIS 25523 (S.D.N.Y. 2004).

9 See Sloane Overseas Fund v. Sapiens Intern. Corp. N.V., 941 F.Supp. 1369 (S.D.N.Y. 1996).

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adopting Securities Offering Reform the SEC suggested reasonable care is an easier standard to satisfy.

Impact of Securities Offering Reform

SEC Commentary on Securities Offering Reform

The SEC's commentary in the Securities Offering Reform adopting release includes two interpretations of Section 12(a)(2) that may be helpful to defendants. One is that Section 12(a)(2) does not require every communication to include all information required by SEC rules or all material information. The second is an acknowledgement that the standards of investigation and due care necessary to establish an affirmative defense under Section 12(a)(2) are lower than those required by Section 11(b).

Rule 159 – Information "Conveyed" at Time of Sale

Of all the rules adopted by the SEC as part of Securities Offering Reform, Rule 159 under the 1933 Act has probably had the most significant impact on how most capital markets transactions, whether SEC-registered, Rule 144A or Regulation S, are processed. The adoption of this rule has resulted in the development of new procedures to ensure that investors have all material pricing and other information at the time they agree to purchase a security, with the final offering documents and pricing supplements now relegated to a secondary role in providing such information to investors.

Pursuant to Rule 159, the question of material misstatement or omission must be evaluated on the basis of information "conveyed" to purchasers up to the point of sale. "Sale," as construed by the SEC for purposes of Rule 159, is the point at which an investor becomes committed to purchase the securities offered, not at closing or when payment is made.

Rule 159 provides that, for purposes of Section 12(a)(2), only information known to the investor at the time of sale should be taken into account. Information later provided should not be considered, in the SEC's view. In practice, Rule 159 is taken to apply in both 1933 Act-registered offerings and offerings where either the issuer or the offering is exempt from 1933 Act registration, although its applicability in the latter cases is not free from doubt. Rule 159 does not apply to Section 11, which judges only the information included in the registration statement as of the effective date. The SEC's other actions multiplying the number of events deemed to be the effective date lessen the value of the distinction.

Rule 159 creates serious liability concerns for issuers of all kinds in the situation where material developments occur around the time of sale but have not yet been reflected in SEC filings or in the information otherwise conveyed to investors. The problems Rule 159 creates may be most acute for issuers of asset-backed securities and for structured corporate securities. In offerings of asset-backed securities, the exact composition of the portfolio of pooled assets may not be known until closing. As a result, Rule 159 may present difficult evaluations of the disclosures made before the portfolio was formed. Similarly, the terms of complex structured securities are frequently not finalized until shortly before closing.

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Rule 159 does not define the term "conveyed." The commentary of the SEC and its senior staff suggests that an investor may have to have been made actually aware of a new disclosure before it would be deemed to have been adequately "conveyed." The SEC's commentary also suggests that, in some cases, delivery of a new disclosure included in filed documents might not suffice unless investors otherwise have been made aware of the filing.

Based on the anti-waiver provision provided by Section 14 of the 1933 Act, the SEC does not believe that its intent for Rule 159 might be avoided by drafting documents so that a final contract would not exist until the final prospectus had been filed. Conceding that Rule 159 may provide reason to invalidate enforceable contracts to purchase securities, the SEC noted in adopting Securities Offering Reform its view that renegotiation of such contracts may also involve anti-waiver issues unless purchasers are given "adequate disclosure" of their contractual rights and of the new disclosure in question and the "meaningful ability to elect" whether to terminate the old contact and to enter into a new contract.

Limitation to Sellers

Liability under Section 12(a)(2) attaches to any person who "offers or sells" by means of a materially misleading prospectus or oral communication. Although privity of contract between plaintiff and defendant is not necessary, the courts have found that, to hold persons other than immediate sellers liable, the person in question must have been an active participant in creating the defective disclosure. In direct offerings and in best-efforts underwritings, the issuer is, of course, a seller within the meaning of Section 12(a)(2). Most courts that have considered the question have found that, in the case of a firm commitment underwriting, where sales are made by the underwriters who have taken title to the securities from the issuer, the issuer does not become a seller through its customary participation in the preparation and filing of the registration statement.

Claiming to believe that "there is unwarranted uncertainty" concerning the question, as part of Securities Offering Reform, the SEC adopted Rule 159A under the 1933 Act, which provides that an issuer is generally a seller of securities for purposes of Section 12(a)(2), without regard to the form of underwriting agreement. The purport of Rule 159A is to make the issuer a person selling "by means of" any of the following communications that include an actionable misstatement or omission:

- any preliminary prospectus or prospectus of the issuer required to be filed under Rule 424;
- any free writing prospectus prepared by or on behalf of the issuer or used or referred to by it;
- any part of any other free writing prospectus including material information about the issuer or its securities and furnished by or on behalf of the issuer; or
- any other communication constituting an offering made by the issuer to the plaintiff.

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Damages

Under Section 12 of the 1933 Act, a plaintiff may seek to rescind his purchase of the security. Alternatively, the plaintiff may recover rescissionary damages if he or she no longer owns the security. However, a defendant may be able to avoid rescissionary damages if the defendant proves that the depreciation in the value of a security resulted from factors unrelated to the alleged misstatement or omission contained in the prospectus.

Limitation on Actions

An action under Section 12(a)(2) of the 1933 Act must be brought within one year after the discovery of the untrue statement or omission, or after discovery should have been made by the exercise of reasonable diligence, and within three years after the sale. An action under Section 12(a)(1) must be brought within one year after the violation on which it is based, and in no event shall any such action be brought more than three years after the security was *bona fide* offered to the public.

1934 ACT – MANIPULATIVE OR DECEPTIVE DEVICES

Section 10(b) of the 1934 Act and Rule 10b-5 thereunder are the provisions most frequently invoked by persons seeking redress for alleged securities fraud. Rule 10b-5 provides as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 10(b) and Rule 10b-5 apply to manipulative or deceptive acts in either the purchase or sale of securities in both the initial distribution and the secondary market, whether arising from a registration statement, private negotiations, a corporate report, a proxy statement, a tender offer or otherwise. Investors have an implied private right of action under Rule 10b-5 that has been recognized consistently by the courts. There is no private civil cause of action for aiding and abetting a violation of Rule 10b-5.[10]

[10] The Supreme Court, in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008), reaffirmed that a private civil action under Section 10(b) of the 1934 Act may only be brought against a party that makes a public statement or otherwise commits some act that is relied upon by the

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Mere negligence or innocent mistakes will not render a person liable under Rule 10b-5. The Supreme Court has ruled that *scienter*, *i.e.*, a mental state embracing intent to deceive, manipulate or defraud, is required for liability under Rule 10b-5. More specifically, the plaintiff must plead facts giving rise to a strong inference of the defendant's fraudulent intent.[11] However, it is not required that the defendant be aware that his acts were illegal. Knowledge of the underlying facts is sufficient. Recklessness[12] may also satisfy the *scienter* requirement.[13]

A plaintiff asserting a Rule 10b-5 claim based on a material misrepresentation or omission in connection with the purchase or sale of a security must ordinarily establish that he or she justifiably relied on the issuer's disclosure. When the purchase or sale takes place in the secondary market, the so-called "fraud on the market" theory may excuse the plaintiff from having to demonstrate actual reliance. Under this theory, there is a presumption that the plaintiff traded in reliance on the integrity of a price set by the market and that this price is affected by any material misrepresentation or omission (*e.g.*, in the issuer's 1934 Act reports). The "fraud on the market" theory has not yet been applied to disclosure documents released by non-U.S. issuers in their home country.

An analysis of the various fraud actions brought under Rule 10b-5 is beyond the scope of this chapter. However, the impact of the anti-fraud provisions of Rule 10b-5 generally on ongoing disclosure and corporate communications by non-U.S. issuers in the U.S. markets is discussed in more detail in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.[14]

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plaintiff, and does not extend to parties that merely engage in transactions that are misrepresented in the issuer's financial statements.

11 In Tellabs v. Makor, 127 S.Ct. 2499 (2007), the Supreme Court defined a "strong inference" for pleading purposes as an inference, based on all of the facts alleged, "*at least as likely* as any plausible opposing inference." The inference need not be irrefutable or the most plausible inference, but it must be more than merely a plausible inference.

12 Recklessness has been defined in this context to mean highly unreasonable conduct, involving not merely simple, or even inexcusable negligence, but "an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the defendant must have been aware of it." Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719, 725 (W.D. Okla. 1976).

13 The prevailing view in the U.S. Courts of Appeals is that reckless misconduct is sufficient to establish *scienter*. See, *e.g.*, Press v. Chemical Inv. Serv. Corp., 166 F.3d 529 (2d Cir. 1999); City of Philadelphia v. Fleming Cos., 264 F.3d 1245 (10th Cir. 2001). In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999), which held that mere recklessness is insufficient under the PSLRA and that "deliberate and conscious recklessness" is necessary to satisfy the *scienter* requirement, has been criticized and is not followed in most jurisdictions. The Supreme Court decision in Tellabs v. Makor refused to decide whether recklessness was sufficient, but may be understood to have cast doubt on the view that scienter requires "deliberate and conscious recklessness."

14 Section 18 of the 1934 Act creates a cause of action on behalf of persons who can prove that they purchased or sold a security in reliance upon a "false or misleading" statement contained in a document filed with the SEC and that the statement affected the price of the security. Actions are rarely brought under this section due to the difficulty of proving that the purchase or sale was made in reliance upon the false or misleading statement and that such statement affected the price of the security. The 1934 Act also creates a limited cause of action in Section 9 for certain types of market manipulation. Section 14 of the

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Damages

A plaintiff under Rule 10b-5 may seek damages or rescission. Recovery for damages under the 1934 Act may include a disgorgement remedy, but is limited to an amount not in excess of actual damages on account of the act complained of, and the plaintiff must prove that the disclosure of the previously concealed facts, or the materialization of previously concealed risks, caused the loss in value of the plaintiff's investment.[15] Accordingly, punitive damages are not recoverable in a fraud action brought under Rule 10b-5. Such damages may be available, however, under state law. A defendant against whom a Rule 10b-5 claim is asserted has a right to contribution as a matter of federal law.

Limitation on Actions

Actions under Rule 10b-5 must be brought within two years after discovery of the facts constituting the violation and within five years after such violation.

1934 ACT – INSIDER TRADING

The 1934 Act expressly provides for liability for acts of insider trading and tipping. Under the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA"), insider traders and tippers may be subject to private actions as well as SEC civil actions and criminal proceedings.

The remedies provided under the ITSFEA are in addition to others that may be available under the U.S. federal securities laws, including Rule 10b-5.

The U.S. Supreme Court has held that a person who trades on material non-public information need not be an insider or receive the information from an insider to be liable under Rule 10b-5. It is enough that the person trading used the information in breach of a fiduciary duty owed to the source of the information.[16] However, a Rule 10b-5 claim may only be brought by the party to whom the duty was owed.

1934 Act has also been read by the courts to create private civil causes of action for false or misleading proxy statements (Section 14(a)) or "fraudulent, deceptive, or manipulative acts or practices" in connection with tender offers (Section 14(e)). The elements of the Section 14 causes of action – false or misleading statements or transactions, materiality, causation – are substantially similar to the Section 10(b) cause of action, but with a few significant differences, notably the fact that the Section 14(a) cause of action does not require proof of scienter and does not require the same showing of reliance. See, *e.g.*, Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991); Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985); Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).

[15] See Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 346 (2005).

[16] Rule 10b5-1 under the 1934 Act provides that insider trading liability arises when a person effects a transaction while "aware" of material non-public information and acted in breach of "a duty of trust or confidence" owed to the issuer, the shareholders of the issuer or the source of the non-public information. However, the rule provides certain affirmative defenses (*e.g.*, if the individual who traded while in possession of the material information can demonstrate that the transaction was part of a pre-existing contract or plan made in good faith).

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CONTROLLING PERSON LIABILITY

Section 15 of the 1933 Act provides that "controlling persons"[17] are jointly and severally liable with the controlled person who is liable under Section 11 or 12 of the 1933 Act. A controlling person may assert the affirmative defense that "the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." Controlling persons may include persons who have the direct or indirect power to direct the management and policies of the issuer. Depending on the circumstances, the officers, directors or substantial shareholders of an issuer, for example, may be deemed to be controlling persons.

Section 20 of the 1934 Act sets forth a similar provision with respect to joint and several liability of controlling persons for violations by controlled persons of any provision of the 1934 Act or the rules and regulations thereunder.

SOVEREIGN IMMUNITY

The liability of foreign governmental issuers under the U.S. federal securities laws must be considered in light of the doctrine of sovereign immunity and related U.S. laws.

The question of whether the doctrine of sovereign immunity shields non-U.S. sovereigns from the jurisdiction of U.S. courts is currently governed by the Foreign Sovereign Immunities Act of 1976 ("FSIA"). The FSIA is now the exclusive means for both U.S. federal and state courts to exercise jurisdiction over non-U.S. governments. Pursuant to the FSIA, public acts of "foreign states" are immune from U.S. jurisdiction, but commercial activities are subject to such jurisdiction.

The issuance of securities in the United States would likely be considered a commercial activity. Thus, the issuance of securities in the United States will subject a non-U.S. sovereign to jurisdiction in U.S. courts for claims arising in connection with such securities under U.S. federal securities and other laws. However, a governmental issuer still may be able to invoke the shield of sovereign immunity, depending, for example, on the actions of the non-U.S. issuer that are the subject of the litigation. The particular action may be found by the court to be a governmental action protected by sovereign immunity, and not part of the commercial activity.

Other foreign governmental issuers, such as agencies or instrumentalities of governments, may also be shielded from liability with respect to certain claims under U.S. law, depending on

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Under Rule 10b5-2, a person receiving material non-public information owes a duty of trust or confidence, and thus could be liable under the misappropriation theory, in the following circumstances: (1) the person agreed to keep the information confidential; (2) the persons involved in the communication had a history, pattern, or practice of sharing confidences that resulted in a reasonable expectation of confidentiality; or (3) the person who provided the information was a spouse, parent, child or sibling of the recipient of the information, unless it were shown affirmatively, based on the facts and circumstances of the family relationship, that there was no reasonable expectation of confidentiality.

[17] The term "controlling person" means every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency or otherwise, controls another person.

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their particular circumstances and the applicability of such other legal theories as the act of state doctrine. Foreign governmental issuers wishing to analyze their position with respect to liability under the U.S. federal securities laws should consult their U.S. counsel prior to making an offering in the United States.

CLASS ACTIONS

Private civil claims for violations of the federal securities laws may be brought under Rule 23 of the U.S. Federal Rules of Civil Procedure as "class actions." A class action is a suit brought by a representative of a group of persons with similar claims against a defendant. In order for an action to proceed as a class action, the court must be satisfied as to a number of factors, including that the class is too numerous to join each member as a plaintiff, that common questions of law or fact predominate over individual issues, and that the claims of the class representative are typical of those of the rest of the class. The PSLRA requires that the most appropriate plaintiff, usually the one with the greatest financial stake in the case, represent the class and select the lead counsel. The outcome of a class action generally is binding on all members of the class, unless they have affirmatively chosen to "opt out" of the class action.

Under the Securities Litigation Uniform Standards Act of 1998, the U.S. federal court is the exclusive venue for securities class actions, and securities claims based on state law may not be brought as class actions.

SEC ENFORCEMENT POWERS AND CRIMINAL SANCTIONS

In addition to the private actions discussed in this chapter above, an issuer that has violated the U.S. federal securities laws may face SEC civil actions and criminal sanctions.

SEC Enforcement Powers

The SEC has a variety of enforcement and investigatory powers under the 1933 Act and the 1934 Act. In its discretion, the SEC may seek both judicial and administrative remedies.

The SEC may use the judicial process by going to court to seek injunctive relief against violators of the U.S. federal securities laws and other equitable relief, such as disgorgement of profits for violations of Section 10(b) and Rule 10b-5 under the 1934 Act. In addition, the SEC may seek civil fines in court. For example, with respect to insider trading violations, the SEC may seek a penalty of up to three times the profit gained or loss avoided by such insider trading. The SEC also may seek to bar or suspend any person from serving as an officer or director of an issuer that has securities registered under, or is required to file reports pursuant to, the 1934 Act.

Administrative remedies available to the SEC include the power to impose fines for violations of the U.S. federal securities laws. The SEC also has the power to enter cease-and-desist orders for any violation of the U.S. federal securities laws.

Criminal Sanctions

Persons who willfully violate the 1933 Act or the 1934 Act or the rules and regulations thereunder may be subject to criminal sanctions consisting of fines or imprisonment, or both.

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For example, natural persons who willfully violate the 1934 Act may be punished by a fine of up to U.S.$5 million (U.S.$25 million in the case of a person other than a natural person) or a prison term of up to 20 years, or both (though no person is subject to imprisonment for violation of a rule or regulation if he proves he had no knowledge of such rule or regulation).

SARBANES-OXLEY

Sarbanes-Oxley created new civil liabilities in the areas of audit committee standards and disclosure rules regarding financial experts, executive officer codes of ethics, off-balance sheet arrangements, and non-GAAP financial measures. Criminal penalties may apply in the areas of management disclosure certifications, document retention and whistleblower protections.[18]

[18] See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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CHAPTER 18

DE-REGISTERING UNDER THE 1934 ACT

GENERAL 345
DE-REGISTRATION BY ANY ISSUER 346
TERMINATION BY FOREIGN PRIVATE ISSUERS 347
HOLDERS OF RECORD 351

GENERAL

Under the 1934 Act reporting regime, whether a U.S. or non-U.S. issuer can suspend or terminate its reporting obligations under Section 13(a) or 15(d) of the 1934 Act depends on how it became subject to those obligations and whether, at the time it intends to de-register and suspend or terminate its reporting obligations, it has any remaining reporting obligations under the 1934 Act. As discussed in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume, an issuer may have become subject to 1934 Act reporting obligations by any one or more of the following:

- listing a class of equity or debt securities on U.S. securities exchange under Section 12(b) of the 1934 Act;
- registering a class of equity securities under Section 12(g) of the 1934 Act either voluntarily or because it had 500 or more securityholders of record and more than U.S.$10 million in total assets and, if the issuer is a foreign private issuer, more than 300 shareholders identified as hold of record as resident in the United States on the last day of its most recently completed fiscal year;[1] or
- registering either equity or debt securities under a 1933 Act registration statement, which has gone effective, thus triggering 1934 Act reporting obligations under Section 15(d) of the 1934 Act until such time as the issuer has filed at least one annual report on Form 10-K, 20-F or 40-K, as applicable, for the fiscal year of the issuer in which the registration statement became effective[2] and thereafter the offered securities are held of record by less than 300 persons which, in the case of a foreign private issuer, means 300 persons resident in the United States.

The 1934 Act and the SEC's rules thereunder, among other things, establish an issuer's reporting requirements and subject an issuer to the other obligations it imposes, including those

[1] A foreign private issuer may avoid a 1934 Act registration obligation under Section 12(g) by establishing the exemption under Rule 12g3-2(b) under the 1934 Act as described in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume. However, Canadian issuers filing an MJDS registration statement under the 1933 Act or 1934 Act will be precluded from claiming this 12g3-2(b) exemption, as described in Chapter 13 (*Canadian Issuers*) of this volume. See SEC Release No. 34-58465 (Sept. 5, 2008) (http://www.sec.gov/rules/final/2008/34-58465.pdf).

[2] For purposes of this rule, the offering and selling securities under a 1933 Act-registered shelf registration constitutes effectiveness and triggers the obligation to file an annual report with respect to the fiscal year in which such offer and sale took place.

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under Sarbanes-Oxley, because the issuer has a particular class or classes of securities that require it to register or report under the 1934 Act. So it is the securities, not the issuer, that are registered and de-registered under the 1934 Act. Accordingly, an issuer may only terminate its 1934 Act obligations if it does so with respect to all of its outstanding classes of securities. In other words, an issuer will only be able to be relieved of its obligations under the 1934 Act if it has no securities listed on a U.S. securities exchange, it is not obligated to file 1934 Act reports pursuant to Section 13(a) or 15(d) of the 1934 Act and it meets the requirements for filing a Form 15 or, if a foreign private issuer, Form 15F as discussed in this chapter below.[3]

DE-REGISTRATION BY ANY ISSUER[4]

Under Rule 12g-4 under the 1934 Act, so long as a class of the issuer's securities is not listed on any U.S. securities exchange and the issuer is not required to file reports with respect to that class of securities pursuant to Section 15(d) of the 1934 Act, the issuer may terminate the registration of that class of securities under Section 12(g) of the 1934 Act by certifying to the SEC on Form 15 that the subject class of securities is held of record by fewer than 300 persons or, if the issuer's total assets have not exceeded U.S.$10 million on the last day of each of the issuer's most recent three fiscal years, by fewer than 500 persons.

Under Rule 12h-3 under the 1934 Act, so long as a class of the issuer's securities is not listed on any U.S. securities exchange, the issuer may de-register that class of securities under Section 12(g) of the 1934 Act by certifying to the SEC on Form 15 that the subject class of securities is held of record by less than 300 persons or, if the issuer's total assets have not exceeded U.S.$10 million on the last day of each of the issuer's most recent three fiscal years, by less than 500 persons.

While Rule 12h-3's standards are substantially similar to those under Rule 12g-4, there are two important differences. First, under Rule 12h-3, an issuer may generally not suspend its Section 15(d) reporting obligations until it has filed one prescribed annual report with the SEC after the offering in question. Second, under Rule 12h-3, an issuer cannot permanently terminate its reporting obligations under Section 15(d) but can only suspend those obligations so long as the holders of record are below the prescribed numbers. Therefore, under Rule 12h-3 (unlike Rule 12h-6 discussed in this chapter below, which permits termination and not just suspension by foreign private issuers), for as long as the subject class of securities is outstanding, an issuer must also determine at the end of each fiscal year whether the total number of record holders has increased enough to revive its Section 15(d) reporting obligations.

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[3] SEC Release No. 34-55540 (Mar. 27, 2007) (http://www.sec.gov/rules/final/2007/34-55540.pdf).

[4] While technically Rules 12g-4 and 12h-3 under the 1934 Act are available to foreign private issuers, as a result of changes by the SEC to those rules and the adoption by the SEC of Rule 12h-6, described below, that establishes special 1934 Act de-registration provisions for foreign private issuers other than Canadian issuers using MJDS, it is likely that only U.S. issuers and possibly Canadian issuers using MJDS will use Rule 12g-4 or 12h-3.

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TERMINATION BY FOREIGN PRIVATE ISSUERS

Rule 12h-6 under the 1934 Act establishes the conditions that a foreign private issuer must satisfy and the procedures that a foreign private issuer must follow in order to terminate its reporting and other obligations under the 1934 Act with respect to a class of securities, although in some cases after termination, the issuer may need to publish information it makes public in its home country and satisfy certain other conditions of Rule 12g3-2(b) for the benefit of U.S. investors. Information submitted to the SEC pursuant to Rule 12g3-2(b) does not itself subject the issuer to liability under the U.S. federal securities laws.[5]

As mentioned earlier, unlike Rule 12h-3, Rule 12h-6 permits a foreign private issuer to terminate, not merely suspend, its obligations under Section 15(d) of the 1934 Act. Other benefits of Rule 12h-6 over Rules 12g-4 and 12h-3 include an additional trading volume test for termination of 1934 Act reporting obligations for equity securities and more clarity regarding the process of termination.

Rule 12h-6 provides different conditions for terminating the 1934 Act registration or reporting obligations for equity securities, debt securities and following a merger, acquisition, securities exchange or similar event. In this section, after describing the conditions for each of those categories, we describe the termination process. To provide more certainty to foreign private issuers, Rule 12h-6 also contains procedures and conditions for filing a Form 15F with respect to a class of securities as to which a foreign private issuer has terminated or suspended its 1934 Act registration or reporting obligations prior to June 4, 2007 (the effective date of the rule). These procedures and conditions are similar to those discussed in this chapter below.

Right to Terminate 1934 Act Obligations for Equity Securities

ADTV and Holder Tests

Under Rule 12h-6, a foreign private issuer that satisfies the basic conditions for equity securities described below may terminate the registration of a class of equity securities under Section 12(g) of the 1934 Act or its obligation under Section 15(d) of the 1934 Act to file reports under Section 15(d) of the 1934 Act with respect to a class of equity securities by filing a Form 15F with the SEC, but only if:

- the average daily trading volume of the class of equity securities in the United States or the "U.S. ADTV" for a recent twelve-month period is no greater than 5% of the average daily trading volume of the class of equity securities worldwide or the "worldwide ADTV,"[6] which we refer to as the "ADTV Test;" or

[5] The information and filing requirements of Rule 12g3-2(b) under the 1934 Act are discussed in detail under the heading "Information Reporting under Rule 12g3-2(b) for Foreign Private Issuers" in Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

[6] Where the issuer's equity securities trade in the form of ADRs in the United States, it must calculate U.S. ADTV and worldwide ADTV in terms of the number of securities represented by those ADRs. See Rule 12h-6(a)(4)(ii) under the 1934 Act.

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- within 120 days prior to the date on which the issuer files the Form 15F, the class of securities is either held of record by less than 300 persons worldwide or less than 300 persons resident in the United States, which we refer to as the "Holder Test."

A foreign private issuer must wait at least 12 months before it may file a Form 15F to terminate its obligations under the 1934 Act with respect to a class of equity securities using the ADTV Test if:

- the issuer has delisted a class of equity securities from a U.S. securities exchange or inter-dealer quotation system and, at the time of de-listing, the U.S. ADTV exceeded 5% of the worldwide ADTV for the preceding 12 months; or

- the issuer has terminated a sponsored ADR facility and, at the time of termination, the U.S. ADTV exceeded 5% of the worldwide ADTV for the preceding 12 months.

Basic Conditions for Equity Securities

In order for a foreign private issuer to terminate its registration and reporting obligations under the 1934 Act with respect to a class of equity securities, it must satisfy and certify on Form 15F that it satisfies the following basic conditions:

- the issuer must have (i) reporting obligations under Section 13(a) or 15(d) of the 1934 Act for at least the 12 months preceding the date on which it files the Form 15-F with the SEC, (ii) filed with or furnished to the SEC all reports required during that period and (iii) filed at least one annual report on a prescribed form with the SEC;

- the issuer's securities must not have been sold in the United States in a 1933 Act-registered offering during the 12 months preceding the date on which it files the Form 15F with the SEC other than (i) to the issuer's employees, (ii) by selling securityholders in non-underwritten offerings, (iii) upon exercise of outstanding rights granted by the issuer if the rights are granted *pro rata* to all existing securityholders of the class of securities to which they attach, (iv) pursuant to a dividend or interest reinvestment plan or (v) upon the conversion of outstanding convertible securities or upon exercise of outstanding transferable warrants, other than, in the case of items (iii) through (v), securities issued pursuant to standby underwriting or similar arrangements;

- the issuer must have a listing outside the United States of the subject class of equity securities that it has maintained for at least 12 months preceding the date on which it files the Form 15F with the SEC and the listing must be on one or more securities exchanges that, either singly or together with the trading of the same securities in another non-U.S. jurisdiction, constitutes the primary trading market for those securities.

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Certain Defined Terms

The term "equity security" means "any stock or similar security, certificate of interest or participation in any profit sharing agreement, pre-organization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; and any security future of any such security." It does not include debt securities convertible into an equity security (with or without consideration), a warrant to purchase an equity security whether or not attached to a debt security or an option to purchase or sell an equity security.

The expression "recent twelve-month period" means a 12-calendar-month period that ends no more than 60 days before the date on which the Form 15F is filed with the SEC.

The term "primary trading market" means (i) at least 55% of the trading in a foreign private issuer's class of securities that is the subject of the Form 15F took place in, on or through the facilities of a securities market or markets in a single non-U.S. jurisdiction or no more than two non-U.S. jurisdictions during a recent twelve-month period and (ii) if a foreign private issuer aggregates the trading of its subject class of securities in two non-U.S. jurisdictions for purposes of determining whether it satisfies the third basic condition for equity securities listed above, the trading for the issuer's securities in at least one of the two non-U.S. jurisdictions must be larger than the trading in the United States for the same class of the issuer's securities.

For purposes of the Holder Test, a foreign private issuer must calculate the holders of record of a class of equity securities as discussed in this chapter below under the heading "—Holders of Record."

Right to Terminate 1934 Act Obligations for Debt Securities

As a practical matter, an issuer will only become subject to the 1934 Act's reporting obligations with respect to a class of debt securities if it offers and sells those securities in a 1933 Act-registered offering. Accordingly, the SEC's tests and conditions for terminating 1934 Act obligations with respect to a class of debt securities are more easily satisfied than those for a class of equity securities.

Holder Test

Under Rule 12h-6, a foreign private issuer that satisfies the basic condition for debt securities described below may terminate the registration of a class of debt securities under Section 12(g) of the 1934 Act or its obligation under Section 15(d) of the 1934 Act to file reports under Section 15(d) of the 1934 Act with respect to a class of debt securities by filing a Form 15F with the SEC, but only if within 120 days prior to the date on which the issuer files the Form 15F, it satisfies the Holder Test with respect the subject class of debt securities, which is described above.

Basic Condition for Debt Securities

To be eligible to terminate its 1934 Act obligations for a class of debt securities, at the time it files the Form 15F with the SEC, a foreign private issuer must have filed or furnished all

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reports required by Section 13(a) or 15(d) of the 1934 Act, including at least one annual report on an SEC-prescribed form after the 1933 Act-registered offering giving rise to the obligation to file an annual report with the SEC and must make a certification on Form 15F to that effect.

Definition of "Debt Security"

For purposes of Rule 12h-6, the term "debt security" means any security other than an equity security, as defined above, including non-participating preferred stock (*i.e.*, non-convertible capital stock, the holders of which are entitled to a preference in payment of dividends and in distribution of assets on liquidation, dissolution or winding up of the issuer, but are not entitled to participate in the residual earnings or assets of the issuer), and the other instruments expressly excluded from the definition of equity security as described above.

Right to Terminate 1934 Act Obligations Following a Merger, Consolidation, Securities Exchange, etc.

Following a merger, consolidation, exchange of securities, acquisition of assets or otherwise, a foreign private issuer that has succeeded to the registration of a class of securities registered under Section 12(g) of the 1934 Act pursuant to Rule 12g-3 under the 1934 Act or the reporting obligations with respect to a class of securities under Section 15(d) of the 1934 Act pursuant to Rule 15d-5 under the 1934 Act may terminate the registration or the reporting obligations, as the case may be, with respect to that class of securities by filing a Form 15F with the SEC, but only if the successor issuer meets the requirements discussed in this chapter above for that class of securities. In determining whether the successor issuer meet the requirement described above, the successor may take into account the reporting history of the issuer whose obligations it has assumed.

Termination Process

Upon filing a Form 15F with respect to a class of its securities, a foreign private issuer's obligation to file reports under the 1934 Act is immediately suspended if the filing is made as discussed in this chapter above. If the SEC has no objections to the filing, then 90 days after the issuer has filed the Form 15F with the SEC (or such shorter period as determined by the SEC), the issuer's 1934 Act registration or reporting obligations with respect to the subject class of securities shall terminate. However, if the Form 15F is subsequently withdrawn or denied by the SEC, the issuer must, within 60 days after the date of withdrawal or denial, file with or submit to the SEC all reports that would have been required had the issuer not filed the Form 15F.[7]

As a condition to terminating its registration or reporting obligations under the 1934 Act with respect to a class of securities, either before or on the date it files the Form 15F with the SEC, the issuer must publish a notice in the United States that discloses its intent to terminate its registration obligations, its reporting obligations or both, as applicable, under the 1934 Act. The issuer must publish the notice through a means reasonably designed to provide broad

[7] Rule 12h-6(i)(3) under the 1934 Act.

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dissemination of the information to the public in the United States and submit a copy to the SEC on Form 6-K before or at the time of filing the Form 15F or as an exhibit to the Form 15F.[8]

HOLDERS OF RECORD

Holders Generally

Rule 12g5-1 under the 1934 Act provides that securities shall be deemed to be "held of record" by each person who is identified on the records maintained by or on behalf of the issuer as the owner of the securities with the following qualifications:

- if the issuer's records of securityholders have not been maintained in accordance with accepted practice, each additional person who would be identified as an owner on those records had the record been kept properly must be counted as a holder of record;
- securities identified as held of record by a corporation, a partnership, a trust or another organization shall be counted as held of record by one person;
- securities identified as held of record by one or more persons acting as trustees, executors, guardians, custodians or in other fiduciary capacities with respect to a single trust, estate or account shall be counted as held of record by one person;
- securities held by two or more persons as co-owners shall be included as held by one person;
- each outstanding unregistered or bearer security shall be counted as held of record by a separate person unless the issuer can establish that, if they were registered securities, they would be held of record in accordance with the provisions of this rule by a lesser number; and
- securities registered in substantially similar names shall be counted as held by one person if the issuer can demonstrate they are all held of record by the same person;

subject to the following three provisions:

(1) if the issuer knows that securities are held subject to a voting trust, deposit agreement or similar arrangement, the number of record holders of interests in that arrangement shall be included as the number of record holders of those securities – for these purposes, the issuer may rely in good faith on the information it receives from a non-affiliated issuer of the interests in such an arrangement;

(2) where the issuer is a savings and loan association, building and loan association, cooperative bank, homestead association or similar institution, securities issued

8 Rule 12h-6(h) under the 1934 Act.

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for the sole purpose of qualifying a borrower for membership in the issuer, and which are to be redeemed or repurchased by the issuer when the borrower's loan is terminated, shall not be included as held of record by any person; and

(3) if the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the registration and reporting provisions of the 1934 Act, the beneficial owners of such securities shall be deemed to be the record owners thereof.

U.S. Residents

For the purpose of determining the number of U.S. residents holding a foreign private issuer's debt or equity securities under Rule 12h-6, Rule 12h-6(e) requires the foreign private issuer to use the method of described above, except that:

- securities held by a broker, dealer, bank or nominee for any of them for the accounts of customers resident in the United States shall be counted as held in the United States by the number of separate accounts for which the securities are held. Under this rule, issuers are required to make inquiries of all nominees, wherever located and wherever in the chain of ownership, for the purpose of assessing the number of U.S. resident holders;
- the issuer may limit its inquiry regarding the amount of securities represented by accounts of customers resident in the United States to brokers, dealers, bank and other nominees located in the United States, the jurisdiction where the foreign private issuer is legally organized, and if different to the latter, the issuer's primary trading market; and
- if, for purposes of determining compliance with the basic conditions that apply to the termination of 1934 Act obligations with respect to equity securities described above, if the issuer aggregates the trading volume of the issuer's securities in two non-U.S. jurisdictions, the issuer must include both of those jurisdictions as primary trading markets for purposes of the last clause.

If, after reasonable inquiry, a foreign private issuer is unable without unreasonable effort to obtain the information regarding the amount of securities represented by accounts of customers resident in the United States pursuant to the foregoing, the issuer may assume that the customers are the residents of the jurisdiction in which the nominee has its principal place of business. The issuer must count securities as owned by U.S. residents when publicly-filed reports of beneficial ownership or other reliable information provided to or obtained by the issuer indicate that the securities are held by U.S. residents. In calculating the number of U.S. resident securityholders, the issuer may rely in good faith on the assistance of an independent information services provider that in the regular course of its business assists issuers in determining the number of, and collecting other information concerning, their securityholders.

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CHAPTER 19

ACQUISITIONS BY NON-U.S. ENTITIES

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INTRODUCTION

This chapter provides a brief overview of certain U.S. federal and state laws to be considered by non-U.S. individuals, groups or companies (a "non-U.S. acquiror") in connection with a possible acquisition of a U.S. company, a subsidiary or division of a U.S. company or any other U.S. legal entity, or the assets of any of the foregoing (a "U.S. target"). This chapter, particularly the discussion under "Cross-Border Rules," also addresses U.S. federal and state laws to be considered by acquirors of non-U.S. issuers with U.S. securityholders. This chapter does not review all the considerations related to acquiring a publicly-held company, such as the advisability of structuring such a transaction to avoid premature announcement of negotiations and to minimize the period between the announcement of a transaction and its consummation or other tactical and strategic, operating or home country considerations that may be involved.

STRUCTURAL MATTERS

As a general matter, a non-U.S. acquiror is subject to the same rules and provisions as a U.S. company in effecting a U.S. merger and acquisition transaction. A non-U.S. acquiror, therefore, can benefit from the same techniques and methods that are available to domestic acquirors. As discussed below, however, non-U.S. acquirors may be subject to additional or different rules and requirements where certain regulated industries are involved.

There are three primary means of effecting merger and acquisition transactions involving a U.S. target – asset purchase, stock purchase and merger.

Asset Purchase

A non-U.S. acquiror can purchase all or substantially all the assets or only specified assets of a U.S. target, as may be agreed upon by the parties to the transaction. As part of such a transaction, the non-U.S. acquiror may assume specified liabilities of the U.S. target, again as may be agreed to by the parties, except in cases where the law specifically imposes successor liability on the purchaser. An asset purchase transaction can be utilized where the U.S. target is either a public company or a private company, or where the assets are housed in a division or operating unit of one of the foregoing. Having said that, transactions involving the purchase of substantially all the assets of a public company are relatively rare, because such transactions may expose the directors of such company to personal liability in circumstances where the liabilities, (including contingent liabilities) of the public company are not fully satisfied. Where divisions or

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operating units of public or private companies are involved, there are a number of additional considerations that may need to be taken into account in effecting such a transaction, which considerations are beyond the scope of this chapter.

Stock Purchase

A non-U.S. acquiror can also purchase the stock of the U.S. target by means of (i) an agreement with the U.S. target's shareholders (in the case of a privately held company or a subsidiary of a publicly- or privately-held company) or (ii) a tender offer (in the case of a U.S. target that is a publicly-held company) for all or part of the securities of the U.S. target, which latter purchase can then be followed by a back-end merger (usually of a wholly-owned subsidiary of the non-U.S. acquiror into the U.S. target) in order to "squeeze out" any shareholders of the publicly-held U.S. target that did not participate in the tender offer. The tender offer aspects of such a transaction are discussed in greater detail below. Partnership and limited liability company interests could also be purchased in a similar manner as the foregoing.

In addition to those situations where a non-U.S. acquiror is seeking to acquire all of the outstanding stock of a U.S. target, a non-U.S. acquiror may also wish to acquire, for strategic investment or other reasons, less than all the stock of a U.S. target. In such situations, the non-U.S. acquiror may become subject to restrictions on insider trading, reporting requirements under Section 13 of the 1934 Act, and the applicability of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"), which matters are discussed further below.

Merger

A non-U.S. acquiror can also structure the acquisition of a U.S. target as a one-step statutory merger between the U.S. target and either the non-U.S. acquiror directly or, more frequently, a U.S. or (rarely) a non-U.S. subsidiary of the non-U.S. acquiror that acts as the acquisition vehicle. Generally, the shareholders of the U.S. target will need to approve such a transaction under the laws of the state in which the U.S. target is domiciled, which approval is obtained at a special or annual meeting of shareholders. Where the U.S. target is a publicly-traded entity, the merger, as discussed above, can be combined with a tender offer as a means to obtain all the outstanding stock of the U.S. target.

While the foregoing are the basic types of transactions, there are variations that could be structured depending on the facts and circumstances of the particular transaction being contemplated. A description of such variations is beyond the scope of this chapter, as is a description of possible joint venture structures. As noted above, any of the foregoing transactions can be effected by the non-U.S. acquiror directly or through a subsidiary (wholly-owned or otherwise) that may either be a non-U.S. or a U.S. subsidiary. The structuring of any transaction will depend upon a variety of strategic, operational, tax and accounting considerations that are beyond the scope of this chapter. Such considerations should, of course, be fully considered by the non-U.S. acquiror and its advisors prior to implementation.

In addition, while the acquisition by a non-U.S. acquiror of a U.S. target is most often effected through a negotiated transaction approved in advance by the U.S. target, a non-U.S. acquiror can propose the acquisition of a U.S. target without prior approval from the U.S. target

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of such a proposal. The making of any such "hostile" or "unsolicited" acquisition proposals or tender offers, or the commencement of any stock accumulation programs by a non-U.S. acquiror seeking a significant equity position in, or control of, a U.S. target, and a review of the mechanics and other issues involved is also beyond the scope of this chapter.

Forms of Payment

To effect any of the foregoing types of merger or acquisition transactions, a non-U.S. acquiror can use cash, stock of the non-U.S. acquiror, a combination thereof or some other form of consideration to pay for either the assets acquired or the stock purchased. Again, tax and accounting considerations, as well as timing considerations, need to be taken into account as part of such an assessment as to which form of consideration should be used.

If a non-U.S. acquiror issues its securities as consideration to purchase a U.S. target, the non-U.S. acquiror will be deemed to have offered its securities for sale and, absent an exemption, such securities would have to be registered on Form F-1, Form F-3 or, most often, Form F-4 under the 1933 Act. Registration under the 1933 Act can be complex since a substantial amount of information must be disclosed about both the non-U.S. acquiror and the U.S. target.[1] The filing of such a registration statement will affect timing considerations. If the non-U.S. acquiror were purchasing a closely-held U.S. entity with securities, it could consider using the private placement exemption to avoid the registration process.[2] As referenced below under the description of the SEC's Cross-Border Rules, securities of a non-U.S. acquiror issued in a merger and acquisition transaction may be exempt from registration when U.S. investors hold small percentages of the non-U.S. acquiror's equity securities.

SELECTED RELATED MATTERS

Non-U.S. acquirors should also bear in mind the following when contemplating U.S. mergers and acquisitions.

Antitrust Issues

Regardless of whether there are any antitrust obstacles to effecting a proposed transaction, non-U.S. acquirors, like U.S. acquirors, usually need to report an acquisition exceeding certain size thresholds in advance to the U.S. antitrust agencies as discussed in greater detail below.

Insider Trading and Disclosure of Information

Non-U.S. acquirors should be aware that insider trading issues may be involved whenever the other party is a public company (including the seller of assets or the parent of a division that may be acquired in a stock or asset transaction). A non-U.S. acquiror, like a U.S.

[1] See Chapter 3 (*The Securities Registration and Reporting Process*) of this volume.

[2] See Chapter 8 (*1933 Act-Exempt Offerings and Securities*) of this volume.

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acquiror, may also be precluded from purchasing shares of the U.S. target if the non-U.S. acquiror is in possession of material non-public information about the U.S. target.[3]

Schedules 13D and 13G

If any acquiror, including a non-U.S. acquiror, directly or indirectly acquires beneficial ownership in excess of 5% of a publicly-traded class of equity securities of a U.S. target, the acquiror will be required to file a Schedule 13D[4] or, in certain cases, a short-form statement under Schedule 13G, within ten calendar days of such event.[5] The SEC broadly interprets "beneficial ownership" as arising whenever a person or entity possesses or shares, directly or indirectly, alone or with others, the power to vote, sell or determine the disposition of a security.[6]

Section 16

If any acquiror, including a non-U.S. acquiror, acquires more than 10% of any publicly-traded class of equity securities of the U.S. target, it will become an "insider" and accordingly will have an obligation to file within ten days a report with the SEC under Section 16(a) of the 1934 Act. Thereafter, subsequent trades must be reported within two business days. In addition, an insider may have to disgorge any short-swing profits resulting from purchases and sales made within any six-month period.[7]

Sarbanes-Oxley

Non-U.S. acquirors also need to be mindful of the enhanced disclosure and financial reporting requirements under the U.S. securities laws as a result of the enactment of Sarbanes-Oxley if they seek to register securities as part of a proposed transaction or are otherwise required to file ongoing reports with the SEC. Many of the requirements contained in Sarbanes-Oxley apply to all public companies in the United States, including non-U.S. companies, such as those requiring certifications of financial reports, preparation and disclosure of internal controls reports, rules governing the composition of boards and audit committees and prohibitions on extending, maintaining or arranging loans to directors and executive officers.[8]

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3 Rule 10b-5 under the 1934 Act.

4 Section 13(d)(1) of the 1934 Act, Rule 13d-1(a) under the 1934 Act.

5 Rule 13d-1(c) under the 1934 Act. Acquirors generally may file a Schedule 13G instead of a Schedule 13D if (a) the acquiror does not beneficially own, directly or indirectly, more than 20% of the class; and (b) the acquiror has acquired the securities without the purpose or effect of changing or influencing the control of the issuer of the securities.

6 Rule 13d-3(a) under the 1934 Act.

7 Directors and officers also have obligations under Section 16(b) of the 1934 Act, as do control shareholders who own more than 10% of any class of stock.

8 See Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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TENDER OFFERS AND EXCHANGE OFFERS; COMMUNICATIONS UNDER THE 1933 ACT

As noted above, in certain instances, a U.S. target can be acquired using a tender offer. A tender offer is an offer to buy shares of a publicly-held U.S. target (usually at a premium above the prevailing market price) for cash, securities or both, most often with the objective of taking control of the target company. An exchange offer is a tender offer in which the bidder offers securities (usually its own) in exchange for the securities of the U.S. target at a specified exchange ratio.

The rules governing tender offers and exchange offers for shares of U.S. companies are complex and a full review of these rules is beyond the scope of this chapter. In brief, however, under the current rules, when a non-U.S. acquiror decides to make a tender offer for the securities of a U.S. target, it first publicly announces its intention to make the offer. The SEC's rules prohibit bidders and their representatives from announcing an offer with the intent to manipulate the market price of the stock of the bidder or the target without the intent to commence the offer within a reasonable time or without a reasonable belief that the bidder has the means to purchase the securities sought. The public announcement of information regarding a tender offer must be filed with the SEC on the date of first use and must contain a legend advising securityholders to read the full tender offer statement when it becomes available.

An obligation to file certain disclosure documents is triggered at the time of the "commencement" of a tender offer. Under the SEC's 1999 Release regarding mergers and acquisitions ("Regulation M-A"),[9] the obligation to file the required disclosure document with the SEC commences upon providing the U.S. target's securityholders with the "means to tender" their securities, which may include, for example, transmittal forms or instructions on how to tender shares. The tender offer must remain open for at least 20 business days (during which time securities may not be purchased by the bidder, either in the tender offer or otherwise, and shareholders may withdraw tendered shares). The tender offer rules provide for a subsequent offering period, if so desired, without withdrawal rights. Changes to the terms of the tender offer may require extension of the 20 business day-period.

Exchange offers, on the other hand, commence when the registration statement covering the securities of the bidder to be exchanged for the securities of the U.S. target is first filed with the SEC, assuming the bidder satisfies certain specified requirements, or at a later date (when the bidder satisfies these requirements) up to the date of effectiveness. Any securities tendered in the offer cannot be purchased until after the registration statement covering the exchange offer becomes effective, the minimum 20-business-day tender offer period has expired and all material changes to the registration statement are disseminated to securityholders of the U.S. target with adequate time remaining in the offer for securityholders to review and act upon the information. If material changes require the dissemination of a supplement to the registration statement, the SEC rules require that the offer must remain open for at least five business days from the date of such changes if the material changes do not relate to the offer price or the amount of securities being sought and ten business days from such date if the material changes relate to price, the number of shares sought, the dealer's soliciting fee or changes of similar significance. If fewer

[9] SEC Release No. 33-7760 (Oct. 26, 1999) (http://www.sec.gov/rules/final/33-7760.htm).

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days remain in the offer than the material changes would require, then the expiration date would have to be extended for the appropriate period of time. The shareholders of the target company have the right to withdraw their tendered securities at any time before they are purchased by the bidder.

Required Disclosure

Any party commencing a tender offer is required to file a Schedule TO with the SEC and deliver the Schedule TO to the U.S. target on the day the tender offer commences. The information that the filing party (including a non-U.S. acquiror) is required to disclose is described in the 1934 Act's tender offer rules and Schedule TO. This includes, among other things, information about its directors and officers, including any controlling person and its directors and officers, any criminal convictions or certain civil injunctions against such persons in the past five years, the purpose of the transaction, and the source and amount of funds for the purchase of shares. The acquiror has the obligation not to misstate any material fact or to omit to state any material fact necessary in order to make its statements in the Schedule TO not misleading. This means that a non-U.S. acquiror may have to disclose material non-public information about itself. Thus, prior to commencing a tender offer, a non-U.S. acquiror should consider whether there are any matters concerning its directors and officers and its business that it would prefer not to disclose. In addition, a non-U.S. acquiror may need to disclose certain financial information about itself and may need to reconcile its financial information to U.S. GAAP. In a cash merger, financial statements and other information about an acquiror must be provided only if they are material to a voting securityholder's evaluation of the transaction. The SEC also requires financial statements covering the acquiror's past two fiscal years where the acquiror's financial statements will be material to a securityholder's voting decision.

Communications under the Tender Offer Rules

Under Regulation M-A, a bidder is permitted to communicate with securityholders and the marketplace about an upcoming tender offer or business combination (orally or in writing) prior to the filing and effectiveness of a registration or tender offer statement. There are no content restrictions on such communications other than the anti-fraud provisions of the 1934 Act and regulations thereunder, as well as state securities laws. All written communications in connection with a business combination transaction, however, must be filed on or before the date of first use. The goal of the rules is to end selective disclosure of information to analysts but not to the public at large, although it is acknowledged that such selective disclosure may continue on a limited basis, since oral communications are not required to be filed.

Again, the rules related to communications in connection with tender offers are complex, and the foregoing only touches on certain aspects of these rules. A party seeking to fully understand such rules should consult its advisors.

PROXY SOLICITATIONS

Proxy solicitations are requests by one party (generally, institutional investors or potential acquirors) for authority to act for another (usually to vote shares). Solicitations of proxies are sometimes used in a variety of corporate transactions, including acquisitions. Certain

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transactions, such as the merger of a publicly-traded company, or the sale of substantially all the assets of a public company, generally require approval by the shareholders of the target company. The solicitation of approval of these transactions is governed by Section 14 of the 1934 Act. Section 14 prohibits any person from soliciting a proxy in violation of the SEC's proxy rules. These rules apply to every proxy solicitation of the shareholders of a U.S. target, with few exceptions. The proxy rules expressly prohibit certain solicitations, including those containing any false or misleading statements. Each proxy must clearly and impartially identify each matter or related group of matters to be acted on. It must also provide a means to allow the person solicited an opportunity to specify a choice among approval, disapproval and abstention regarding each matter. Copies of the preliminary proxy statement usually must be filed with the SEC at least ten calendar days before definitive copies are first published or delivered to shareholders. There are numerous other rules relating to proxies that either must be complied with or to which parties may avail themselves that are not reviewed here.

CROSS-BORDER RULES

In addition to issuing Regulation M-A, the SEC has also adopted rules for cross-border tender and exchange offers, business combinations and rights offerings ("Cross-Border Rules").[10] The primary purpose of the Cross-Border Rules is to encourage bidders for the securities of foreign private issuers with a limited number of U.S. securityholders to extend their offers to U.S. holders of those securities. The Cross-Border Rules are intended to balance this goal against the need to provide U.S. securityholders with the protections of the U.S. securities laws. In brief, the Cross-Border Rules provide exemptive relief from certain aspects of U.S. securities laws, as discussed in this chapter below and as more fully described in the Cross-Border Release.

Tier I Exemption

Tender offers for securities of non-U.S. issuers are exempt from most provisions of the U.S. tender offer rules so long as U.S. investors hold 10% or less of the securities subject to the offer. (Under the Cross-Border Release, this is known as the "Tier I" exemption.) The acquiror must submit Form CB to the SEC for the purpose of providing U.S. securityholders and the SEC with an English translation of any informational materials sent by it to non-U.S. stockholders. Non-U.S. acquirors must also file with the SEC a consent to service of process in the United States on Form F-X. Both of these Forms must be filed electronically. The most important requirement under the Tier I exemption is "equal treatment," which requires, subject to certain exceptions, that U.S. stockholders be permitted to participate in the offer on terms at least as favorable as those for non-U.S. stockholders. A non-U.S. acquiror must also comply with the applicable regulations of its home jurisdiction in order to be entitled to the Tier I relief.

Tier II Exemption

Tender offers for securities of non-U.S. issuers are also granted limited exemptive relief from certain U.S. tender offer rules if U.S. investors hold more than 10% but not more than 40%

[10] SEC Release No. 33-7759 (Oct. 22, 1999) (http://www.sec.gov/rules/final/33-7759.htm) (the "Cross-Border Release").

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of the securities subject to the offer. (Under the Cross-Border Release, this is known as the "Tier II" exemption.) For example, acquirors meeting the exemption requirements may reduce or waive the minimum tender condition requirement without extending withdrawal rights during the remainder of the offer if certain conditions are satisfied. This exemption avoids the need for an SEC exemptive order or a no-action letter in certain situations where U.S. tender offer rules conflict with rules of other jurisdictions. The Tier II exemption largely represents a codification of relief previously granted to acquirors on a case-by-case basis. The exemption is a limited exemption, which means that the remaining U.S. tender offer rules (related to procedural, disclosure and filing aspects) must be complied with. For example, non-U.S. acquirors must file a Schedule TO disclosure form. Like the Tier I exemption, separate offers may be made to U.S. stockholders and non-U.S. stockholders, so long as the offers are on similarly favorable terms. Unlike the Tier I exemption, the Tier II exemption does not permit a bidder to offer cash to U.S. securityholders while offering securities to non-U.S. securityholders. Other exceptions are considered on a case-by-case basis.

Exemptions from Rule 14e-5

Under Rule 14e-5 under the 1934 Act, persons making a tender or exchange offer for a security are prohibited from purchasing the securities that are the subject of such an offer, other than pursuant to the terms of the offer. Most foreign jurisdictions have no such prohibition. Tier I transactions are exempt from Rule 14e-5, provided that (i) the offering documents prominently disclose the possibility of purchases not pursuant to the terms of the offer and the manner in which the information about such purchases will be disclosed and (ii) the acquiror discloses information about such purchases in a manner comparable to that in its home jurisdiction. Tier II transactions are not *per se* exempt from Rule 14e-5, but the SEC will review requests for exemptions of these transactions on a case-by-case basis. The Cross-Border Rules also codify a limited class exemption for U.K. market makers and principal traders from Rule 14e-5 during certain Tier I or Tier II transactions.

OVERVIEW OF OTHER SELECTED LEGAL ISSUES

The acquisition of a U.S. target by a non-U.S. acquiror involves many areas of U.S. law in addition to the U.S. securities laws, such as antitrust law, federal and state regulatory law, tax law and state corporate law. The following is only a brief overview of some of these areas.

Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act")

A non-U.S. acquiror effecting any of the foregoing types of transactions may have to report the acquisition to the Federal Trade Commission and the U.S. Department of Justice ("Antitrust Agencies") and wait a prescribed period before consummating the transaction under the HSR Act.[11] The HSR Act reportability is triggered once certain statutory size-of-the-parties

[11] The HSR Notification and Report Form is not part of the public record and is specifically exempt from disclosure in response to a request made under the Freedom of Information Act. The most controversial item on the Form is Item 4(c), which requires an acquiror to submit all studies or analyses that were prepared by or for any officer or director that were used for the purpose of evaluating the acquisition with respect to its competitive effects. The U.S. Federal Trade Commission has interpreted this provision broadly.

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and size-of-the-transaction thresholds are met. The initial waiting period (15 days in the case of an all cash tender offer and 30 days for all other reportable transactions) may be extended by the Antitrust Agencies in the event that they decide to investigate possible anticompetitive effects of the proposed transaction. Rules promulgated by the Antitrust Agencies contain a specific exemption for certain acquisitions by a non-U.S. acquiror. The exemption, however, is fact specific and focuses on the value of the U.S. assets or securities being acquired.

The HSR Act generally will require the filing of prior notification before the non-U.S. acquiror closes the acquisition of a U.S. target's assets or voting securities that are valued in excess of a threshold amount (U.S.$65.2 million as of January 2009, and adjusted yearly for inflation), except in the case of an acquisition of up to 10% of a U.S. target's voting securities "solely for the purpose of investment." The HSR waiting period commences for most transactions upon receipt by the Antitrust Agencies of complete notification forms from all parties to the transaction that are required to file a notification report. In the case of a tender offer for a U.S. target by a non-U.S. acquiror (or an acquisition of voting securities from a third party), the waiting period commences on the date the non-U.S. acquiror files its notification report with the Antitrust Agencies. Although the U.S. target will be required to file a responsive report, its filing does not affect the waiting period. Because of the numerous technical exemptions from the HSR Act's reporting requirements, each acquisition should be reviewed independently to determine whether it is reportable under the HSR Act.

Other Federal and State Law Requirements

Certain U.S. industries are governed by statutes and regulations that require approval from, or filing with, a U.S. federal or state governmental agency prior to a non-U.S. acquiror assuming control of a U.S. target. Delays associated with obtaining such approvals must also be considered as part of the overall evaluation process and may affect structuring considerations. Some of these industries include, but are not limited to, aviation, financial services, broadcasting and telecommunications, defense, energy and natural resources and shipping. Certain industries, including banking, insurance and land ownership, are also regulated at the state level.

In addition, a non-U.S. acquiror should note that acquisitions in certain industries may effectively be precluded by laws that regulate those industries. The following is a brief listing of historic statutory or regulatory provisions that may restrict the acquisition of a U.S. target by a non-U.S. acquiror or the activity of non-U.S. entities or U.S. businesses (incorporated in the U.S.) that are owned by non-U.S. citizens or entities:

- ***Agricultural Foreign Investment Disclosure Act***. This Act requires a non-U.S. person or entity to file a report following the acquisition or transfer of an interest, other than a lien or security interest, in U.S. farming, ranching or forestry.

- ***Communications Satellite Act***. This Act restricts non-U.S. ownership of wireless satellite networks.

- ***Edge Act***. This Act places limits on non-U.S. ownership of corporations chartered by the Federal Reserve Board to participate in international banking and finance.

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- ***Federal Aviation Act***. This Act prohibits non-U.S. airlines from operating domestic service in the U.S. and prevents non-U.S. airlines from owning more than 25% of the voting stock in a U.S. corporation serving the domestic market.

- ***Federal Communications Act***. This Act prevents non-U.S. persons, entities or governments and U.S. entities controlled by non-U.S. interests from possessing a broadcast or common carrier license unless the Federal Communications Commission concludes that it will serve the "public interest" or unless certain conditions are met.

- ***Foreign Bank Supervision Enhancement Act***. This Act establishes special clearance and oversight for non-U.S.-owned banks doing business in the United States.

- ***Foreign Investment in Real Property Tax Act***. This Act requires reporting by non-U.S. entities holding direct investments in U.S. property interests having an aggregate value in excess of specified amounts.

- ***Immigration and Nationality Act***. This Act provides that employees of non-U.S. companies who have obtained work visas in order to work in the U.S. for the purposes permitted by the Act may lose their legal status if U.S. investors obtain more than 50% of such company. Thus, a non-U.S. company should be aware of the immigration status of its employees and identify critical immigration consequences prior to permitting a U.S. investor to acquire a majority stake in its company.

- ***International Investment and Trade in Services Survey Act***. This Act requires U.S. business entities to report acquisitions of a voting interest of 10% or more by non-U.S. persons. Along with the reporting requirements of non-U.S. investors, there are reporting requirements for U.S. citizens who assist in the acquisition or who enter into a joint venture with a non-U.S. person to create a U.S. business enterprise.

- ***Merchant Marine Act***. This Act restricts the registration and licensing of vessels to those that are owned, chartered, or leased from the Secretary of Commerce by (i) a U.S. citizen or (ii) a business entity that is organized in the United States and is controlled by U.S. citizens.

- ***Mineral Lands Leasing Act***. This Act requires that an entity applying to the U.S. government for a federal lease to develop certain natural resources of the United States disclose the identity and citizenship of those owning more than 10% of the equity interest in such entity. The lease will be granted only on the condition that U.S. persons can obtain reciprocal licenses or leases from the home governments of non-U.S. shareholders.

- ***Shelflands Act***. This Act states that offshore leases for the development of energy resources be held only by citizens, nationals and permanent resident aliens of the United States.

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- ***Tax Equity and Fiscal Responsibility Act***. This Act requires domestic and non-U.S. corporations that are controlled by a non-U.S. person and engage in a trade or business in the United States to file annual information reports.

Internal Revenue Code

The acquisition of a U.S. target by a non-U.S. acquiror also presents a number of complex tax issues under the Internal Revenue Code of 1986, as amended, that may determine the optimal structure of the transaction and may factor into the determination of how to finance the transaction. The purchaser's effective tax rate must also be analyzed along with any tax differences that may exist between the U.S. and the country of the non-U.S. acquiror's domicile and the effect of any tax treaties that may exist. The non-U.S. acquiror's home country tax rules may play a significant role in such a determination.[12]

Exon-Florio Amendment

The Exon-Florio Amendment to the Defense Production Act of 1950 ("Exon-Florio") gives the President of the United States, through his designee, the Committee on Foreign Investment in the United States ("CFIUS"), which is made up of a number of U.S. executive branch departments and agencies, the authority to suspend or prohibit the acquisition of a U.S. business by a non-U.S. acquiror if (i) there is credible evidence to believe that the non-U.S. acquiror might take action that threatens to impair the national security[13] and (ii) existing laws, other than the International Emergency Economic Powers Act and the Exon-Florio provision, do not provide adequate and appropriate authority to protect the national security.

Under the Exon-Florio provision, parties to certain transactions, including a non-U.S. acquiror, may wish to file a report with CFIUS on the transaction for review. If CFIUS decides that the transaction may present national security concerns, it commences a 45-day investigation to decide whether the issues require further mitigation efforts or a recommendation to the President for action. At the end of the 45-day period, the matter may be referred to the President who then has 15 days to take final action. Since a typical transaction involving a non-U.S. acquiror and a U.S. target does not implicate the national security, many non-U.S. acquirors do not provide notice to CFIUS (notice, in any case, is voluntary). Consideration as to filing should be given, however, where the business of the U.S. target employs personnel with security clearance for classified governmental materials or enters into classified contracts with security-sensitive U.S. governmental agencies. In addition, under amendments to Exon-Florio that were passed in 2007, any transaction involving critical infrastructure, major energy assets and critical technologies is deemed to implicate the national security and acquirors of such assets

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[12] See Chapter 15 (*Home Country Matters*) of this volume for a discussion of certain other of non-U.S. laws or regulations that affect nonresident securityholders. See *Accessing the U.S. Capital Markets – Securities Products* for a discussion of certain tax considerations for non-U.S. issuers.

[13] The term "national security" is undefined in the regulations. However, the U.S. Treasury Department has recently given guidance to the effect that CFIUS will continue to focus narrowly on genuine national security issues, and not on broader economic or other national interests. Among the key issues are the nature of the business being acquired, the identity of the foreign person acquiring control and the types of information required to access national security concerns. See http://www.ustreas.gov/offices/international-affairs/cfius/docs/GuidanceFinal_12012008.pdf.

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should consider filing for review. Those amendments have also created a presumption that a 45-day investigation by CFIUS is required when (i) the acquiror is controlled by or acting on behalf of a foreign government or (ii) the transaction could result in the control of any "critical infrastructure" by a foreign business, unless the Secretary of the Treasury and the head of the lead agency of the U.S. executive branch responsible for the review of the transaction jointly determine that the transaction will not impair the national security.

U.S. targets in hostile takeover situations may have some strategic alternatives available under Exon-Florio. In what is colloquially referred to as the "Pentagon Ploy," the U.S. target may choose to lobby the Department of Defense, or one of the other 11 agencies affiliated with CFIUS, to influence support for a formal investigation or to simply delay the acquisition. Even if foreign ownership restrictions do not apply, a non-U.S. acquiror must comply with the reporting requirements under the International Investment and Trade in Services Survey Act if it acquires 10% or more of a U.S. target's voting securities.

State Corporate Law; Other Impediments

In order to effect a merger or other form of acquisition, a non-U.S. acquiror must follow the procedures prescribed by the corporate laws of the state under which the U.S. target is organized. Such laws comprise the rules regarding shareholder and director approval of an acquisition transaction. In addition, state law frequently provides "appraisal rights" to dissenting shareholders that may entitle the shareholders to greater consideration than has been provided for in the merger agreement if certain steps are followed.

The U.S. target's organizational documents and state law requirements must to be reviewed for any other rules or impediments that a non-U.S. acquiror should consider, including, but not limited to, any control share, business combination, or fair price anti-takeover statutes under the applicable state law. For example, Section 203 of the Delaware General Corporation Law generally prohibits a Delaware corporation from engaging in a "business combination" with any "interested stockholder" for a period of three years following the date that the stockholder became an interested stockholder, unless the transaction in which the person became an interested stockholder is approved in the manner required by such Section or the business combination is approved by a two-thirds vote of the shares held by persons unaffiliated with the interested stockholder. Generally, a "business combination" is defined to include mergers, asset sales and other transactions resulting in financial benefit to a stockholder, and an "interested stockholder" is a person who, together with affiliates and employees, owns, or within three years, did own, 15% or more of a corporation's voting stock.

The NYSE and NASDAQ also have rules governing certain share issuances that may need to be taken into account depending on the proposed structure of the transaction. In addition, acquirors should be aware of possible takeover defenses that may be included in the charter or bylaws of a U.S. target or imposed by state law or adopted contractually.

A common takeover defense is the "poison pill," or shareholder rights plan, that acts to allow shareholders other than the hostile acquiror to purchase additional shares of the target company at a discounted price, thereby diluting the acquiror's security ownership position. Because the board of directors usually retains the right to redeem these plans, poison pill

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provisions can be used to force acquirors to negotiate with target companies. Some other anti-takeover defenses are:

- constituency statutes found under state law, which allow consideration of social, economic, and other factors relating to constituencies other than the shareholders (*e.g.*, the employees or residents of the state of incorporation) when evaluating a bid;
- staggered boards, which also prevent potential acquirors from electing their own board by requiring that only a portion of the total number of directors on the target's board be elected each year;
- fair price requirements;
- limitations on and methods for changing the size of the board;
- supermajority voting requirements for shareholders approving mergers, consolidations, and sales of assets; and
- cumulative voting, which allows shareholders to cast all their votes for one candidate for election to the board of directors, thereby limiting a potential acquiror's ability to elect the entire board of directors after acquiring a majority of the outstanding stock of a company.

CONCLUSION

There are many legal considerations that a non-U.S. acquiror needs to consider when contemplating an acquisition of a U.S. target or a non-U.S. target with U.S. securityholders. These issues must be identified and rapidly resolved in order to bring about a successful completion to any such acquisition. The foregoing briefly summarizes certain, but not all of these considerations. It is not intended to be a step-by-step guide for a non-U.S. acquiror to effect the acquisition of a U.S. target or a non-U.S. target with U.S. securityholders, which should only be effected after a careful review with counsel of all relevant factors.

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GLOSSARY

Term	Definition
10b-5 statement	statement to the underwriters by U.S. counsel that confirms nothing has come to such counsel's attention to cause it to believe that the registration statement (in the case of a 1933 Act-registered offering) or the offering documents (in the case of a 1933 Act-exempted offering) contain or incorporate by reference any material misstatement or omit any material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading
18(b)(1)(C) Covered Securities	securities exempt from U.S. state or territorial regulation under Section 18(b)(1)(C) of the 1933 Act
18(b)(4)(C) Covered Securities	securities exempt from U.S. state or territorial regulation under Section 18(b)(4)(C) of the 1933 Act
1933 Act	U.S. Securities Act of 1933
1934 Act	U.S. Securities Exchange Act of 1934
1939 Act	U.S. Trust Indenture Act of 1939
1940 Act	U.S. Investment Company Act of 1940
1986 Release	defined on page 280
2007 Regulation D Proposing Release	defined on page 229
ADRs	American Depositary Receipts issued by a depositary, typically a U.S. bank, that evidence a direct interest in underlying securities held by the depositary
ADSs	American Depositary Shares are securities (or a fraction or multiple thereof) that are evidenced by an ADR and that represent underlying securities held by or on behalf of the depositary that issued the ADR
ADTV	average daily trading volume
affiliated purchaser	defined on page 51
Alternative Listing Standards	alternative minimum numerical listing standards to the NYSE Alternext US Initial Listing Standards
Antitrust Agencies	U.S. Federal Trade Commission and U.S. Department of Justice
AS 1	Auditing Standard No. 1 of the PCAOB
AS 5	Auditing Standard No. 5 of the PCAOB
at-the-market offering	an offering of securities into an existing trading market at other than a fixed price
audit committee financial expert	defined on page 203
bank issuers	U.S. banks and U.S. branches and agencies of non-U.S. banks

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Term	Definition
bank notes	bank securities that include senior or subordinated bank-level debt securities
bank securities	securities issued by U.S. banks and U.S. branches and agencies of non-U.S. banks
BHCA	U.S. Bank Holding Company Act of 1956
blue sky laws	securities laws adopted by U.S. states and territories
business combination	generally, mergers, asset sales and other transactions resulting in financial benefit to a stockholder
Canadian issuer	any non-U.S. issuer (other than an investment company) incorporated or organized under the laws of Canada or any Canadian province or territory
CEO	chief executive officer
CFO	chief financial officer
CFIUS	Committee on Foreign Investment in the United States
CFTC	Commodity Futures Trading Commission
COBRA	FINRA's Corporate Offerings Business Regulatory Analysis System
consideration cap	total consideration that an issuer will pay under a modified "Dutch auction" tender offer
Cross-Border Release	SEC Release No. 33-7759 (Oct. 22, 1999)
Cross-Border Rules	SEC rules for cross-border tender and exchange offers, business combinations and rights offerings
CSA	Canadian Securities Administrators
CUSIP	Committee on Uniform Security Identification Procedures
deposit notes	certificates of deposit structured to resemble debt securities
depositary	a bank organized in the United States that provides the security transfer and agency services in connection with an ADR or GDR facility.
disclosure package	defined on page 27
DOWNREIT	defined on page 269
DTC	The Depository Trust Company
ELDS	Equity-Linked Debt Securities
ELTN	Equity-Linked Term Note
EU	European Union
Exon-Florio	defined on page 363
expertised	defined on page 334
FASB	Financial Accounting Standards Board
FCPA	Foreign Corrupt Practices Act of 1976
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Company
Federal Reserve Board	Board of Governors of the U.S. Federal Reserve System

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Term	Definition
FFO	funds from operations
FIN 46	defined on page D-8
financial services affiliate	defined on page 51
FINRA	Financial Industry Regulatory Authority, Inc.
foreign governmental issuer	any government of any country other than the United States or any of its political subdivisions, and any other entity that the SEC determines is eligible for similar treatment in connection with U.S. public offerings
foreign private issuer	defined on page 2
free writing prospectus	defined on page 27
FSIA	Foreign Sovereign Immunities Act of 1976
GDRs	Global depositary receipts issued by a depositary, typically a bank, that evidence a direct interest in underlying securities held by the depositary
graphic communications	defined on page 30
HSR Act	U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976
IAS	International Accounting Standards
IAS 34	International Accounting Standard No. 34 "Interim Financial Reporting"
IAS 39	International Accounting Standard No. 39 "Financial Instruments: Recognition and Measurement"
IASB	International Accounting Standards Board
IBA	U.S. International Banking Act of 1978
IDEA	Interactive Data Electronic Applications, the SEC's electronic filing system, formerly known as EDGAR
IFRS	International Financial Reporting Standards
Industry Guide	SEC regulations covering required disclosure for issuers in certain industries, as available at http://www.sec.gov/about/forms/industryguides.pdf
ineligible issuer	defined on page 25
investment company	defined on page 11
IPO	initial public offering
ITSFEA	U.S. Insider Trading and Securities Fraud Enforcement Act of 1988
MD&A	the section of an SEC filing entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations."
MJDS	Multi-jurisdictional Disclosure System
MVPHS	market value of publicly-held shares
NAREIT	National Association of Real Estate Investment Trusts
NASAA	North American Securities Administrators

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	Association
NASD	National Association of Securities Dealers, Inc.
NASDAQ	National Association of Securities Dealers Automated Quotation System
NASDAQ Governance Rules	Rules 4350 and 4351 of NASD Manual
NASDAQ security	defined on page 52
national securities exchange	any U.S. securities exchange regulated as such under the 1934 Act
non-expertised	defined on page 334
non-GAAP financial measure	defined on page 137
non-reporting issuer	issuer that does not file 1934 Act reports with the SEC voluntarily or otherwise
non-U.S. acquiror	defined on page 353
non-U.S. issuer	any issuer that is a government (other than the government of the United States or any of its political subdivisions), a national of any country (other than the United States) or a corporation or other organization incorporated or organized under the laws of any such country or any of its political subdivisions
NRSRO	nationally recognized statistical ratings organization
NSMIA	National Securities Markets Improvement Act of 1996
NYSE	New York Stock Exchange, Inc.
NYSE Alternative Listing Standards	defined on page 150
NYSE Alternext US	the name of the U.S. securities exchange formerly referred to as the American Stock Exchange prior to its acquisition by NYSE Euronext.
NYSE Alternext US Initial Listing Standards	defined on page 165
NYSE Domestic Listing Standards	defined on page 150
OCC	Office of the Comptroller of the Currency of the U.S. Department of the Treasury
OFAC	Office of Foreign Assets Control of the U.S. Department of the Treasury
offering memorandum	a disclosure document used for an offering that is not registered under the 1933 Act; also referred to as an "offering circular"
OTS	Office of Thrift Supervision of the U.S. Department of the Treasury
Part 8	Part 8 of the AMEX Company Guide contains corporate governance requirements for companies listed on that exchange
payment default	defined on page 277
PCAOB	U.S. Public Company Accounting Oversight Board
Plain English	SEC requirement regarding writing principles and

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	techniques that produce disclosure that is easy to read, including the use of pictures, logos, charts, graphs and other similar design features
PRC	Peoples' Republic of China
PREP	post-receipt pricing
Previous GAAP	the body of accounting principles used by an issuer prior to preparing its financial statements for the first time under IFRS as adopted by the IASB
primary trading market	defined on page 349
prospectus	primary offering document for a securities offering registered under the 1933 Act
PSLRA	U.S. Private Securities Litigation Reform Act of 1995
QIB	qualified institutional buyer as defined in Rule 144A
QIU	qualified independent underwriter
QLCC	defined on page 211
QRS	qualified REIT subsidiary
reference security	defined on page 49
Reg. G Adopting Release	defined on page 137
Regulation FD	Regulation FD under the 1934 Act
Regulation G.	SEC Regulation containing disclosure requirements relating to "non-GAAP financial measures"
Regulation M-A.	SEC Regulation containing certain requirements relating to mergers and acquisitions
Regulation S	Regulation S under the 1933 Act
Regulation W	defined on page D-4
REIT	Real Estate Investment Trust
Related Party	for purposes of the NYSE rules, a director, officer or substantial securityholder of an issue
restricted securities	defined on page 240
Rule 144A	Rule 144A under the 1933 Act
Rule 144A offering	a private placement that is sold to QIBs by underwriters or agents pursuant to Rule 144A under the 1933 Act
Sarbanes-Oxley or SOA	Sarbanes-Oxley Act of 2002
SAS 72	Statement on Accounting Standards No. 72 "Letters for Underwriters and Certain Other Requesting Parties"
SDNs	Specially Designated Nationals and Blocked Nationals
seasoned issuer	those issuers that do not qualify as WKSIs but that are eligible to make primary offerings of securities on Form S-3 or Form F-3
SEC	U.S. Securities and Exchange Commission
Securities Offering Reform	the SEC interpretations and rule and Form changes adopted by the SEC in SEC Release No. 33-8591

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	(July 19, 2005)
senior bank notes	defined on page 274
SFAS 131	Statement of Financial Accounting Standards No. 131
subject security	defined on page 48
subordinated bank notes	defined on page 274
SUSMI	substantial U.S. market interest
tax code	U.S. Internal Revenue Code of 1986, as amended
time of sale	time at which an investor becomes committed to purchasing a security
TLG Program	Temporary Liquidity Guarantee Program
TLGP Rule	defined on page 275
TRS	taxable REIT subsidiary
unseasoned issuer	issuers that are required to file reports under the 1934 Act but are ineligible to make primary offerings on Form S-3 or F-3
UPREIT	umbrella partnership REIT
U.S. GAAP	U.S. generally accepted accounting principals
U.S. GAAS	U.S. generally accepted auditing standards
U.S. person	defined on page 234
USA	Uniform Securities Act adopted by the NASAA
USA PATRIOT Act	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001
WKSI	well-known seasoned issuer, as defined in Rule 405 under the 1933 Act
written communication	any written material, graphic communication or radio or television presentation, without regard to the manner of transmission
XBRL	eXtensible business reporting language

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DETERMINING WHETHER AN ISSUER IS A PRIMA FACIE INVESTMENT COMPANY OR EXEMPT PURSUANT TO RULE 3a-1 UNDER THE INVESTMENT COMPANY ACT OF 1940

The U.S. Investment Company Act of 1940 ("1940 Act") regulates the business, corporate governance and securities activities of securities issuers that fall within the definition of "investment company" set forth in the 1940 Act by imposing registration, disclosure and other substantive requirements on such issuers. Any operating company contemplating a securities offering in the United States should be aware of the broad range of the definition. Furthermore, an issuer that is a holding company with minority holdings in subsidiaries may inadvertently fall within the definition of investment company and should carefully consider the factors set forth in this memorandum in analyzing the application of the 1940 Act.

An issuer is a prima facie investment company subject to regulation under the 1940 Act if it is engaged in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

An issuer can avoid application of the 1940 Act if it is not a prima facie investment company or if it can take advantage of the exemption afforded by Rule 3a-1 under the 1940 Act. In either case, the issuer cannot be engaged or hold itself out as being engaged primarily in the business of investing, reinvesting or trading in securities.[1]

DEFINITIONS

The following definitions contained in the 1940 Act are helpful in determining whether an issuer can avoid application of the 1940 Act:

"**Investment securities**" means all securities except (A) Government securities, (B) securities issued by employees' securities companies and (C) securities issued by majority-owned subsidiaries of the issuer that (i) are not investment companies and (ii) are not relying on the exceptions from the definition of investment company in Sections 3(c)(1),[2] concerning beneficial ownership by not more than 100 persons, or 3(c)(7),[3] concerning ownership by qualified purchasers, of the 1940 Act.

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[1] The Rule 3a-1 exemption is only available to those Issuers falling under the 1940 Act's definition of "investment company" in Section 3(a)(1)(C), but not to those covered by Sections 3(a)(1)(A) and (B). See 1 TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS §6.17 (2d ed. Supp. 2004).

[2] Section 3(c)(1) states that "any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities" is not an investment company for purposes of Section 3(a)(1)(C). See Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

[3] Section 3(c)(7) exempts "[a]ny issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities." See Chapter 6 (*Listing on U.S. Securities Exchanges*) of this volume.

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"**Security**" is broadly defined to include, among others, any note, stock, bond, debenture, evidence of indebtedness, transferable shares, investment contract, certificate of deposits for a security, security future, among others, or, in general, any interest or instrument commonly known as a "security." For purposes of the issuer's analysis, intercompany and other loans (including time deposits with a bank), as well as many types of receivables, should be counted as securities.

"**Government security**" means any security issued or guaranteed as to principal or interest by the United States, or by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit of the foregoing.[1] Thus, securities issued by other governments do not fall within this definition.

"**Majority-owned subsidiary**" of the issuer means a company 50% or more of the outstanding voting securities of which are owned by the issuer or by a company that is a majority-owned subsidiary of the issuer.

"**Value**" of assets of the issuer, as used in Section 3 of the 1940 Act, means (i) with respect to securities owned at the end of the last preceding fiscal quarter for which market quotations are readily available, the market value of such securities at the end of such quarter; (ii) with respect to other securities and assets owned at the end of the last preceding fiscal quarter, fair value at the end of such quarter as determined in good faith by the board of directors of the issuer; and (iii) with respect to securities and other assets acquired after the end of the last preceding fiscal quarter, at cost. Consequently, the 1940 Act technically requires the board of directors of an issuer wishing to establish that it is not a *prima facie* investment company or that it may meet the requirements of Rule 3a-1 to determine (*e.g.*, by board resolution, the fair value of the issuer's total assets (other than assets consisting of marketable securities)). Thus, merely reviewing the most recent financial statements, while often a helpful starting point, is not sufficient. The board may, however, seek assistance from other parties in that valuation. Note: For purposes of the 1940 Act analysis, asset valuations will have to be updated to the latest practical date preceding the filing with the U.S. Securities and Exchange Commission ("SEC") of the registration statement (*e.g.*, Form S-1 or F-1) used to register the issuer's U.S. public offering, and further valuation may be necessary prior to closing the offering.

"**Wholly-owned subsidiary**" of the issuer means a company 95% or more of the outstanding voting securities of which are owned by the issuer or by a company that, within the meaning of the definition of the term, is a wholly-owned subsidiary of the issuer.

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[1] The SEC has refused to recognize repurchase agreements involving Government securities as government securities for purposes of Rule 3a-1. See SEC No-Action Letter The Prospect Group, Inc., available Nov. 29, 1988.

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PRIMA FACIE INVESTMENT COMPANY

In order to determine whether less than 40% of the value of an issuer's assets, on an unconsolidated basis, constitute investment securities (exclusive of Government securities and cash items),[2] take the following steps:

1. Determine the value as of a recent date of the investment securities owned, on an unconsolidated basis, by the issuer.

2. Determine the value as of a recent date of the other assets (other than Government securities and cash items) owned, on an unconsolidated basis, by the issuer.

3. Divide the value of the issuer's investment securities by the aggregate value of those investment securities and the other assets (other than Government securities and cash items) owned, on an unconsolidated basis, by the issuer.

It is important to emphasize that for purposes of the above computation, the analysis is on an unconsolidated basis. Thus, it becomes necessary to analyze each subsidiary separately to determine whether or not that subsidiary is itself an investment company (or a company relying on Sections 3(c)(1) or 3(c)(7) of the 1940 Act) in order to determine whether or not the Issuer's holdings in that subsidiary should be considered investment securities.

An alternative way to perform the above analysis, which is often easier because it helps to avoid uncertainties that exist in the definition of "securities," is to focus on assets that clearly are not securities (*e.g.*, inventory, property, plant and equipment) and determine whether these assets exceed 60% of total assets.

RULE 3a-1

Even if an issuer constitutes a prima facie investment company under the 1940 Act, it will not be deemed an investment company under the 1940 Act if, pursuant to Rule 3a-1, (i) no more than 45% of the aggregate value of the issuer's assets, consolidated only with the assets of any wholly-owned subsidiary (exclusive of Government securities and cash items), consists of securities other than "Good Assets" (as defined below) and (ii) no more than 45% of the issuer's net income after taxes, again consolidated only with the net income of any wholly-owned subsidiary (for the last four fiscal quarters combined) is derived from securities other than "Good Assets." (The issuer's holdings of securities of less than wholly-owned subsidiaries, and its net income derived therefrom, are examined on an unconsolidated basis.)

[2] *E.g.*, cash on hand, demand (not time) deposits, checks payable in immediately available funds, cashier checks, bank drafts and letters of credit. Certificates of deposit generally would not be considered cash items. In SEC No-Action Letter, Willkie Farr & Gallagher, available Oct. 23, 2000, the SEC agreed that (subject to the terms and conditions set forth in the letter) an issuer may treat as cash items for purposes of Section 3(a)(1)(C), and Rule 3a-1 thereunder, shares of a registered investment company that holds itself out as a money market fund and seeks to maintain a stable net asset value of U.S.$1.00 per share.

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"**Good Assets**" means:

- Government securities;
- securities issued by employees' securities companies;
- securities issued by majority-owned subsidiaries of the issuer that are not investment companies (private or public) or that do not rely on the Section 3(b)(3) or 3(c)(1) exclusions to avoid classification as an investment company;[3]
- securities issued by companies that (i) are controlled[4] primarily by the issuer, (ii) through which the issuer engages in a business other than that of investing, reinvesting, owning, holding or trading in securities and (iii) that are not investment companies; and
- assets other than securities, such as property, buildings, inventory, equipment and cash items.

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[3] Although Rule 3a-1 has not been revised specifically to exclude securities issued by Section 3(c)(7) companies from being treated as "Good Assets," there is a significant risk that the SEC will interpret the Rule in that fashion.

[4] "Control" means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with the company.

If the issuer owns beneficially, either directly or through one or more controlled companies, more than 25% of the voting securities of a company, it is presumed to control such company unless actual management or policy control does not exist. Section 2(a)(42) of the 1940 Act defines "voting security" as "any security presently entitling the owner or holder thereof to vote for the election of directors of a company." However, the SEC has stated in a no-action letter that the Section 2(a)(42) definition of voting security "should include not only the formal legal right to vote for the election of directors pursuant to the provisions of the law . . ., but also the *de facto* power, based on all the surrounding facts and circumstances, to determine, or influence the determination of, the identity of a corporation's directors." See, *e.g.*, SEC No-Action Letter Real Estate Investment Trusts, available Nov. 4, 1998. Under Rule 3a-1, the issuer also must be the one primarily in control. For instance, if the issuer owns more than 25% of another company (directly or indirectly) but another beneficial owner either alone or as part of a group owns more than 25%, additional evidence of management or policy control would be required and the SEC may need to be consulted. See, *e.g.*, SEC No-Action Letter Health Communications Services, Inc., available Apr. 26, 1985.

If the issuer owns beneficially, directly or indirectly, less than or equal to 25% of the voting securities of a company, it shall be presumed not to control such company. Evidence to the contrary may rebut this presumption, but to determine control, application to the SEC should be made. See, *e.g.*, SEC No-Action Letter American Century Cos., Inc., available Dec. 23, 1997; In the Matter of Safeguard Scientifics, Inc., SEC Release Nos. 40-24317 (Feb. 25, 2000) (notice); 40-24345 (Mar. 22, 2000) (order) (granting applicant an exemption under Section 2(a)(9) of the 1940 Act and declaring that applicant controls a company despite owning less than 25% of its voting securities).

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Asset Test. To determine whether an issuer passes the Asset Test of Rule 3a-1, take the following steps:

- Determine the value as of a recent date of the Good Assets of the issuer and its wholly-owned subsidiaries.
- Determine the value as of a recent date of the other assets of the issuer and its wholly-owned subsidiaries (other than Government securities and cash items).
- Divide the value of the assets (other than the Good Assets) of the issuer and its wholly-owned subsidiaries by the value of the total assets of the issuer and its wholly-owned subsidiaries (other than Government securities and cash items).
- To pass the Asset Test of Rule 3a-1, the result should be 45% or less.

Net Income After Taxes Test. To determine whether an issuer passes the Net Income After Taxes Test of Rule 3a-1, take the following steps:

- Determine the net income after taxes for the last four fiscal quarters combined derived from the Good Assets owned by the issuer and its wholly-owned subsidiaries.
- Determine the net income after taxes for the last four fiscal quarters combined derived from the other assets owned by the issuer and its wholly-owned subsidiaries.
- Divide the net income after taxes for the last four fiscal quarters combined derived from such other assets by the total net income after taxes for that period derived from all the assets of the issuer and its wholly-owned subsidiaries.[5]
- To pass the Net Income After Taxes Test of Rule 3a-1, the result should be 45% or less.

[5] The SEC has stated in a no-action letter that a net loss for the last four quarters combined does not make the Net Income After Taxes Test irrelevant. Rather, if the issuer has both total net loss (total expenses in excess of total income) and net investment loss (investment expenses in excess of investment income), the issuer must compare its net investment loss to its total net loss to determine if investment activity accounts for more than 45% of revenue. Furthermore, the SEC stated that "whether the expenses are allocable to investment or operating income depends on whether the expenses are reasonably related to those activities." See SEC No-Action Letter DRX, Inc., available June 28, 1988. Difficulties in applying the Net Income After Taxes Test often make it desirable, where possible, for an issuer to rely solely on the statutory analysis of whether it is a prima facie investment company.

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DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION

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We have prepared this memorandum to assist you in understanding the operating segment and other related disclosures required by the U.S. Securities and Exchange Commission (the "SEC") in the financial statements of certain public business enterprises. These requirements are set forth in Statement of Financial Accounting Standards No. 131 ("SFAS 131"), which are published by the Financial Accounting Standards Board ("FASB"), and are applicable to filings made with the SEC in accordance with the rules and regulations of the SEC. The following is a only a summary of SFAS 131, which is available on the FASB's web site at http://www.fasb.org/pdf/aop_FAS131.pdf, and the applicable rules and regulations of the SEC, which are available at http://www.sec.gov/rules.shtml.

GENERAL

To help investors to analyze an enterprise's financial statements and to assess an enterprise's past performance and future prospects, the SEC requires certain public business enterprises to report certain financial and descriptive information about their operating segments and other related information. Operating segments are parts of an enterprise about which separate financial information is available and which the "chief operating decision maker" of the enterprise regularly evaluates in allocating resources and assessing performance. The chief operating decision maker is often the issuer's chief executive officer or chief operating officer, but such term is used broadly to describe a business function and not a title, and therefore may describe a group of decision makers within the enterprise.

SFAS 131 requires certain public business enterprises to report certain information about their operating segments in their annual financial statements and interim financial reports issued to shareholders about their products and services, the geographic areas in which they operate, and their major customers.

The enterprise must report the segment's profit or loss, certain specific revenue and expense items, and the assets of each segment. It must reconcile total segment revenues, total profit or loss, total assets and other segment amounts with the corresponding amounts in the enterprise's general financial statements. Additionally, the enterprise must report information about the revenues earned from products or services, the countries in which the enterprise earns revenues and holds assets, and major customers regardless of whether that information is used in making operating decisions. However, an enterprise is not required to report information that has not been prepared for internal use if reporting it would be considered impracticable.

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An enterprise must also report certain descriptive information. It must disclose how operating segments were determined, the products and services each segment provides, discrepancies between the measurements used in reporting segment information and those used for the general financial statements, and changes in the measurements of segment performance from one period to another. Some commentators theorize that poor segment disclosure of public business enterprises leads investors to approach the value of segmental earnings streams cautiously, thereby discounting the market value of the overall enterprise. Better disclosure serves to reduce the degree of information asymmetry between the enterprise and the investor.

SCOPE OF APPLICATION

SFAS 131 applies to public business enterprises, which are those business enterprises that report under U.S. GAAP and (a) have issued debt or equity securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets) or (b) are required to file financial statements with the SEC or that provide financial statements in connection with any issuance of a class of securities in a public market. SFAS 131 does not apply to:

(1) parent enterprises, subsidiaries, joint ventures, or investees accounted for by the equity method if their separate company statements are also consolidated or combined in a complete set of financial statements and both the separate company statements and the consolidated or combined statements are included in the same financial report;

(2) enterprises that are public enterprises that issue their financial statements separately; and

(3) not-for-profit organizations or non-public enterprises.

SFAS 131 applies to "foreign private issuers," as defined in Rule 405 under the U.S. Securities Act of 1933 ("1933 Act"), that file registration statements with respect to an offering of securities under the 1933 Act or file reports under the Securities Exchange Act of 1934, other than:

(1) foreign private issuers that prepare their financial statements in compliance with International Financial Reporting Standards as adopted by the International Accounting Standards Board, including the segment reporting requirements thereof;

(2) Canadian foreign private issuers that file reports under the Multi-jurisdictional Disclosure System and prepare their financial statements in compliance with Canadian GAAP, as discussed in Chapter 13 (*Canadian Issuers*) of this volume; and

(3) for fiscal years ending prior to December 15, 2009, foreign private issuers that present their financial statements in accordance with U.S. GAAP and satisfy certain disclosure requirements, as discussed in Chapter 4 (*Disclosure Requirements*) of this volume, but only if their financial statements are being filed

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with the SEC (a) to support a listing of securities on a U.S. exchange, (b) as an annual report or (c) as a basis of disclosure in connection with a 1933 Act-registered offering of non-convertible securities that are "investment grade securities" or that relates to the exercise of certain outstanding rights, the conversion or exercise of rights to obtain outstanding securities or a dividend or interest reinvestment plan.

OPERATING SEGMENTS

Definition

An operating segment is defined as a component of an enterprise:

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other parts of the same enterprise);

(b) whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and to evaluate its performance; and

(c) for which discrete financial information is available. Defining segments based on the structure of an enterprise's internal organization is designed to improve information because it highlights the risks and opportunities which management considers relevant to the enterprise.

Typically, these three characteristics clearly identify a single set of operating segments for many enterprises. However, an enterprise may produce reports in which its business activities are presented in a variety of ways. If the chief operating decision maker uses more than one set of segment information, other factors may identify a single set of components as constituting an enterprise's operating segments, including the nature of the business activities of each component, the existence of managers responsible for them, and information presented to the board of directors.

Not every part of an enterprise will be an operating segment or part of one. For example, a corporate headquarters may not earn revenues or may only earn revenues that are incidental to the activities of an enterprise and, therefore, would not be an operating segment. Additionally, pension and other post-retirement benefit plans are not operating segments. An operating segment may engage in business activities for which it has not yet earned revenues (*e.g.*, start-up operations may be operating segments before earning revenues).

The method describing the reporting requirements of operating segments is referred to as the "management approach," which is based on how management organizes the segments within the enterprise for making operating decisions and assessing performance and assists investors to be able to see the enterprise through "the eyes of management." The management approach focuses on the financial information that management uses to make decisions concerning the enterprise's operating matters. The components that these decision makers create for that reason are called the operating segments. Under this approach, FASB believes financial statement

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preparers should be able to provide the required information in a cost-effective and timely manner.

An enterprise must report a measure of each segment's profit or loss and certain items included in determining segment profit or loss, segment assets and certain related items. It does not require the enterprise to report segment cash flow (although it does require reporting of certain items which may provide an indication of the cash-generating ability or cash requirements of an enterprise's operating segments).

To provide comparability between enterprises, an enterprise must also disclose certain information about earnings from each of its products and services and about the countries in which it earns revenues and holds assets, regardless of how the enterprise is organized. Therefore, some enterprises may be required to disclose additional information that will not be used internally for making operating decisions and assessing performance.

Enterprise Segments Reporting Guidelines

An enterprise must report separately each operating segment satisfying the requirements of an operating segment identified above, although an enterprise may aggregate segments in accordance with the criteria established by SFAS 131. A segment must be reported separately if it meets any of the following quantitative criteria:

(1) its reported revenue is 10% or more of the combined revenue, derived from both internal and external sales, of all reported operating segments;

(2) its reported profit or loss is 10% or more of the greater of (a) the combined reported profit of all operating segments not reporting a loss, or (b) the combined reported loss of all operating segments reporting a loss; or

(3) its assets are 10% or more of the combined assets of all operating segments.

If total external revenue by operating segments constitutes less than 75% of total consolidated revenue, additional operating segments must be identified as reporting segments even if they do not satisfy the quantitative criteria described above until the 75% threshold has been reached by reportable segments. A reporting segment that, in the immediately preceding period, was reportable in accordance with the quantitative criteria described above but no longer satisfies any of those criteria may still be reported as a separate segment if management judges that segment to be of continuing importance.

Information about business activities and operating segments that are not reportable must be combined and disclosed in an "all other" category separate from other reconciling items in the required reconciliations and such sources of revenue must be described.

While there is no precise limit regarding the number of reportable segments that an enterprise must separately report, if the number of reportable segments exceeds ten, a practical limit may be considered to have been reached.

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REQUIRED DISCLOSURE

General Information

An enterprise must disclose the factors used to identify the enterprise's reportable segments, including the basis of organization (*e.g.*, whether management has organized the enterprise based on differences in products and services, geographic areas or regulatory environments) and the types of products and services from which each reportable segment derives its revenues.

Information about Profit or Loss, Assets and the Basis of Measurement

Segment Profit or Loss. An enterprise must report a measure of profit or loss and total assets for each reportable segment. An enterprise must also disclose the following information for each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker or are regularly provided to the chief operating decision maker, even if not so included:

(1) revenues from external customers;

(2) revenues from transactions with other operating segments of the same enterprise;

(3) interest revenue;

(4) interest expense;

(5) depreciation, depletion and amortization expense;

(6) certain unusual items;

(7) equity in the net income of investees accounted for by the equity method;

(8) income tax expense or benefit;

(9) extraordinary items; and

(10) significant non-cash items other than depreciation, depletion, and amortization expense.

Interest revenue for each reportable segment must be reported separately from interest expense unless a majority of the segment's revenues represent interest and the chief operating decision maker relies primarily on net interest revenue to assess performance of the segment and make allocation decisions. In such case, an enterprise may report the segment's interest revenue net of its interest expense and disclose that it has done so.

Information about Assets. An enterprise must disclose the following information for each reportable segment if the specified amounts are included in the determination of segment assets reviewed by the chief operating decision maker or are regularly provided to the chief operating decision maker, even if not so included:

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(1) the amount of investment in equity method investees; and

(2) total expenditures for additions to long-lived assets other than financial instruments, long-term customer relationships of a financial institution, mortgage and other servicing rights, deferred policy acquisition costs, and deferred tax assets.

Measurement. The amount of each item within a reported segment shall be the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to such segment and assessing its performance. Adjustments, eliminations and allocations made in preparing financial statements, need not be included unless they are included in the measure of the segment's profit or loss. Similarly, only the assets included in the measure of the segment's assets needs to be reported for that segment.

If the chief operating decision maker uses only one measure of profit or loss and assets in assessing performance and deciding resource allocation, profit or loss and assets shall be reported as those measures. If more than one method is used, then the measures that management believes are most consistent with those used in measuring the corresponding amounts in the enterprise's consolidated financial statements should be reported.

In explaining the measurements of profit or loss and assets for a segment, an enterprise must disclose at a minimum:

(1) the basis of accounting for any transactions between reportable segments;

(2) the nature of any differences between measurements of profit or loss and assets and the enterprise's total income before taxes, extraordinary items and discontinued operations;

(3) the nature of any differences between the measurements of the assets of the reportable segments and the consolidated assets of the enterprise;

(4) the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of profit or loss; and

(5) the nature and effect of any asymmetrical allocations to segments (*e.g.*, there may be an allocation of depreciation expense to a segment without the corresponding allocation of depreciable assets to that segment).

Reconciliations of Segment Revenues, Reported Profit or Loss, Assets and Other Significant Items to the Corresponding Enterprise Amounts

An enterprise must provide reconciliations of the following:

(1) the total of the revenues of the reportable segments to the total consolidated revenues of the enterprise;

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(2) the total of the measures of profit or loss of the reportable segments to consolidated income before taxes, extraordinary items and discontinued operations;

(3) the total of the assets of the reportable segments to the consolidated assets; and

(4) the total of amounts of other information disclosed to the corresponding consolidated amount (*e.g.*, if liabilities for each segment are disclosed, then the enterprise would have to reconcile the total liabilities for all segments to the consolidated liabilities if the segment liabilities are significant).

All significant reconciling items must be separately identified and described. For example, the amount of each significant adjustment to reconcile accounting methods used in determining segment profit or loss to the enterprise's consolidated amounts must be separately identified and described.

Interim Period Information

Financial statements for interim periods issued to investors must include the following disclosure relating to each of its segments:

(1) revenues from external customers;

(2) intersegment revenues;

(3) a measure of segment profit or loss;

(4) total assets for which there has been a material change from the last annual report;

(5) a description of differences from the last annual report in the basis of segmentation or measurement of segment profit or loss; and

(6) a reconciliation of the segment's profit or loss to consolidated income before taxes, extraordinary items and discontinued operations, unless the enterprise allocated items such as income taxes and extraordinary items to segments, in which case the enterprise may reconcile and total of the segments' measure for profit or loss to consolidated income after those items.

Restatement of Previously Reported Information

If an enterprise changes the structure of its internal organization so that it changes the composition of its reportable segments, there must be a restatement of the corresponding information unless to do so would be impracticable. Following a change in the composition of its reportable segments, an enterprise must disclose whether it has restated the corresponding items of segment information for earlier periods. If there is not a restatement to reflect the change, the enterprise shall disclose in the year in which the change occurs segment information for the current period under both the old basis and the new basis of segmentation unless to do so would be impracticable.

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ENTERPRISE-WIDE DISCLOSURE

The following descriptive information is required to be disclosed by an enterprise if it has not yet been provided in the other provisions of SFAS 131:

Information about Products and Services

An enterprise must report the revenues from external customers for each product and service or each group of products and services unless to do so would be impracticable. The amounts of revenues reported shall be based on the financial information used to produce the general-purpose financial statements. If providing such information is impracticable, that fact must be disclosed.

Information about Geographic Areas

Unless impracticable, an enterprise must report:

(1) revenues from external customers that are: (a) attributed to the enterprise's country of domicile and (b) attributed to all foreign countries from which the enterprise derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues are required to be disclosed separately; and

(2) long-lived assets other than financial instruments, long-term customer relationships of a financial institution, mortgage and other servicing rights, deferred policy acquisition costs, and deferred tax assets that are (a) located in the country of domicile and (b) in all foreign countries where the enterprise holds assets. If assets in any foreign country are material, those assets are required to be disclosed separately.

If providing geographic information is impracticable, that fact must be disclosed. An enterprise may choose to allocate revenues from external customers in any reasonable, consistently applied and disclosed manner. With this flexibility, enterprises may report geographic revenue information by selling location, customer location, or the location to which the product is delivered.

Information about Major Customers

An enterprise must provide information about the extent to which it relies on its major customers. If revenues from transactions with a single external customer amount to 10% or more of total revenues, the enterprise must disclose that fact, the total amount of revenues received from that customer, and the identity of the segment or segments reporting such revenues. However, the identify of the customer, or the amount of revenues each segment reports from such customer need not be reported.

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Since December 2001, the Securities and Exchange Commission (the "SEC") has taken a series of actions regarding the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") section of companies' disclosure documents. For foreign private issuers ("foreign private issuers"), MD&A disclosure is required to be included in Form 20-F and in Form F-1, and is incorporated by reference into Forms F-2, F-3 and F-4. Canadian issuers using Form 40-F are required to disclose off-balance sheet arrangements under General Instruction B.(II) thereof. We use the term "MD&A" although the comparable disclosure for foreign private issuers is required under Item 5 of Form 20-F, "Operating and Financial Review and Prospects," which is discussed in Chapter 4 (*Disclosure Requirements*) of this volume.[1] A summary of the relevant releases follows.

THE JANUARY 2002 RELEASE

On January 22, 2002, the SEC issued a statement setting forth its views regarding additional disclosure that public companies should consider in the preparation of their MD&A.[2]

The SEC issued the statement in response to a petition from the former Big Five accounting firms for additional guidance in preparing annual reports as a result of events that have raised questions about the integrity and sufficiency of financial and accounting disclosures.[3]

The SEC's statement elaborated its views on the requirements of MD&A as they relate to:

- liquidity and capital resources, including off-balance sheet arrangements;
- trading activities in certain types of commodity contracts (non-exchange traded contracts accounted for at fair value); and
- related party transactions and other transactions or relationships that are not on an arm's-length basis.

The SEC believes that the quality of information provided in these three areas should be improved and suggests specific steps that companies should consider in meeting their disclosure obligations. At the same time, the SEC said that its statement does not create new legal requirements or modify existing requirements.

The statement reminds companies that a "basic and overriding" requirement of MD&A is to "provide such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations"

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1 The adopting release for revisions to Item 5 of Form 20-F in 1999 noted that the SEC interprets that Item as corresponding to the requirements of Item 303 of Regulation S-K under the 1933 Act. See SEC Release No. 33-7745 (Sept. 28, 1999). Instruction 1 to Item 5 of Form 20-F refers companies to the SEC's interpretive release No. 33-6835 on MD&A disclosure under Item 303 of Regulation S-K for guidance in preparing the Item 5 disclosure.

2 The SEC's statement (SEC Release No. 33-8056 (Jan. 22, 2002) (http://www.sec.gov/news/headlines/discreqsjan22.htm)).

3 A copy of the petition can be found at http://www.sec.gov/rules/petitions/petndiscl-12312001.htm.

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with particular emphasis on prospects for the future. The statement also reiterates the requirement that companies disclose any known trends or uncertainties that are "reasonably likely" to have a material effect on their financial condition or results of operations. The SEC contends that this disclosure threshold is lower than "more likely than not." Considering these general principles, the statement proceeds to provide a more detailed description of the types of disclosure that companies should consider in the three identified categories.

Liquidity and Capital Resources, Including Off-Balance Sheet Arrangements

The statement indicates that disclosures with respect to liquidity, capital resources and off-balance sheet arrangements are interrelated and should be considered together, as well as individually, when drafting MD&A.

Liquidity and Capital Resources. The statement reminds companies of their obligations to identify and discuss trends and any known demands, commitments, events or uncertainties relating to liquidity, such as operating cash flows or commercial paper, and capital resources. These may include equity, debt and any off-balance sheet financing arrangements. The disclosures might include discussions of material risks relating to liquidity and capital resources, such as the effects of changes in customer demand for the company's products, rapid technological changes, a debt rating downgrade or deterioration in certain of the company's financial ratios or other measures of financial performance. If liquidity or capital resources are dependent on the use of off-balance sheet financing arrangements, the company should consider disclosure of the factors that are reasonably likely to affect its ability to continue using those off-balance sheet financing arrangements.

The statement lists several examples of items that should be considered in order to help identify trends, demands, commitments, events and uncertainties that require disclosure. These include:

- provisions in agreements that may trigger an adverse financial requirement, such as the acceleration of debt;
- circumstances that could impair the company's historical manner of doing business, such as a credit rating downgrade;
- factors that are relevant to the company's credit rating and ability to raise financing;
- guarantees and commitments; and
- options on non-financial assets.

The SEC advised against disclosures that are excessively general, boilerplate or merely statements of a conclusion, such as a statement that a company has sufficient short-term funding sources. Instead, the SEC said, the disclosures should explain the circumstances and the basis for each statement in sufficient detail to permit an investor to understand the material facts and be able to reach his or her own conclusion.

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Off-Balance Sheet Arrangements. The SEC stated that off-balance sheet arrangements should be disclosed if they are reasonably likely to have a material effect on liquidity or the availability of or requirements for capital resources. It may also be necessary to describe the extent of a company's reliance on such arrangements and their relative significance to the company's financial position. For instance, disclosure may need to be provided about arrangements using special-purpose entities that:

- provide financing, liquidity or market or credit risk support for the company;
- engage in leasing, hedging, research and development services with the company; or
- expose the company to liability that is not reflected on the face of the financial statements.

Disclosure of uncertainties and their effects should also be provided where contingencies inherent in the arrangements are reasonably likely to affect the continued availability of material historical sources of liquidity and financing. Disclosure of the effects and risks of off-balance sheet arrangements may be required even if the company has obtained a "true sale" legal opinion or otherwise complied with technical requirements to keep such arrangements off the balance sheet or to limit recourse to the company, although such matters may affect the type of disclosure and the risks involved.

In the SEC's view, information regarding exposures arising from off-balance sheet arrangements should be included if necessary in order to provide investors with a clear understanding of the company's business activities, financial arrangements and financial statements. The statement lists examples of additional disclosures that should be considered to explain the effects and risks of off-balance sheet arrangements. These include:

- the amount and description of the assets and obligations of the off-balance sheet entity;
- the possible termination of the entity or its arrangements with the company;
- the amount of receivables, payables, revenues, expenses and cash flows resulting from the arrangements;
- payment terms of amounts due to the company from the arrangements and any uncertainties or contingencies as to realization;
- the amounts and key terms and conditions of agreements; and
- the amounts and descriptions of any guarantees, lines of credit, standby letters of credit, commitments or other similar types of arrangements.

Contractual Obligations and Commercial Commitments. Although accounting standards require disclosure concerning a company's obligations and commitments to make future payments under contracts and other contingent commitments, the statement suggests that

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all such information should be described in one location in MD&A. The statement includes examples of charts or schedules that could be included in MD&A to present a total picture of a company's liquidity, capital resources, contractual obligations and commitments as of the latest balance sheet date. The examples of charts and schedules also include columns that could be used to show the amounts of contractual obligations that become due and commitments that expire in future periods. The charts and schedules could be accompanied by a description of provisions that create, increase or accelerate liabilities or other data that may be helpful to a full understanding of the company's obligations and commitments.

Non-Exchange Traded Contracts Accounted for at Fair Value

The SEC said that it is concerned that there may be a lack of transparency and clarity with respect to companies engaged to a material extent in energy trading activities, weather trading activities or non-exchange traded commodity trading contracts that are marked to fair value. In contrast to exchange traded commodity contracts that have a publicly-available market price, a lack of market price quotations for such contracts necessitates the use of fair value estimation techniques. These contracts may be indexed to measures of weather, commodities prices or quoted prices of service capacity, such as energy storage and bandwidth capacity contracts.

Companies engaged to a material extent in trading activities involving such types of contracts should consider disclosing in their MD&A how the activities affect reported results for the most recent reporting period(s) and how the company's financial position is affected as of the latest balance sheet date. This might include a discussion of material trends and uncertainties arising from these trading activities and may include information about the activities themselves, contracts and modeling methodologies, assumptions, variables and inputs, and an explanation of the different outcomes reasonably likely under different circumstances or measurement methods. Disclosures regarding trading activities might also address any derivative contracts involving the same commodities.

The statement refers to cautionary advice issued by the SEC[4] encouraging companies to include in their MD&A full explanations, in plain English, of their "critical accounting policies," the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions. Consistent with that advice, the SEC suggested that companies should consider furnishing the following qualitative and quantitative information with respect to non-exchange traded contracts:

- disaggregated realized and unrealized changes in fair value;
- changes in fair value attributable to changes in valuation techniques;
- disaggregated estimated fair values at the latest balance sheet date; and
- maturities of contracts at the latest balance sheet date.

[4] SEC Release Nos. 33-8040, 34-45149, FR-60 (Dec. 12, 2001).

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The statement provides an example of this disclosure in the form of a schedule that could be included in MD&A.

Companies should also consider their disclosure obligations regarding risk management in connection with the trading activities. For example, companies may consider discussing the risks of changes in credit quality or market fluctuations of underlying, linked or indexed assets or liabilities, especially where such assets are illiquid or susceptible to material uncertainties in valuation. In addition, companies should consider the need to disclose the fair value of net claims against counterparties that are reported as assets at the most recent balance sheet date, based on the credit quality of the contract counterparty (*e.g.*, investment grade, non-investment grade or no external ratings).

Related Party and Similar Transactions

The statement indicates that MD&A should include a discussion of material related party transactions to the extent necessary for an understanding of the company's current and prospective financial position and operating results. Discussion of the following may be necessary:

- business purpose;
- identification of the related parties;
- how transaction prices were determined;
- whether and how the transaction has been evaluated for fairness; and
- any ongoing contractual or other commitments resulting from the arrangement.

The discussion may also include a description of the elements of the transaction, its economic substance, any special risks or contingencies and its effect on the financial statements.

In addition, the statement appears to go beyond previous guidance given by the SEC as to the appropriate disclosure with respect to related party transactions. The statement says that companies should consider whether it is necessary to disclose transactions involving a relationship that enables the parties to negotiate terms of material transactions that may not be available from clearly independent third parties on an arm's-length basis, even if the transaction is not with parties that fit within the definition of "related parties." The statement indicates that this disclosure is necessary if investors would be unable to understand a company's reported results of operations without a clear explanation of these arrangements and relationships.

The SEC's release is an important indication of its heightened sensitivities in the area of accounting and financial disclosure in light of recent events. Companies should carefully consider the suggestions and guidance of the SEC and recognize the possibility that their annual and other periodic reports may be reviewed with these issues in mind.

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THE DECEMBER 2001 AND MAY 2002 RELEASES (CRITICAL ACCOUNTING POLICIES)

On December 12, 2001, the SEC issued cautionary advice regarding disclosure about critical accounting policies.[5] In the December 2001 advice, the SEC said that it intended to consider new rules during 2002 (see the discussion of the May 2002 proposal below) to elicit more precise disclosures about the accounting policies that management believes are the most "critical" – "that is, they are both most important to the portrayal of the company's financial condition and results, and they require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain." The SEC encouraged companies to include their critical accounting policies in the MD&A.

The SEC also emphasized the importance of employing a disclosure regime along the following lines:

- each company's management and auditor should bring particular focus to the evaluation of critical accounting policies used in the financial statements;
- management should ensure that disclosure in MD&A is balanced and fully responsive;
- prior to finalizing and filing annual reports, audit committees should review the selection, application and disclosure of critical accounting policies; and
- if companies, management, audit committees or auditors are uncertain about the application of specific GAAP principles, they should consult with the SEC's accounting staff.

On May 10, 2002, the SEC proposed rules to mandate additional disclosure in public company filings. The proposal would require almost all public companies to expand the MD&A to include complex and detailed narrative disclosure to explain the application and, in some cases, the adoption of critical accounting policies.[6] While the SEC has taken no further action of the proposal, it remains instructive of the views of the SEC staff. The May 2002 proposal includes hypothetical examples illustrating the application of the proposed rules (See Attachment A to this memorandum).

With very limited exceptions, the May 2002 MD&A proposal would require that public companies' annual reports on Form 20-F include within a separate section of the MD&A explanations of their "critical accounting estimates." The same presentation would be required in long-form registration statements under both the 1933 Act and the 1934 Act.

In general terms, a "critical accounting estimate" is an accounting estimate that requires management to exercise judgment in the determination of an amount that would have a material

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5 Supra footnote 4.

6 SEC Release Nos. 33-8098, 34-45907 (May 10, 2002) (http://www.sec.gov/rules/proposed/33-8098.htm).

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effect on the company's financial condition. Approximation in these determinations is appropriate under the accounting regulations as a practical necessity because the amount in question may be affected by future events that are not currently certain.

The May 2002 proposal is related thematically to the January 2002 release. In that statement, the SEC recommended that public companies "should consider" its suggestions for MD&A disclosures of off-balance sheet financing arrangements and over-the-counter derivative contracts. The SEC's recommendations included the use of elaborate tabular presentations.

The SEC, which calls its new proposal "an initial step in improving the transparency of companies' financial disclosure," believes that the added narratives will improve investors' understanding of financial statement disclosures.

Companies Covered

The proposal would have affected all foreign private issuers. Foreign governments and Canadian companies eligible for the Multi-jurisdictional Disclosure System ("MJDS") would not be affected by the proposals.

Foreign Company Filings Covered

Foreign private issuers would have been subjected to the new MD&A disclosures through an amendment to Item 5 of Form 20-F that tracks the proposal for domestic companies. The proposed amendment to Form 20-F also would have had the effect of changing the disclosures required in 1933 Act Form F-1. Form F-3, the most abbreviated form of registration statement, incorporates MD&A disclosure by reference from the company's Form 20-F into the legal contents of the prospectus and would not have been affected directly by the proposal. Because most foreign private issuers do not present their financials according to Generally Accepted Accounting Principles ("GAAP") in the United States, their additional MD&A disclosures must include narratives relating both to financial presentations under the accounting principles of their home jurisdictions and to the reconciliations of those presentations to U.S. GAAP.

THE JANUARY 2003 RELEASE

On January 28, 2003, the SEC adopted new rules required in part by Section 401(a) of the Sarbanes-Oxley Act. Section 401(a) added new provisions to the 1934 Act, including Section 13(j), which directed the SEC to adopt rules requiring disclosure of off-balance sheet arrangements in each annual and quarterly report. On its own motion, the SEC adopted additional tabular disclosure requirements for aggregate contractual obligations.

The complex new disclosures must be presented in the MD&A. The requirements for off-balance sheet arrangements affect all reporting companies except registered investment companies. Non-U.S. companies, including Canadian companies using the MJDS, are subject to the new disclosure requirements.

The final rules differ in several significant respects from the proposals the SEC made in October 2002. In general, the adopted rules call for a narrower range of disclosure than the proposals. Items required to be disclosed by the final rules are generally specified in the

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accounting literature, including particularly three recent FASB statements. In contrast to the proposals, which would have required disclosures of many arrangements and understandings not reflected in the financials, the rule as adopted largely calls for disclosure in the MD&A of information already in the footnotes to the financial statements. The SEC receded from the proposed disclosure threshold that would have called for descriptions of certain events unless management could determine their likelihood to be remote. Instead, it adopted the "reasonably likely" disclosure threshold already applicable to MD&A. The SEC abandoned its proposal calling for disclosure of contingent liabilities and commitments. However, the SEC stated that companies should refer to its interpretation of MD&A requirements in the January 2002 release (SEC Release No. 33-8056) and should consider whether tabular disclosure of aggregate commitments would be beneficial to investors.

Registration statements and annual reports required to include financial statements for fiscal years ending on or after June 15, 2003, must include the off-balance sheet disclosures prescribed by the new rules. The rules for disclosures of aggregate contractual liabilities will affect filings (except for small business filings) required to include financial statements for fiscal years ending on or after December 15, 2003. Thus, calendar-year public companies will not be officially subjected to the new disclosure rules until 2004. It is clear, however, that the SEC regards the new rules at least in part to be only explicit codifications of existing MD&A requirements, at least as they are construed by the SEC and its staff.[7]

Off-Balance Sheet Arrangements

Definitions

Section 13(j) of the 1934 Act calls for disclosure of "all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the company with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses." The SEC has defined "off-balance sheet arrangements" in four categories:

- obligations under guarantee contracts identified and required to be recognized by certain provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (November 2002);
- retained or contingent interests in assets transferred to unconsolidated entities (such as special-purpose entities) that serve as credit, liquidity, or market risk support to the entities for the assets;
- obligations, including contingent obligations, under contracts accounted for as derivative instruments, unless indexed to the company's own stock and accounted

[7] SEC Release No. 33-8182 (Jan. 28, 2003) (http://www.sec.gov/rules/final/33-8182.htm).

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for therefore as equity, and excluded from the scope of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (June 1998); and

- obligations, including contingent obligations, arising from a variable interest (within the meaning of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (January 2003)) in an unconsolidated entity held by and material to the company, if the entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the company.

The SEC believes that the definition as adopted will not cause disclosure of "routine transactions" such as employment agreements, leases, licenses, and employee pension plans. Off-balance sheet arrangements do not include contingent liabilities related to litigation, arbitration or regulatory actions. Instructions to the item provide that no disclosure will be required before there is an unconditionally binding agreement or agreement subject only to customary closing conditions or, in the absence of an agreement, on settlement of the arrangement. To satisfy the disclosure requirements, companies need not repeat in the MD&A information included in the financial statement footnotes if clear cross-references are provided and if the MD&A integrates the information in question into the discussion. Off-balance sheet arrangements may include arrangements in which the company is not party to the agreement representing the primary obligation. In the SEC's view, the definition will focus on off-balance sheet arrangements used for financing, liquidity or risk-sharing purposes.

Because the SEC has drawn from U.S. accounting literature to define off-balance sheet arrangements, non-U.S. companies will need to consider U.S. GAAP in the preparation of their MD&A disclosures. The SEC noted specifically that the new rules do not require foreign companies to prepare their primary financial statements in accordance with U.S. GAAP.

Disclosure Threshold

1934 Act Section 13(j) refers to off-balance sheet arrangements "that may have a material current or future effect" on an company. In the rules as adopted, the standard of probability for disclosure of an off-balance sheet arrangement is whether such an effect is "reasonably likely," which is the same standard used for MD&A disclosure generally. It is important to note, however, the SEC's view that "'reasonably likely' is a lower disclosure threshold than 'more likely than not.'"

Required Disclosures

The new rules require off-balance sheet arrangements to be disclosed in a separately captioned section of MD&A. Any off-balance sheet arrangement as defined by the SEC with effects material to investors on the company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources is subject to the disclosure requirement. The detailed disclosures first proposed have been replaced with a "principles based" standard. "To the extent necessary to an understanding of such arrangements," the disclosures must include statements of:

- the nature and business purpose of the arrangements;

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- the importance of the arrangements for the company's liquidity, capital resources, market risk support, credit risk support or other unspecified benefits;
- amounts of revenues, expenses and cash flow related to the arrangements, the nature and amount of any retained interests, securities issuances or debt incurrences related to the arrangements, and the nature and amounts of any other obligations or liabilities with reasonably likely material effects (including an explanation how such obligations or liabilities could be triggered); and
- known events, demands, commitments, trends or uncertainties that will or are reasonably likely to result in the termination or material reduction of off-balance sheet arrangements with material benefits and of the course of action the company has taken or proposes to take in the event of such a termination or reduction.

Filings Affected

All of the SEC's forms for annual reports for foreign private issuers (Forms 20-F and 40-F) will be required to include the MD&A disclosures on off-balance sheet arrangements. A Form 20-F used as a registration statement under Section 12(b) or (g) of the 1934 Act also will be required to include the new disclosure. Noting that the Sarbanes-Oxley Act generally does not distinguish public companies inside or outside the United States, the SEC declined to provide relief for non-U.S. companies, as had been recommended by some public commentators. Form 6-K is not subject to these requirements because it is neither an annual nor quarterly report within the meaning of the SEC's rules. 1933 Act registration statements, including those requiring interim period information and related MD&A disclosure, but not including the MJDS forms, are subject to the off-balance sheet disclosure requirements.

Contractual Obligations

Definition

As with off-balance sheet arrangements, the SEC has defined the four categories of disclosable contractual obligations largely in reference to accounting authorities. These are:

- long-term debt obligations-payment obligations described in FAS No. 47, *Disclosure of Long-Term Obligations* (March 1981);
- capital lease obligations- payment obligations classified as capital leases in FAS No. 13, *Accounting for Leases* (November 1976);
- operating lease obligations-payment obligations classified as operating leases within the same FAS; and
- purchase obligations-binding agreements to purchase goods or services with specific terms for purchase fixed or minimum quantities at fixed, minimum or variable prices and for approximate timing of performance, which are not recognized as liabilities under GAAP, but which have been included because the SEC believes they may have a "significant effect" on liquidity.

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Required Disclosures

Each annual reporting form filed with the SEC will be required to include a table showing each of the four categories of contractual obligations as of the end of the most recent fiscal year and showing the amounts due under the obligations as a total and by periods – less than one year, one to three years, three to five years, and more than five years. The table must be presented under a separate caption within the MD&A.

Liability Matters

Acting under Section 27A of the 1933 Act and Section 21E of the 1934 Act, the SEC included in the new rules liability protections for any forward-looking statement made pursuant to the disclosure requirements applicable to off-balance sheet arrangements and contractual obligations. The requirement of the statutory safe harbors for "meaningful cautionary statements" will be deemed to have been satisfied for MD&A disclosures of off-balance sheet arrangements through compliance with the new rules. This does not apply, however, to the table of contractual obligations.

THE DECEMBER 2003 RELEASE

On December 19, 2003, the SEC provided further advice on MD&A for the purpose of assisting companies in preparing MD&A disclosure that is easier to follow and understand and providing more information regarding the SEC's previously enunciated principal objectives of MD&A.[8] In the December 2003 advice, the SEC stated that "MD&A should not be a recitation of financial statements in narrative form or an otherwise uninformative series of technical responses to MD&A requirements," neither of which provides management's "unique perspective on its business …." The SEC also encouraged early top-level involvement by a company's management in identifying key disclosure themes and items to be included in the MD&A. The SEC's advice is applicable to foreign private issuers through Item 5 of Form 20-F and General Instruction B.(11) of Form 40-F.

Presentation of MD&A

The SEC emphasized the following points regarding overall presentation in the MD&A:

- within the universe of material information, present disclosure so that the most important information is the most prominent;
- avoid unnecessary duplicative disclosure; and
- start the MD&A with an executive-level overview that provides context.

While noting that "complex companies and situations require disclosure of complex matters" and that the SEC is "not in any way seeking over-simplification or 'dumbing down' of MD&A," it emphasized the need for improving the clarity and understandability of MD&A by using language that is clearer and less convoluted. The SEC recommended considering the use

[8] SEC Release No. 33-8350 (Dec. 19, 2003) (http://www.sec.gov/rules/interp/33-8350.htm).

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of tabular presentations, headings, introductory sections or overviews and the use of a "layered approach," whereby material information and analysis that it the most important would be emphasized. An introductory overview would

- include economic or industry-wide factors relevant to the company;
- discuss how the company earns revenues and income and generates cash;
- to the extent necessary or useful, discuss lines of business, locations or locations of operations and principal products and services (but not merely duplicating the disclosure on the "Description of Business" section); and
- provide insight into material opportunities, challenges and risks, such as those presented by known material trends and uncertainties, upon which the company's executives at most focused for the short and long-term, and the actions they are taking to address these opportunities, challenges and risks.

Content and Focus of MD&A

The SEC emphasized the following points regarding content and focus of MD&A:

- focus on material information and de-emphasize or eliminate immaterial information;
- identify and discuss key performance indicators, including non-financial performance indicators;
- identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance; and
- provide an analysis explaining management's view of the implications and significance of the information provided in response to the MD&A requirements.

Focus on Materiality

The SEC emphasized that MD&A most specifically focus on known material events and uncertainties that would cause reported financial information not to be necessarily indicative of future operating performance or future financial conditions. The SEC noted that segment data should be provided where it is material to an understanding of the consolidated financial information. Segment discussion should be designed to avoid unnecessary duplication and immaterial detail. The SEC also warned against excessive disclosure of line item changes where such disclosure is not material.

Key Performance Indicators

The SEC noted that if companies include in their MD&A material information disclosed other than in their filed documents (such as in earnings releases or publicly-accessible analysts'

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calls or companion web site postings), they should evaluate whether that information is responsive to the MD&A requirements and whether its omission would render misleading the document in which the MD&A appears.

Focus on Material Trends and Uncertainties

With respect to material trends, demands, commitments, events and uncertainties, the SEC stated that such disclosure generally should involve

- the consideration of financial, operational and other information known to the company;
- the identification, based on this information, of known trends and uncertainties; and
- an assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the company's liquidity, capital resources or results of operations.

Disclosure of a trend, demand, commitment, event or uncertainty is required unless a company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect on the company's liquidity, capital resources or results of operations is not reasonably likely to occur.

Focus on Analysis

The SEC stressed the importance of including an analysis when a description of known material trends, events, demands, commitments and uncertainties is set forth. That analysis should explain the underlying reasons or implications, interrelationships between constituent elements, or the relative significance of those matters. A thorough analysis often will involve discussing both the intermediate effects of those matters and the reasons underlying those intermediate effects. The SEC provided the following example:

> For example, if a company's financial statements reflect materially lower revenues resulting from a decline in the volume of products sold when compared to a prior period, MD&A should not only identify the decline in sales volume, but also should analyze the reasons underlying the decline in sales when the reasons are also material and determinable. The analysis should reveal underlying material causes of the matters described, including for example, if applicable, difficulties in the manufacturing process, a decline in the quality of a product, loss in competitive position and market share, or a combination of conditions.

The SEC also warned that "if there is a reasonable likelihood that reported financial information is not indicative of an company's future financial condition or future operating performance due, for example, to the levels of subjectivity and judgment necessary to account for highly uncertain matters and the susceptibility of such matters to change, appropriate disclosure in the MD&A should be considered and may be required."

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Liquidity & Capital Resources

With respect to MD&A disclosure regarding liquidity and capital resources, the SEC recommended that:

- companies should consider enhanced analysis and explanation of the sources and uses of cash and material changes in particular items underlying the major captions reported in their financial statements;
- companies using the indirect method in preparing cash flow statements should pay particular attention to disclosure and analysis of matters not readily apparent from the face of their cash flow statements; and
- companies consider enhanced MD&A disclosure regarding debt instruments, guarantees and related covenants.

The SEC also advised that companies should evaluate separately their ability to meet upcoming cash requirements over both the long and short term. The discussion of disclosure regarding liquidity and capital resources covered four areas:

- cash requirements;
- sources and uses of cash;
- debt instruments, guarantees and related covenants; and
- cash management.

Cash Requirements

The SEC recommended that companies consider whether the following information would have a material impact on liquidity:

- funds necessary to maintain current operations, complete projects underway and achieve stated objective or plans;
- commitments for capital and other expenditures; and
- the reasonably likely exposure to future cash requirements associated with known trends or uncertainties, and an indication of the time period in which resolution of the uncertainties is anticipated.

The SEC suggested the use of tabular disclosure of contractual requirements, where helpful. The SEC advised that companies should address, where material, the difficulties involved in assessing the effect of the amount and timing of certain events, such as loss contingencies, on cash requirements and liquidity.

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Sources and Uses of Cash

Disclosure of this factor should not only explain how the particular cash requirements fit into a company's overall business plan, but should also focus on the resources available to satisfy those cash requirements. If there has been material variability in historical cash flows, the disclosure should focus on the underlying reasons for those changes as well as their reasonably likely impact on future cash flows and management decisions.

The SEC also emphasized disclosure regarding material changes in operating, investing and financing cash flows and the reasons underlying those changes.

The SEC advised that the discussion and analysis of operating cash flows should address material changes in the underlying drivers, rather than merely describing items identified on the face of the statement of cash flows, such as the reconciling items used in the indirect method of presenting cash flows. Companies should also consider whether, in order to make the required disclosures, it is necessary to expand the MD&A to address the cash requirements of and the cash provided by its reportable segments or other subdivisions of the business, including issues related to foreign subsidiaries, as well as the indicative nature of those results. Companies should also discuss the effect of an inability to access the cash flow and financial assets of any consolidated entities.

A discussion of historical financing arrangements and their importance to cash flows should include an analysis of a company's

- external debt financing;
- off-balance sheet financing arrangements;
- issuances and purchases of derivative instruments linked to the company's stock;
- use of its stock as a form of liquidity; and
- the potential impact of known or reasonably likely changes in credit ratings or ratings outlook (or inability to achieve changes).

Consideration should be given to disclosure regarding prospective financing sources, or of types of financing sources that a company would want to use but that are, or are reasonably likely to be, unavailable, and the impact on the company's cash position and liquidity. Such disclosure should be considered if an company will, or if it is reasonably likely that it will, raise material external equity or debt financing, and should include the amounts or ranges involved, the nature and terms of the financing and other material terms, as well as the impact on the company's cash position and liquidity.[9]

[9] With respect to disclosure about possible future financing, the SEC stated that "we believe that disclosure satisfying the requirements of MD&A can be made consistently with the restrictions of Section 5 of the 1933 Act. See, *e.g.*, 1933 Act Rule 135c."

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Debt Instruments, Guarantees and Related Covenants

The SEC noted two situations in which a discussion and analysis of material covenants related to a company's outstanding debt may be required in MD&A.

If a company is in breach, or reasonably likely to be in breach, of a material covenant, the company must disclose and analyze, as applicable:

- the steps that the company is taking to avoid the breach;
- the steps that the company intends to take to cure, obtain a waiver of or otherwise address the breach;
- the impact or reasonably likely impact of the breach (including the effects of any cross-default or cross-acceleration or similar provisions) on financial condition or operating performance; and
- alternate sources of funding to pay off resulting obligations or replace funding.

If covenants in a company's outstanding debt limit, or are reasonably likely to limit, the company's ability to undertake financing to a material extent, the company is required to discuss the covenants in question and the consequences of the limitation to the company's financial condition and operating performance.

Cash Management

The SEC noted that a company should describe how known material trends or uncertainties affect the company's determination as to when and how to use its cash resources to satisfy obligations and make other capital expenditures.

Critical Accounting Estimates

With respect to MD&A disclosure of critical accounting estimates, the SEC recommended that companies consider enhanced discussion and analysis that supplements, but does not duplicate, the description of accounting policies in the notes to the financial statements and provides greater insight into the quality and variability of information regarding financial condition and operating performance.

When preparing disclosure under the current SEC requirements, companies should consider whether they have made accounting estimates or assumptions where:

- the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimates and assumptions on financial condition or operating performance is material.

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The MD&A discussion should present a company's analysis of the uncertainties involved in applying a principle at the given time or the variability that is reasonably likely to result from its application over time. The company should also address specifically why its accounting estimates or assumptions bear the risk of change.

MD&A DISCLOSURE ON FAIR VALUE

In late 2007 and early 2008, and in response to the subprime crisis, the SEC staff reviewed issuers' MD&A and commented on whether exposure to subprime securities or other higher risk loans has been adequately disclosed. The SEC staff's review focused on issuers that are significantly affected by the impairment of securities and the liquidation of collateralized debt obligations.[10] In March 2008, the SEC staff commented on the application of SFAS 157 on fair value measurements.[11]

[10] See CCH SEC Today, January 2, 2008, Volume 2008-1, discussing the remarks of SEC Associate Chief Accountant Stephanie Hunsaker.

[11] Comments by Brian Breheny, Deputy Director, SEC Division of Corporation Finance, at the ABA Committee on Federal Regulation of Securities, April 11, 2008.

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U.S. REGULATION OF ACTIVITIES OF NON-U.S. BANKS IN THE UNITED STATES

LEGAL FRAMEWORK D-1
CAPITAL MARKETS VEHICLE/ACTIVITIES D-3
MONEY LAUNDERING AND TERRORIST FINANCING D-9

In connection with executing a securities offering for a non-U.S. bank in the U.S. capital markets, it may be important to understand the U.S. laws and regulations that apply to its U.S. operations. Set forth below is an overview of the legal framework that applies to U.S. operations of a non-U.S. bank.

LEGAL FRAMEWORK

Supervision

Non-U.S. banks can conduct their U.S. activities through several different types of banking and non-banking entities, including subsidiary banks, non-bank subsidiaries, and U.S. branches, agencies or commercial lending companies. Before a non-U.S. bank can open a branch, agency or other office in the United States it must first obtain approval of the Board of Governors of the U.S. Federal Reserve System ("Federal Reserve Board"). Proposed federally-licensed U.S. branches and agencies must also obtain a license from the Office of the Comptroller of the Currency ("OCC"); while proposed state-licensed U.S. branches or agencies must obtain a license from the states where the branches or agencies are located. Other banking and non-banking activities also require prior approval.

The Federal Reserve Board is responsible for general oversight of the U.S. activities of foreign banking organizations. Additionally, the Federal Reserve Board is the "umbrella" supervisor of all bank holding companies that file declarations to become financial holding companies. In the case of "functionally-regulated subsidiaries," principal regulatory, supervisory, and examination authority resides with the appropriate functional regulatory agency. For example, the primary functional regulator for securities firms that are subsidiaries or affiliates of banks is the United States Securities and Exchange Commission ("SEC").

International Banking Act and Bank Holding Company Act

Non-U.S. bank operations in the United States are principally governed by the International Banking Act of 1978 and the Bank Holding Company Act of 1956, as amended ("BHCA"). The implementing regulations for these statutes are the Federal Reserve Board's Regulations K and Y, respectively. These laws generally require national treatment for activities of foreign banks located in the United States. Thus, non-U.S. banks that operate a bank, branch, or agency in the United States are generally subject to the same powers and constraints as domestic banks. However, in some cases, especially for branches and agencies of non-U.S. banks, the laws and regulations may not be identical to domestic banks due to their different form of organization.

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Before a non-U.S. bank can acquire a subsidiary bank in the United States, the non-U.S. bank must obtain Federal Reserve approval to become a bank holding company. Upon becoming a bank holding company, a non-U.S. bank becomes subject to the BHCA and must meet the same standards as a U.S. bank in order to qualify as a financial holding company. Status as a financial holding company is required in order for any bank to engage in securities underwriting and dealing activities in the United States.

The IBA provides that a non-U.S. bank also becomes subject to the BHCA upon establishment of a branch, agency or commercial lending company in the United States. The foreign banking organization that establishes such a branch, agency or commercial lending company is treated as if it were a bank holding company. Section 4 of the BHCA requires each foreign bank to obtain the approval of, or provide appropriate notice to, the Federal Reserve Board prior to engaging in non-banking activities in the United States unless an exemption applies.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act of 1999 eliminated certain barriers that prevented banks and securities underwriting firms from affiliating with one another. The Gramm-Leach-Bliley Act did so by repealing Sections 20 and 32 of the Glass-Steagall Act of 1933. Section 20 prohibited banks from maintaining affiliations with organizations "engaged principally" in the issuance, flotation, underwriting, public sale or distribution of securities. Section 32 prohibited banks from having interlocking directorships or close officer or employee relationships with a firm "principally engaged" in securities underwriting and distribution.

The Gramm-Leach-Bliley Act, however, did not amend Sections 16 and 21 of the Glass-Steagall Act. Section 16 generally prohibits Federal Reserve member banks from purchasing equity securities for their own accounts. Section 21 prohibits depository institutions from both accepting deposits and engaging in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes or other securities. Exceptions to these prohibitions include issuance of U.S. Government obligations, obligations issued by government agencies, college and university dormitory bonds, and general obligations bonds of states and political subdivisions.

Prior to enactment of the Gramm-Leach-Bliley Act, foreign banks that were engaged in non-banking activities in the United States before 1978 (the year the IBA was enacted) were permitted under a grandfather provision to continue their non-banking activities. Pursuant to the Gramm-Leach-Bliley Act, these grandfathered affiliates are now subject to appropriate functional regulation if they become part of a financial holding company.

Financial Holding Company Status

The Gramm-Leach-Bliley Act provides that a non-U.S. bank that qualifies as a financial holding company may engage in activities that are "financial in nature" in the United States. This essentially permits a non-U.S. bank to engage in the full range of securities underwriting, dealing, market making and mutual fund sponsorship, advisory, management, administrative and distribution activities through non-bank subsidiaries of the non-U.S. bank. Previously, so-called

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Section 20 subsidiaries that engaged in securities underwriting and dealing had a revenue limit on income that they could receive from these activities.

All U.S. depository institution subsidiaries must be "well-capitalized" and "well-managed" and have satisfactory community reinvestment ratings in order for a non-U.S. bank to qualify for financial holding company status. A non-U.S. bank with only a branch or agency in the United States may be treated as a financial holding company if the bank itself is "well-capitalized" and "well-managed." The Federal Reserve Board provides two methods for a non-U.S. bank to be considered well-capitalized. The first method is available only to non-U.S. banks from countries that have adopted the Basel Accord. A U.S. branch, agency, or commercial lending company of a foreign bank is considered well-capitalized if the foreign banking organization has a Tier 1 risk-based capital ratio calculated under home country standards of 6% and a total risk-based capital ratio of 10%.

The second method applies to non-U.S. banks whose home countries have not adopted the Basel Accord and to any non-U.S. banks that otherwise do not meet the standards described above. These foreign banks may still be considered well-capitalized if they obtain prior determination from the Federal Reserve Board that their capital is otherwise comparable to the capital that would be required of U.S. banks owned by U.S. financial holding companies.

For a non-U.S. bank to qualify as well-managed for the purposes of achieving financial holding company status, each U.S. branch, agency, and commercial lending company of the foreign bank must have received at least a satisfactory composite rating at its most recent examination. In addition, the home country supervisor of the non-U.S. bank must consider the overall operations of the foreign bank to be satisfactory.

CAPITAL MARKETS VEHICLE/ACTIVITIES

Merchant Banking

The Gramm-Leach-Bliley Act permits a non-U.S. bank that qualifies as a financial holding company to make "merchant banking investments." Merchant banking investments are passive equity investments in non-financial companies (called "portfolio companies") that are typically venture capital in nature. Under the Gramm-Leach-Bliley Act, non-U.S. banks qualifying as financial holding companies may take an ownership interest in the debt and equity securities or assets of any portfolio company as long as the ownership interests are:

- acquired and held by a broker-dealer or affiliate thereof, or an affiliate of an insurance company registered as an investment advisor or an affiliate thereof, as part of a *bona fide* underwriting or merchant or investment banking activity, including investments for the purpose of appreciation and ultimate resale;
- held only for a period of time to enable their sale or disposition on a reasonable basis consistent with the financial viability of these activities;
- not held under circumstances where the investing financial holding company routinely manages or operates the portfolio company except as necessary to obtain a reasonable return on investment; and

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- not acquired or held by a U.S. depository institution (or a U.S. branch or agency of a non-U.S. bank).

On January 10, 2001 the Federal Reserve Board issued a final rule that governs the merchant banking activities of financial holding companies ("Merchant Banking Rule"). The rule became effective on February 15, 2001. The Merchant Banking Rule allows financial holding companies to take up to a 100% equity interest in any portfolio company for up to ten years or make the investment through a qualifying private equity fund for up to fifteen years. The financial holding company is not allowed to involve itself in the routine management of the portfolio company. The Merchant Banking Rule restricts cross-marketing activities between banks and portfolio companies.

Section 20 Subsidiaries

Before the enactment of the Gramm-Leach-Bliley Act, banks had to establish Section 20 subsidiaries to underwrite and deal in securities in the United States. Section 20 of the Glass-Steagall Act prohibited the affiliation of a Federal Reserve member bank with a company that is "engaged principally" in underwriting or dealing in securities. All Section 20 subsidiaries were subject to the Federal Reserve Board's revenue test, which was designed to ensure that these firms would not be "engaged principally" in underwriting and dealing in securities. The revenue test limited bank-ineligible underwriting and dealing activities to less than 25% of the total revenues of the Section 20 subsidiary.

In addition, all Section 20 subsidiaries and their parent organizations were subject to a series of operating standards designed to ensure safe and sound operations. Non-U.S. banks that do not qualify as financial holding companies may continue to operate such subsidiaries.

Affiliate Transaction Restrictions

The federal banking regulators have regarded transactions between banks and their affiliates as a primary concern because in times of severe financial stress, bank holding companies may be tempted to divert resources from their bank subsidiaries to their non-banking affiliates. Sections 23A and 23B of the Federal Reserve Act ("FRA") seek to safeguard against such conduct by imposing restrictions on transactions involving insured banks (including insured U.S. branches and agencies of foreign banks) and their affiliates. On October 31, 2002 the Federal Reserve Board issued a final rule ("Regulation W") that implemented Sections 23A and 23B of the FRA. Regulation W became effective on April 1, 2003.

Section 23A is designed to protect insured depository institutions from abuses that may result from lending and asset purchase transactions with their affiliates. As clarified by Regulation W, Section 23A prohibits a U.S. bank or any of its subsidiaries from engaging in "covered transactions" with an affiliate if the bank's total covered transactions with that affiliate would exceed 10% of the bank's capital and surplus. A 20% aggregate limit is imposed on the total amount of covered transactions by a bank or any of its subsidiaries with all affiliates. Section 23A defines "covered transaction" to mean, with respect to an affiliate of a bank:

- a loan or extension of credit to the affiliate;

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- a purchase of or an investment in securities issued by the affiliate;
- a purchase of assets from the affiliate;
- the acceptance of securities issued by the affiliate as collateral for a loan or extension of credit; or
- the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate.

Regulation W defines “affiliate” for Section 23A purposes to include:

- any company that controls the bank and any other company that is controlled by the company that controls the bank;
- a bank subsidiary of the bank;
- any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the bank or any subsidiary or affiliate of the bank;
- any unregistered investment fund, if the bank or any bank affiliate serves as an investment advisor to the fund and the bank and its affiliates, in the aggregate, own more than 5% of any class of voting shares of the fund or of the equity capital of the fund;
- a financial subsidiary of the bank; and
- companies held under merchant banking or insurance company investment authority.

Section 23A, as further clarified by Regulation W, also places restrictions on transactions between uninsured U.S. branches or agencies of non-U.S. banks and their U.S. affiliates that are engaged in insurance underwriting, securities underwriting and dealing, merchant banking, or insurance company investment activities. The regulation also applies Sections 23A and 23B to transactions between a U.S. branch or agency of a non-U.S. bank and any portfolio company controlled by the non-U.S. bank or an affiliate as a merchant banking investment.

Section 23B of the FRA applies to any covered transaction and certain other transactions with an “affiliate,” as that term is defined in Section 23A, but excludes other banks from the term. It imposes an arm’s-length standard requiring that transactions be on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with or involving other non-affiliated companies.

Bank Anti-Tying Restrictions

A non-U.S. bank that issues securities in the United States or otherwise engages in securities activities in the United States must be careful not to run afoul of bank “anti-tying”

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restrictions. The anti-tying restrictions restrict a variety of combinations of product and services sales by a bank and/or its affiliates. Careful review of prospective securities transactions for potential violations of the anti-tying restrictions should be an ordinary part of the compliance function of any U.S. branch or agency of a foreign bank that desires to avoid penalties for anti-tying violations. Since the liberalization of the types of activities that a bank may engage in following the enactment of the Gramm-Leach-Bliley Act, the U.S. banking industry has been somewhat uncertain about the scope and applicability of bank anti-tying prohibitions. In view of this uncertainty, on August 25, 2003, the Federal Reserve Board issued a proposed interpretation (the "Interpretation") relating to bank anti-tying restrictions. The Interpretation, which became "final" on September 30, 2003, seeks to clarify the role of the anti-tying restrictions in the post Gramm-Leach-Bliley era. Significantly, the Interpretation discusses policies, procedures and systems that will help banks comply with these prohibitions.

As part of the 1970 amendments to the BHCA, the U.S. Congress introduced Section 106, which prevents a bank (including a U.S. branch, agency or commercial lending company of a foreign bank) from conditioning the availability of one product on a requirement that the customer also obtain another product from the bank or one of its affiliates. In other words, a bank may not coerce a customer (whether retail or wholesale) into purchasing a product the customer does not desire by requiring that the customer obtain it in order to get the desired product. In order to constitute an impermissible bank tying arrangement under Section 106, two elements must be present: (1) the arrangement involves a customer's desired product and an undesired "tied" product and (2) the bank requires the customer to obtain the undesired product in order to receive the desired product. There are certain exceptions to the prohibitions such as "traditional bank products" (e.g., loans, deposits or trust services) as long as the products are separately available for purchase by the customer.

While conceptually similar to the identically named anti-tying provisions of the anti-trust laws, bank anti-tying provisions are a distinct and specific body of laws administered by the Federal Reserve Board. In fact, the bank anti-tying provisions are more restrictive than their anti-trust counterparts. A non-exempt "tie" in the banking context is always per se impermissible, while a "tie" in the anti-trust context is generally impermissible only upon a showing that the tying party has significant market power and that anticompetitive effects would likely result from the tie. The U.S. Department of Justice has complained to the Federal Reserve Board about this disparity. The U.S. Department of Justice has asked that the Federal Reserve Board interpret Section 106 to conform to the existing anti-trust laws or, at a minimum, to limit impermissible ties to those involving small businesses and individual consumers.

Brokerage and Investment Advice

Before enactment of the Gramm-Leach-Bliley Act, U.S. branches and agencies of non-U.S. banks could directly conduct securities brokerage activities on a stand-alone basis or combined with investment advisory activities. The Gramm-Leach-Bliley Act, however, amended the 1934 Act to include banks in the definitions of "broker" and "dealer." The effect of this amendment is to require all banks (including U.S. branches or agencies and subsidiaries of non-U.S. banks) to conduct most of their securities broker-dealer activities through separate broker-dealer affiliates, rather than directly through the bank. Of course, transactions between such affiliates are covered by the affiliate transaction restrictions of Sections 23A and 23B of the

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FRA. Nonetheless, under Regulation R which implements the "exceptions for banks" securities activities provided under the Gramm-Leach-Bliley Act, U.S. branches and agencies of international banks may still engage directly in certain limited brokerage activities; trust and fiduciary activities; private placement agency activities and identified banking product activities (*i.e.*, deposit accounts, CDs, loan participations, and swap agreements).

The Gramm-Leach-Bliley Act also provides that a bank (including any U.S. branch or agency of a non-U.S. bank) may not serve as an investment adviser to a registered investment company unless it does so through a "separately identifiable department or division" that is registered with the SEC under the Investment Advisers Act.

Securitization

Bank holding companies, financial holding companies and their bank and non-bank subsidiaries are all allowed to conduct certain securitization activities. Securitization involves the pooling of assets, often mortgage loans, credit card loans or other receivables, and selling them to a trust or special-purpose entity that issues certificates representing an undivided interest in the assets and a right to receive the income they generate. U.S. affiliates of foreign banks have increasingly become involved in securitization activities in the United States because of the significant financial and operational benefits. Securitization releases funds that banks can use to make other investments and to generate additional loans.

Regulation of bank securitization activities has focused on providing regulatory capital standards to address the treatment of recourse obligations, residual interests, and direct credit substitutes. In order to remove assets from a bank's balance sheet by securitizing those assets, a "true sale" must take place. Whether a true sale takes place depends primarily on whether the originating bank remains liable to certificate holders should the borrowers default on principal and interest payments.

In order to attract purchasers, banks sometimes guarantee the payment of interest or principal, which is referred to as a "recourse" to the bank. Regulators have stated that the amount of permissible recourse in order for a true sale to have occurred depends on the type of assets sold and the level of risk retained. Additionally, banks sometimes undertake other credit enhancements known as "residual interests." These include retained subordinated interests, asset repurchase obligations, over collateralization, cash collateral accounts, spread accounts, and interest-only strips. Occasionally a bank may ask a third party to provide credit enhancements called "direct credit substitutes" on its behalf. Where credit enhancements are used, capital adequacy guidelines generally require sellers and third-party providers of credit enhancements to hold certain risk-based capital against the assets securitized.

Derivatives

Banking organizations may be involved in the purchase and sale of derivatives, subject to the affiliate transaction restrictions of Sections 23A and 23B of the FRA, as an end user and as a dealer. Derivatives are instruments whose value derives from the performance of something other than the derivative instrument itself. For example, the value of an option fluctuates based on the performance of the underlying securities. When a bank purchases derivatives in order to

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engage in balance sheet management it is acting as an end user. On the other hand, when a bank holds derivatives in its account for resale to investors it is acting as a dealer.

Banks also engage in credit derivatives activities. Credit derivatives are off-balance sheet arrangements where one party, the beneficiary, transfers the credit risk of a "reference asset," to another party, the guarantor. The guarantor assumes the credit risk associated with the reference asset without directly purchasing it. In some instances, the beneficiary may pay the total return on a reference asset to a guarantor in exchange for a spread over funding costs plus any depreciation in the value of the reference asset. In other situations, a beneficiary may pay a fee to the guarantor in exchange for a guarantee against any loss that may occur if the reference asset defaults. Federal Reserve guidance on credit derivatives states that banking organizations should conduct appropriate risk analysis of the financial strength of the counterparty and hold capital and reserves against their exposure to the reference assets.

The Impact of FIN 46 on Trust Preferred Securities

The U.S. banking regulators have allowed bank holding companies to include certain hybrid securities instruments, such as trust preferred securities, in their Tier 1 capital adequacy calculation. Bank holding companies utilize special purpose subsidiaries to issue the securities so that the parent bank holding company can treat the securities, on a consolidated basis, as debt for tax purposes and equity for Tier 1 capital adequacy purposes.

In January 2003, the Financial Accounting Standards Board ("FASB") issued interpretation No. 46 ("FIN 46") that interprets Accounting Research Bulletin No.51. FIN 46 addresses the consolidation by business enterprises of "variable interest entities" and requires a company that controls another entity to consolidate the controlled entity for financial purposes. FIN 46 also implies, however, that a bank holding company's trust preferred issuing trust subsidiary should be de-consolidated from its parent for accounting purposes. This de-consolidation means that the bank holding company and its trust subsidiary have a relationship based exclusively on a debt interest. As a result of this new relationship, the trust preferred securities are treated as a liability on the bank holding company's consolidated balance sheets, not as equity, and the "related expense [is] recorded as an interest expense on the income statement rather than as a minority interest in the income of its [trust] subsidiary." Thus, if FIN 46 requires trust preferred securities to be counted as debt for the bank holding company, it seemed unlikely that trust preferred securities would qualify as Tier 1 capital for bank regulatory purposes.

The possibility that FIN 46 might have disadvantageous capital consequences for trust preferred securities initiated considerable controversy. Some commentators noted that FIN 46 dealt with consolidation issues and that negative inferences relating to de-consolidation were inappropriate. Other commentators noted that removing trust preferred securities form the ambit of Tier 1 capital was an unintended consequence of FIN 46. They stated that FIN 46 dealt solely with accounting calculations and could not coerce regulatory calculations to follow suit. In order to halt some of the confusion concerning trust preferred securities and Tier 1 calculations, the Federal Reserve Board issued a supervisory letter on July 2, 2003, advising that bank holding companies should continue to calculate trust preferred securities as part of their Tier 1 capital until such time as there is further guidance requiring a different treatment.

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In March 2005, the Federal Reserve Board adopted a final rule allowing the continued inclusion of trust preferred securities in the Tier 1 capital of bank holding companies, subject to quantitative limits.

MONEY LAUNDERING AND TERRORIST FINANCING

USA PATRIOT Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT Act) Act of 2001 ("USA PATRIOT Act") is a broad anti-terrorism law that provides for an array of measures aimed at increasing national security, improving surveillance of terrorist activities, easing information sharing and combating money laundering. Title III of the USA PATRIOT Act contains significant new compliance requirements for financial institutions with respect to the detection and prevention of money laundering. The provisions of Title III amend portions of the Bank Secrecy Act of 1970.

The USA PATRIOT Act requires financial institutions that operate in the United States to implement an anti-money laundering program that includes, at a minimum: (i) internal policies, procedures and controls reasonably designed to guard against money laundering; (ii) designation of a compliance officer to oversee the implementation and enforcement of anti-money laundering policies and procedures; (iii) ongoing employee training in the prevention and detection of money laundering; and (iv) adoption of an independent audit program to test the financial institution's overall compliance.

The definition of "financial institution" in the USA PATRIOT Act is taken from the Bank Secrecy Act and includes, among other entities, (a) any insured bank; (b) a commercial bank or trust company; (c) a private banker; (d) an agency or branch of a non-U.S. bank operating in the United States; (e) a thrift institution; (f) a registered broker-dealer; (g) an investment company; (h) an insurance company; and (i) a loan finance company. Some provisions of the USA PATRIOT Act apply only to "covered financial institutions," a term meant to define a smaller subset of financial institutions. "Covered financial institutions" generally include, but is not limited to, banks, broker-dealers, branches and agencies of non-U.S. banks, trust companies and private bankers.

The USA PATRIOT Act and its implementing regulations provide rules on how financial institutions must verify the identity of customers and report any suspicious activity to law enforcement officials. It also requires financial institutions to conduct special and enhanced due diligence for customers that are non-U.S. financial institutions, as well as for non-U.S. persons including senior foreign political figures who hold private banking accounts in the United States.

Section 313(a) of the USA PATRIOT Act prohibits covered financial institutions from maintaining correspondent accounts in the United States for "foreign shell banks" – basically, unregulated foreign banks without a physical presence in any country. Covered financial institutions are required to have each non-U.S. bank customer complete a certification that attests that the bank is not a foreign shell bank and does not use the account with the covered financial institution to indirectly provide services to foreign shell banks. Each non-U.S. bank customer must also provide the names of the owners of the non-U.S. bank and the name and address of a

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person in the United States who will act as agent for service of process. Each non-U.S. bank customer must recertify the information previously provided every 3 years. A covered financial institution that becomes aware it maintains an account for a foreign shell bank must close the account immediately.

Banks, on a periodic basis, must screen all customer names against the list of "Specially Designated National and Blocked Persons" maintained by OFAC. Financial institutions must also verify that a customer is not located in, or is not a national of, any country that appears on the list of countries subject to OFAC-administered sanctions or designated as non-cooperative by the Financial Action Task Force for money laundering. Financial institutions are required to contact designated authorities should the financial institutions discover a match.[1]

[1] For a further discussion of OFAC, see "The Office of Foreign Assets Control ('OFAC')" in Chapter 7 (*Ongoing Reporting and Other Requirements*) of this volume.

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