

THE INTERNATIONAL  
CAPITAL MARKETS  
REVIEW

SEVENTH EDITION

Editor  
Jeffrey Golden

THE LAWREVIEWS

# THE INTERNATIONAL CAPITAL MARKETS REVIEW

SEVENTH EDITION

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# PREFACE

This book serves two purposes, one obvious, but the other possibly less so.

Quite obviously, and one reason for its continuing popularity, *The International Capital Markets Review* addresses the comparative law aspect of our readers' international capital markets (ICM) workload and equips them with a comparative law reference source. Globalisation and technological change mean that the transactional practice of a capital markets lawyer, wherever based, no longer enjoys the luxury, if ever it did, of focusing solely at home within the confines of a single jurisdiction. Globalisation means that fewer and fewer opportunities or challenges are truly local, and technology more and more permits a practitioner to tackle international issues.

Moreover, the client certainly may have multijurisdictional ambitions or, even if unintended, its activities often may risk multijurisdictional impact. In such cases, it would be a brave but possibly foolish counsel who assumed: 'The only law, regulation and jurisdiction that matter are my own!'

But actually the second purpose that this book aims to serve is, ironically, to equip its readers to do a better job as practitioners at home. In other words, reading the summaries of foreign lawyers, who can describe relevant foreign laws and practices, is perfectly consistent with and helpful when interpreting and giving advice about one's own law and practice.

As well as giving guidance for navigating a particular local, but, from the standpoint of the reader, foreign scene, the comparative perspectives presented by our authors present an agenda for thought, analysis and response about home jurisdiction laws and regulatory framework, thereby giving lawyers, in-house compliance officers, regulators, law students and law teachers also an opportunity to create a checklist of relevant considerations both in light of what is or may currently be required in their own jurisdiction but also as to where things there could or should best be headed (based on best practices of another jurisdiction) for the future.

Thus, an unfamiliar and still-changing legal jurisdiction abroad may raise awareness and stimulate discussion, which in turn may assist practitioners to revise concepts, practices and advice in our domestic as well as international work. Why is this so important? The simple answer is that it cannot be avoided in today's ICM practice. Just as importantly, an ICM practitioner's clients would not wish us to have a more blinkered perspective.

A week before writing this Preface, I had the honour of sharing the platform with a United Kingdom Supreme Court Justice, a distinguished Queen's Counsel and three American academics. Our topic was 'Comparative Law as an Appropriate Topic for Courts'. The others concentrated their remarks, as might have been expected, in the context of matters of constitutional law, and that gave rise to a spirited debate. I attempted to take some of the

more theoretical aspects of our discussion and ground them in the specific example of the capital markets, and particularly the over-the-counter derivatives market.

Activity in that market, I said, could be characterised as truly global. More to the point, I posited that, whereas you might get varied answers if you asked a country's citizens whether they considered it appropriate for a court to take account of the experiences of other jurisdictions when considering issues of constitutional law, in my view derivatives market participants would uniformly wish courts to at least be aware of and consider relevant financial market practice beyond their jurisdictional borders and comparative jurisprudence (especially from English and New York courts, which are most often called upon to adjudicate disputes about derivatives), even when traditional approaches to contract construction as between courts in different jurisdictions may have differed.

In such cases, with so much at stake given the volumes of financial market trading on standard terms and given the complexity and technicality of many of the products and the way in which they are traded and valued, there appears to me to be a growing interest in comparative law analysis and an almost insatiable appetite among judges to know at least how experienced courts have answered similar questions.

There is no reason to think that ICM practitioners are any differently situated in this regard or less in need of or less benefited by a comparative view when facing up to the often technical and complex problems confronting them than are judges. After all, it is only human nature to wish not to be embarrassed or disadvantaged by what you do not know.

Of course, it must be recognised that there is no substitute for actual exchanges of information between lawyers from different jurisdictions directly. Ours should be an interdependent professional world. A world of shared issues and challenges, such as those posed by market regulation. A world of instant communication. A world of legal practices less constrained by jurisdictional borders. In that sense and to that end, the directory of experts and their law firms in the Appendices to this book may help identify local counterparts in potentially relevant jurisdictions (one new jurisdiction, Thailand, having been added this year). And, in that case, hopefully a pre-read of this book's content may facilitate discussions with a relevant author.

In conclusion, let me add that our authors are indeed the heroes of the stories told in the pages that follow. My admiration of our contributing experts, as I wrote in the preface to the last edition, continues. It remains too a distinct privilege to serve as their editor, and once again I shall be glad if their collective effort proves helpful to our readers when facing the challenges of their ICM practices amidst the growing interdependence of our professional world.

**Jeffrey Golden**

P.R.I.M.E. Finance Foundation

The Hague

October 2017

# UNITED STATES

*Mark Walsh and Michael Hyatte<sup>1</sup>*

## I INTRODUCTION

Regulation of the capital markets in the United States is principally conducted by federal government agencies, particularly the Securities and Exchange Commission (SEC).

The Securities Act of 1933 (the Securities Act) requires that all offers and sales of securities in the United States be made either pursuant to an effective registration statement or an explicit exemption from registration. In addition, any class of securities listed on a US exchange must be registered under the Securities Exchange Act of 1934 (the Exchange Act), and the issuer of the relevant class is required to file annual and other reports with the SEC. Exchange Act registration and reporting also apply to unlisted equity securities, including securities of companies traded and organised outside of the United States, held by a sufficiently large population of US record holders. Companies with securities registered under the Exchange Act are also subject to the SEC's rules on ownership reporting and tender offers.

The perspective of the SEC statutes is that persons making investment decisions in regulated transactions should have complete and reliable information. The detailed disclosure requirements that apply to such transactions are found in the rules promulgated by the SEC under the securities laws.

In addition to the SEC, other federal and state regulators and self-regulatory organisations, such as the Financial Industry Regulatory Authority, play important roles in the oversight of the securities activities of banks, insurers and broker-dealers, in particular. Finally, the Commodities Futures Trading Commission (CFTC) continues to adopt and propose important rules relevant to the securities industry and the capital markets.

Although the SEC proposes and adopts rules under the federal securities laws every year, particularly wide-ranging rule changes were adopted in recent years as a result of the financial crisis, including those mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). The thrust of the Dodd-Frank Act, which sought to increase investor protection through substantive market regulation, was somewhat at odds with the SEC's previous efforts to reduce the regulatory burden on issuers, and many argue the Dodd-Frank Act reforms have gone so far as to have had a chilling effect on the capital markets. Reflecting these concerns, the new administration of President

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<sup>1</sup> Mark Walsh is a partner and Michael Hyatte is a senior counsel at Sidley Austin LLP. The authors would like to thank their colleague, Kostian Ciko, for his assistance with this chapter. They would also like to thank their colleagues David D Sylofski and William Shirley (structured finance, Volcker Rule and CFTC matters); Daniel A McLaughlin (litigation); Nicholas R Brown and Lena X Qiu (tax); and Dennis M Twomey and Allison Ross Stromberg (bankruptcy).

Trump has announced plans to roll back many of the Dodd-Frank Act reforms. Nonetheless, while the deregulatory stance of the new administration is clear, so far few SEC or other rule changes relevant to the capital markets and the US financial system have been proposed or adopted. Indeed, it is perhaps the decisions of the federal courts that have been of greater impact in the year under review.

This chapter summarises some of the more important rule changes and proposals over the past year, as well as some of the more important litigation, tax and other developments likely to be of interest to capital markets practitioners outside the United States.

## **II THE YEAR IN REVIEW**

### **i Developments affecting debt and equity offerings**

The SEC's recent rule changes of most relevance to debt and equity offerings have been of a generally technical nature. Unlike in recent years, there have been no changes or guidance of more widespread importance to the industry.

#### ***Rule changes in response to technological advancements***

The SEC continues to adopt rules in recognition of technological advances affecting the securities industry. The two most important rules this year relate to public filing procedures and the settlement cycle.

The SEC requires registrants to file a wide range of documents (material contracts, CEO and CFO certifications, etc.) as exhibits to their Securities Act and Exchange Act filings (e.g., registration statements, annual and periodic reports). Effective 1 September 2017, new SEC rules require registrants to include hyperlinks to such exhibits in their filings.<sup>2</sup> These rules affect foreign private issuers because they apply to any exhibits filed under Item 601 of Regulation S-K, including Forms F-3 and F-4, or that are filed under Forms F-10 and 20-F.

On 22 March 2017, the SEC amended Rule 15c6-1(a) to shorten the standard settlement cycle for most securities transactions effected through a broker dealer from three business days to two.<sup>3</sup> The amendment does not affect any other portions of the rule, including any existing exemptions, the most important of which exclude firm-commitment underwritings.

#### ***Expanded confidential review of draft registration statements***

Since the early 1990s, the staff of the SEC has allowed foreign issuers to submit draft registration statements under the Securities Act in advance of the public filing required by the statute before a distribution of securities may be made in the United States. The draft registration statements are held in confidence and are examined by the SEC staff to the same extent as a public filing. Under present SEC practices, foreign issuers that qualify for the confidential process include: (1) a foreign government registering its debt securities; (2) a foreign private issuer that is listed or is concurrently listing its securities on a securities exchange outside the US; (3) a foreign private issuer that is being privatised by government action; or (4) a foreign private issuer that can demonstrate that the public filing of an initial

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2 SEC Release Nos. 33-10322; 34-80132 (1 March 2017).

3 SEC Release Nos. 34-80295 (22 March 2017).

registration statement would conflict with applicable foreign law.<sup>4</sup> The foreign issuers outside these categories are eligible for similar procedures if they are ‘emerging growth companies’ (EGCs), or if they are making an initial public offering (IPO) or initial stock exchange listing in the United States. EGCs are a category of issuer created by statute that enjoy privileges, including confidential review of draft registration statements.<sup>5</sup> Effective 10 July 2017, the SEC staff expanded confidential review of draft registration statements to all IPOs and initial listings on US exchanges.

### ***Reconsideration of the conflict minerals rule***

The conflict minerals rule was adopted by the SEC pursuant to the Dodd-Frank Act and requires public companies, including foreign private issuers, to disclose whether any ‘conflict minerals’ that are necessary to the functionality or production of their products originated in the Democratic Republic of Congo or an adjoining country. In 2015, a United States Court of Appeals decision held certain provisions of the conflict minerals rule requiring statements whether public companies’ products had been found to be free of such minerals were unconstitutional.<sup>6</sup> On 7 April 2017, the staff of the SEC’s Division of Corporation Finance announced it would not recommend enforcement action to the SEC if a company fails to comply with the requirements of Item 1.01(c) of Form SD, the form item related to the invalidated requirements.<sup>7</sup> Companies will still be required to comply with Items 1.01(a) and (b) of Form SD, which require a good faith, reasonable inquiry into the country of origin of the minerals. Item 1.01(c) calls for companies whose products have not been found to be DRC-conflict free to conduct further source of origin due diligence, obtain an independent private sector audit of the due diligence and include a Conflict Minerals Report as an exhibit in their Form SD.

### **ii Developments affecting derivatives, securitisations and other structured products**

For the past several years, the implementation of the Dodd-Frank Act has been the primary focus for US regulators interested in derivatives, securitisations and other structured products.

### ***Margin requirements for uncleared swaps***

The Dodd-Frank Act mandates the margining of bilateral swaps and security-based swaps that are not cleared, and it required US financial regulators to adopt implementing rules for collecting and posting both initial margin and variation margin by registered swap entities

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4 SEC, *Non-Public Submissions from Foreign Private Issuers* (8 December 2011, updated 30 May 2012), available at <https://www.sec.gov/divisions/corpfin/international/nonpublicsubmissions.htm>.

5 Jumpstart Our Business Startups Act (JOBS Act), H.R. 3606 (5 April 2012).

6 *Nat’l Ass’n of Mfrs., et al. v. SEC*, 800 F.3d 518 (D.C. Cir. 2015).

7 Michael S Piwowar, *Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule* (7 April 2017), available at <https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule>.

(i.e., swap dealers and material swap participants). In late 2015, US prudential bank regulators adopted their final joint margin rule,<sup>8</sup> and the CFTC separately adopted its own final margin rule.<sup>9</sup> A phase-in period for the resulting margin requirements began in September 2016.

The rules include different phase-in periods for initial margin and variation margin as applied to new swap transactions. Uncleared swaps executed by a swap entity and a given counterparty before the applicable phase-in date will be grandfathered unless they are subsequently amended.

The phase-in period for initial margin requirements is four years. The largest swap entities and their largest counterparties (generally, other large dealers) became subject to initial margin requirements on 1 September 2016. On that date, variation margin requirements also came into effect for the largest swap entities and their largest counterparties. The requirements were to have been fully phased in after six months on 1 March 2017. However, in February 2017, US regulators effectively extended the phase-in period an additional six months to 1 September 2017.<sup>10</sup>

The prudential regulators and the CFTC adopted separate, though similar, rules that determine the cross-border application of the margin requirements.<sup>11</sup> In some circumstances, the cross-border rules entirely exclude swap transactions from application of the margin requirements. In other circumstances, substituted compliance may be available – either for all purposes or only for a swap entities' obligation to post or to collect initial margin. In September 2016, the CFTC found that Japanese margin requirements for uncleared swaps are comparable to those under the Commodity Exchange Act and CFTC regulations (with one exception related to inter-affiliate swaps).<sup>12</sup> In circumstances where the cross-border

8 See Prudential Regulators, *Margin and Capital Requirements for Covered Swap Entities*, Final Rule, 80 Fed. Reg. 74840 (30 November 2015), available at <http://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf>.

9 See CFTC, *Margin Requirements for Covered Uncleared Swaps for Swap Dealers and Major Swap Participants*, Final Rule, 81 Fed. Reg. 636 (6 January 2016), available at <http://www.cftc.gov/idx/groups/public/@Irfederalregister/documents/file/2015-32320a.pdf>.

10 See Board of Governors of the Federal Reserve System, *Initial Examinations for Compliance with Minimum Variation Margin Requirements for Non-Cleared Swaps and Non-Cleared Security Based Swaps*, SR 17-3 (22 February 2017), available at <https://www.federalreserve.gov/supervisionreg/srletters/sr1703.pdf>; Office of the Comptroller of the Currency, *Initial Examinations for Compliance With Final Rule Establishing Margin Requirements for Non-Cleared Swaps and Non-Cleared Security-Based Swaps*, OCC Bulletin 2017-12 (23 February 2017), available at <https://www.occ.gov/news-issuances/bulletins/2017/bulletin-2017-12.html>; CFTC, *Commission Regulation 23.153: Time Limited No-Action Position for Failure to Collect and/or Post Variation Margin*, Letter No. 17-11 (13 February 2017), available at <http://www.cftc.gov/idx/groups/public/@Irlattergeneral/documents/letter/17-11.pdf>. See also *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636 (6 January 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf>.

11 See CFTC, *Margin Requirements for Non-cleared swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements; Agency Information Collection Activities: Proposed Collection, Comment Request: Final Rule, Margin Requirements for Non-cleared swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements; Final Rule and Notice*, 81 Fed. Reg. 34818 (31 May 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-05-31/pdf/2016-12612.pdf> and Prudential Regulators, *Margin and Capital Requirements for Covered Swap Entities*, Final Rule, 80 Fed. Reg. 74840 (30 November 2015).

12 See Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 63376 (15 September 2016).



rules provide for neither exclusion nor substituted compliance, the rules may nonetheless permit limited relief with respect to non-US legal systems under which margin segregation requirements are problematic or the enforceability of netting agreements is subject to doubt.

***Dodd-Frank final ABS risk retention rules***

In December 2016, final rules became effective requiring sponsors of all US securitisation transactions to retain not less than 5 per cent of the credit risk on the securitised assets.<sup>13</sup> Generally, the risk retention requirements aim to remedy the general erosion of lending standards purportedly resulting from the 'originate to distribute' business model by requiring sponsors of asset-backed securities (ABS) to align their economic interest with those of investors through retention of 'skin in the game'.

The rules apply to ABS whether they are publicly offered or exempt from registration under the Securities Act.

The rules permit a sponsor's 'majority-owned affiliates' to hold the retained interest in lieu of the sponsor holding it. In addition, a sponsor may share its risk retention requirement with originators that meet certain conditions.

The rules allow a sponsor to satisfy the base risk retention requirement by retaining an 'eligible vertical interest', 'eligible horizontal residual interest' or any combination thereof, as long as the percentage amount retained is no less than 5 per cent.

The rules generally prohibit the hedging and transfer of retained interests, with limited exceptions. Separate sunsets on the hedging and transfer restrictions for sponsors of residential mortgage-backed securities (RMBS) and non-RMBS transactions apply.

The rules specify alternative means of retaining risk for certain asset classes and provide exemptions to the standard risk retention requirements for other asset classes.

Of particular importance to foreign private issuers, the rules also contain a safe harbour from risk retention for foreign-based securitisation transactions that satisfy certain conditions, including that:

- a* the securitisation transaction is not, and is not required to be, registered under the Securities Act;
- b* the initial investors that are US persons constitute no more than 10 per cent of the dollar value (or foreign currency equivalent) of all classes of ABS interests in the securitisation transaction;
- c* neither the sponsor nor the issuer is formed under United States federal or state law or is the unincorporated US branch or office of an entity not formed thereunder; and
- d* no more than 25 per cent of the assets collateralising the ABS sold in the securitisation transaction were acquired by the sponsor from a consolidated affiliate of the sponsor or issuing entity that is a US located entity described in (c), above.

Significantly, the regulations do not recognise satisfaction of risk retention under other regimes, including the EU Capital Requirements Regulation, as sufficient to satisfy the rules.

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13 Securities Exchange Act of 1934 (15 U.S.C. §78o–11) (2016).

### iii Cases and dispute settlement

There have been a number of federal court decisions since late 2016 that have been important to capital markets practitioners, including at least two decisions of direct relevance to transactional lawyers.

#### *Jurisdiction over foreign private issuers*

After the US Supreme Court's 2010 decision in *Morrison v. National Australia Bank*,<sup>14</sup> US courts have generally held that foreign issuers whose securities are traded in the US via American depositary receipts (ADRs) cannot be held liable under Section 10(b) of the Exchange Act and Rule 10b-5 by purchasers or sellers of the company's stock traded abroad, but can be sued by buyers or sellers of ADRs if the suit is based on a purchase or sale on a US exchange or otherwise takes place in the US (such as an over-the-counter trade or private placement in which the parties commit to the trade within the US).

The US Court of Appeals has had two recent occasions to address the scope of *Morrison*. In *In re Vivendi, SA Secs Litig*, 838 F.3d 223 (2d Cir. 2016), the court affirmed a 2009 securities fraud jury verdict against a French corporation under Section 10(b), in favour of all purchasers of its ADRs over nearly a two-year period, based on 57 statements relating to the company's liquidity. The *Vivendi* case had been filed in 2002. While the appeals court upheld the verdict, it also affirmed the lower court's decision excluding American purchasers of the company's ordinary shares in France from the class, concluding that 'the location of the Americans who acquired ordinary shares as a result of the merger, who Plaintiffs admit were not parties to it, is not relevant to the question of whether the merger qualifies as a "domestic purchase or sale"'. The court also found that an American court could properly exclude foreign shareholders from a class action if a judgment in the class action would not be recognised as binding on both parties in their home country.

The same court, in *In re Petrobras Secs.*, 862 F.3d 250 (2d Cir. 2017), affirmed the certification of a Section 10(b) class of purchasers of ADRs in a Brazilian company that were traded on the New York Stock Exchange (NYSE), but reversed the certification of class of the company's bonds traded over the counter under Sections 10(b), 11 and 12(a)(2) of the Securities Act.

*Petrobras* involved claims arising from the disclosure of an alleged kickback scheme by company officers that was alleged to affect the company's financials. The equity securities were depositary instruments for the company's common and preferred stock listed and traded on the NYSE. The notes were underwritten in multiple offerings during the class period by US and foreign banks, were not listed or traded on any US exchange, and were traded over the counter globally. The district court certified a Section 10(b) class of purchasers of the depositary shares and the notes, a Section 11 class of buyers of the notes in or traceable to their offerings, and a Section 12(a)(2) class of buyers of the notes in their offerings.

The court found that, because the bonds traded only over the counter and not on an exchange, an individual inquiry into their purchases could be needed to determine which transactions would be considered 'domestic' under *Morrison*, precluding a class action. Notably, the court rejected the plaintiffs' theory that all transactions settled through the Depositary Trust Company (DTC) qualify as 'domestic' transactions under *Morrison* regardless of where the trade takes place, noting that '[t]he mechanics of DTC settlement are

<sup>14</sup> *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010).

actions needed to carry out transactions, but they involve neither the substantive indicia of a contractual commitment . . . nor the formal weight of a transfer of legal title'. The court also concluded that evidence that some of the notes were offered outside the US precluded any class-wide presumption that purchases on the offering date at the offering price were made from the underwriters in the US.

With those two shortcuts eliminated, that left proof by transaction-by-transaction evidence. The court rejected the view it had taken in prior Argentine bond litigation that this made it impossible to even define who was a member of the class, but nonetheless concluded that the district court had failed to consider whether the feasibility of identifying the class members created individual issues that would make a class impractical. Noting that the named plaintiffs had only survived the pleading stage by pointing to individual trade confirmations showings that they had purchased their notes directly from US underwriters in the offerings, the court concluded that this form of proof would not be suitable to a class action. The court also expressed its concern that Section 11 cases, which require that secondary market purchases be traced to a particular offering, may present a significant obstacle to class certification in Section 11 cases involving *Morrison* questions.

### ***Marblegate and impact on debt offerings***

Debt securities issued and sold to investors in an SEC-registered offering, as well as certain other debt securities issued in exempt transactions, must be issued pursuant to an indenture that has been qualified under the Trust Indenture Act of 1939 (TIA). Section 316(b), forbidding impairment of rights to payment without the consent of a security holder, applies to qualified indentures. Historically, the provision had been construed only to prohibit indenture amendments that affect holders' contractual rights to receive payments.

In 2015, the District Court for the Southern District of New York found that an out-of-court restructuring that left the contractual right to payment in place under the governing trust indenture, but impaired the practical ability of noteholders to receive payments of principal and interest, violated Section 316(b) of the TIA.<sup>15</sup> The ruling generated significant concern among securities lawyers because amendments to a qualified indenture are customarily conditioned on the delivery of a legal opinion that the amendment complies with the indenture and the TIA, including Section 316(b). The decision led to uncertainty, particularly in debt restructurings. The rule of the district court's decision effectively meant that the question of Section 316(b) compliance would depend on a factual analysis of whether an indenture amendment would impair the obligor's practical ability to make payments.

On 17 January 2017, the US Court of Appeals for the Second Circuit reversed the district court's decision on Section 316(b) of the TIA.<sup>16</sup> This reversal provides more certainty in that an evaluation of ability to pay will not be required in assessing compliance with Section 316(b) of the TIA.

Indentures relating to Rule 144A and Regulation S are not required to be used or, if used, qualified under the TIA, but many issuers use indentures that include a provision similar to Section 316(b). As a result, the developments in *Marblegate* will be of relevance to non-US issuers that use indentures for their bond offerings even if those offerings are not registered with the SEC.

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15 *Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 111 F. Supp. 3d 542 (S.D.N.Y. 2015).

16 *Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 2017 WL 164318; No. 15-2124, Doc. 195 (2d Cir. 17 January 2017) vacating 75 F. Supp. 3d 592 (S.D.N.Y. 2014) and 111 F. Supp. 3d 542 (S.D.N.Y. 2015).

### ***Cash America's impact on make-whole provisions***

In *Cash America*,<sup>17</sup> the US District Court for the Southern District of New York provided bondholders an additional remedy when an issuer voluntarily breaches the indenture. The decision had an immediate impact on market participants and resulted in the drafting of substantive disclosure which generated significant investor concern.

In May 2013, Cash America International, Inc issued \$300 million of notes pursuant to an indenture. The issuer offered its services through two separate business lines and on November 2014 conducted a spin-off transaction of one of its business lines. The court found that the spin-off violated a covenant and constituted an event of default pursuant to the indenture. It was the court's decision regarding remedies however that is most significant to the bond market.

The indenture for the notes allowed the issuer to redeem the notes in advance of their maturity by paying a premium, commonly known as a 'make whole' premium. The purpose of this premium is to compensate the holders of the redeemed bonds for losing the stream of income that the bond would otherwise provide. The indenture also included an acceleration provision permitting but not requiring the trustee to accelerate the maturity of the notes and another catch-all provision that allows the trustee to use 'any available remedy . . . to enforce the performance of any provision of the Notes or the Indenture'. As is customary, the acceleration provision did not provide bondholders with pre-payment or make-whole fees.

The issuer argued that the only available remedy to the bondholders was acceleration. The court, however, held that the acceleration provision is permissive and not exclusive, and particularly in a situation where the event of default was voluntary, instead of involuntary, the bondholders can seek to enforce the performance of any provision, including the make-whole provision.

This decision is of particular significance to the bond market, including foreign private issuers that use indentures governed by New York law, because the provisions on which the court in *Cash America* relied upon are common. While, in the past, courts have provided bondholders with the right to a make-whole premium if the court found bad faith on the part of the issuer, this case appears to expand such remedy to instances where there is any voluntary default.

Following the court's decision, near the end of the 2016 and beginning of 2017, a number of issuers included language in their offering documents that effectively limited remedies for voluntary breaches to what is provided under the acceleration provision.

### **iv Relevant tax and insolvency law**

#### ***New debt and equity regulations involving related party debt***

On 4 April 2016, the Treasury Department (Treasury) and the Internal Revenue Service (IRS) issued proposed Treasury regulations concerning the classification of purported related party debt instruments as either debt, equity, or partially debt and partially equity, for US federal income tax purposes (Proposed Regulations). The Proposed Regulations targeted various intercompany financing structures and common tax planning techniques that the Treasury and the IRS find objectionable. Although many of these objections relate to inversions, the Proposed Regulations also affected a broad range of common tax structures

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<sup>17</sup> *Wilmington Savings Fund Society, FSB v. Cash America International, Inc.* Case No.15-CV-5027 (JMF), 2016 WL 5092594 (S.D.N.Y. 19 September 2016).

across all industries, including, potentially, structures used by private equity and hedge funds. On 13 October 2016, the Treasury and the IRS published final and temporary Treasury regulations (the Regulations), which substantially revised and narrowed the scope of the Proposed Regulations, which were subject to significant comments.<sup>18</sup>

The Regulations are intended to prevent taxpayers from aggressively using debt in situations in which debt is hardly distinguishable from equity, but in which significant US tax benefits come with the use of debt rather than equity. The classic example is a foreign parent corporation that funds its wholly owned US subsidiary with a mix of interest-bearing debt and equity to minimise the US corporate tax of the US subsidiary through interest deductions. In many cases, the interest payments are not subject to US interest withholding tax under an applicable income tax treaty. Because of the control that the parent has over the subsidiary, and because the parent is both the sole equity holder and the sole lender, the economic significance of this shareholder debt (when compared with equity) is minimal or non-existent compared to the significant tax benefit of the annual interest deduction. Therefore, the Regulations, under certain circumstances, recharacterise such debt as equity. These rules apply to debt issued on or after 5 April 2016. The Regulations also require certain groups to maintain certain documentation to support the debt treatment of intercompany debt. Failure by the group to meet such documentation requirements could result in the debt being recharacterised as equity. These documentation rules apply to debt issued on or after 1 January 2018.

The Regulations are extremely complex and have broad application. Therefore, any related party financing arrangements generally should be analysed to determine if the Regulations apply.

On 21 April 2017, the Secretary of the Treasury was instructed, pursuant to an Executive Order, to review all significant tax regulations issued on or after 1 January 2017, to identify any unduly burdensome or complex regulations and to recommend specific actions to mitigate the burden imposed by such regulations. The Regulations were identified by the IRS as burdensome and complex. It is, therefore, possible that the Treasury and the IRS will rescind, or significantly modify, the Regulations.

### ***Supreme Court to address circuit split concerning application of safe harbour defence in avoidance actions***

In May 2017, the Supreme Court of the United States granted certiorari review of the Seventh Circuit's 2016 decision in *FTI Consulting v. Merit Management Group, LP*,<sup>19</sup> which potentially will resolve a circuit split concerning the application of the Bankruptcy Code's safe harbour defence for avoidance of securities and other financial transactions.

Under the Bankruptcy Code, a debtor or trustee in bankruptcy may avoid pre-petition transfers that are preferential to certain creditors and transfers that are made while the debtor is insolvent if the debtor did not receive sufficient value for such transfers.<sup>20</sup> The Bankruptcy Code, however, provides a defence to these preference and constructive

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18 See Sidley Austin LLP, *Tax Update: Final Debt-Equity Tax Regulations Significantly Narrow the Scope of the Proposed Regulations* (October 17, 2016), available at <https://www.sidley.com/en/insights/newsupdates/2016/10/final-debt-equity-tax-regulations>.

19 *FTI Consulting, Inc. v. Merit Mgmt, Grp. LP*, 830 F.3d 690 (7th Cir. 2016), cert. granted No. 16-784, 2017 WL 1540513 (U.S. 1 May 2017) (U.S. 2017).

20 See 11 U.S.C. §§ 544(b), 547, 548(a)(1)(B).

fraudulent transfer actions for certain qualified financial transactions. For example, Section 546(e) of the Bankruptcy Code prohibits a debtor or bankruptcy trustee from avoiding (1) margin payments or settlement payments or (2) transfers in connection with a securities contract, commodity contract, or forward contract, in each case ‘made by or to (or for the benefit of)’ a qualified entity.<sup>21</sup> For purposes of Section 546(e), a ‘qualified entity’ may be a commodity broker, forward contract merchant, stockbroker, financial institution (such as a bank), financial participant or securities clearing agency.

A question that has led to inconsistent court rulings and significant uncertainty in the financial markets is whether the Section 546(e) safe harbour applies to a transfer in which the sole ‘qualified entity’ involved in the transfer is an intermediary or conduit that has no beneficial interest in the property transferred. In *Merit Management*, a litigation trustee sought to avoid a payment made by a corporate debtor to a shareholder in connection with the debtor’s purchase of privately held stock where neither the debtor nor shareholder were ‘qualified entities’. However, the transfer at issue was a settlement payment made in connection with a securities contract and technically was made by the debtor’s bank to another bank serving as escrow agent for the shareholder, each of which was a qualified entity. The Seventh Circuit held that Section 546(e) does not apply when the qualified entity ‘is neither the debtor nor the transferee but only a conduit’ in the transfer.<sup>22</sup> However, other circuits have concluded that the safe harbour can apply to protect transfers in which the qualified entity is only acting as a conduit or intermediary in the transaction.<sup>23</sup>

The Supreme Court’s ruling may have broad implications for financial markets, as the Bankruptcy Code’s safe harbours frequently play an important role in evaluating risks of contemplated financial transactions. The ruling should resolve the existing circuit split and determine whether the safe harbour can apply to protect financial transactions from avoidance if the qualified entity involved in the transfer is acting only in a conduit or intermediary capacity between non-qualified entities. Such ruling may be relevant to a variety of securities transactions involving trust companies, indenture trustees, banks and exchange or escrow agents, as well as transfers made through securities clearing agencies, in which these entities facilitate the transactions but do not obtain beneficial interest in the property transferred.

### ***Extraterritorial application of bankruptcy avoidance laws***

In November 2016, the Bankruptcy Court in the *Madoff* insolvency proceedings dismissed avoidance claims in 87 pending adversary proceedings on the basis of international comity and extraterritoriality considerations,<sup>24</sup> building upon the July 2014 extraterritoriality decision that Judge Rakoff in the Southern District of New York issued in connection with these adversary proceedings. Judge Rakoff had concluded that the provisions in the Bankruptcy

21 11 U.S.C. § 546(e). Similar ‘safe harbour’ defences exist prohibiting the avoidance of transfers made in connection with repurchase agreements (§ 546(f)), swap agreements (§ 546(g)), and master netting agreements (§ 546(j)).

22 830 F.3d at 691.

23 See *In re Quebecor World (USA)*, 719 F.3d 94 (2d Cir. 2013); *In re Tribune Fraudulent Transfer Litig.*, 818 F.3d 98 (2d Cir. 2016); *Lowenschuss v. Resorts Int’l, Inc. (In re Resorts Int’l, Inc.)*, 181 F.3d 505 (3d Cir. 1999); *In re QSI Holdings, Inc.*, 571 F.3d 545 (6th Cir. 2009); *Contemporary Industrial Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009); see also *Kaiser Steel Corp. v. Charles Schwab & Co. (In re Kaiser Steel Corp.)*, 913 F.2d 846 (10th Cir. 1990).

24 *Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities LLC*, Adv. P. No. 08-01789, 2016 WL 6900689 (Bankr. S.D.N.Y. 2016).

Code and Securities Investor Protection Act of 1970 authorising a trustee in bankruptcy to recover avoided transfers could not be applied extraterritorially to transfers among wholly foreign initial and subsequent transferees, and, even if the provisions could be applied extraterritorially, considerations of international comity would prevent such application.<sup>25</sup>

In *Madoff*, the trustee sued several foreign funds that invested with Madoff and the investors in such foreign funds (among others) to recover pre-petition payments made to the funds in connection with the Ponzi scheme run by Bernard Madoff. Following the Madoff insolvency, several of the foreign funds commenced their own liquidation proceedings in foreign jurisdictions. In dismissing the avoidance claims, the Bankruptcy Court emphasised that international comity is particularly important in the context of bankruptcy law, as deference to foreign insolvency proceedings promotes fair, equitable and orderly distribution of a debtor's estate.<sup>26</sup> The Bankruptcy Court expressed concern that the trustee was trying to reach beyond the foreign liquidation proceedings of the foreign funds to recover transfers on behalf of the Madoff estate, when the investors in those foreign funds had no reason to expect that US law would apply to their relationship with the foreign funds. The Bankruptcy Court also found the trustee's claims against such investors to be duplicative of claims made by the liquidators in the foreign insolvency proceedings.<sup>27</sup> As between the foreign jurisdictions and the United States, the Bankruptcy Court concluded that the foreign jurisdictions had a greater interest in regulating the activities that gave rise to avoidance claims, and US law did not have a sufficient interest in regulating the relationship between the foreign funds and their investors, or the liquidation of the foreign funds.<sup>28</sup> As a result, on the basis of international comity, the Bankruptcy Court dismissed claims against the investors in foreign funds where such funds were subject to their own liquidation proceedings. The Bankruptcy Court additionally dismissed avoidance claims on the basis that US law did not apply extraterritorially to transfers between foreign entities using non-US bank accounts, consistent with the 2014 Rakoff decision.

The trustee in the *Madoff* case recently appealed the decision, and has requested that the appeal be certified for direct appeal to the Second Circuit Court of Appeals. This appeal would provide an opportunity for the Second Circuit to clarify limits to the extraterritorial application of the Bankruptcy Code, and potentially resolve a split in authority on this issue within the New York federal courts. While the *Madoff* cases dismissed avoidance claims on the basis of extraterritoriality, other courts have concluded that Congress did intend to extend the scope of the Bankruptcy Code's avoidance powers to recover assets transferred abroad,<sup>29</sup> and have asserted jurisdiction over foreign defendants in connection with avoidance litigation.<sup>30</sup>

25 *Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities (In re Madoff Securities)*, 513 B.R. 222 (S.D.N.Y. 2014).

26 2016 WL 6900689 at \*11.

27 *Id.* at \*11–12, 14.

28 *Id.* at \*14.

29 See *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016).

30 See *Official Committee of Unsecured Creditors of Arcapita v. Bahrain Islamic Bank*, 549 B.R. 56 (S.D.N.Y. 2016) (asserting personal jurisdiction over foreign investment bank in preference action on the basis of bank's use of US correspondent bank account to receive transfers from foreign entity); *Lehman Bros. Special Financing Inc. v. Bank of Am. N.A. (In re Lehman Bros. Holdings Inc.)*, No. 10-03547 (Bankr. S.D.N.Y. 28 December 2015) (determining that the bankruptcy court had *in rem* jurisdiction over property of the debtor transferred to foreign defendant pre-petition for purposes of avoidance action).

As a result, a ruling from the Second Circuit addressing extraterritorial application of avoidance laws and the role of international comity should be of particular interest to foreign investors participating in the US markets.

#### **v Other strategic considerations**

The Volcker Rule under the Dodd-Frank Act prohibits covered banking organisations from engaging in ‘proprietary trading’, and from acquiring or retaining ownership interests in, or sponsoring, hedge funds, private equity funds and certain other private funds (subject to certain exceptions). Covered banking organisations include non-US banking organisations if they have a licensed branch or agency in the United States (though there are exclusions for non-US activities).

Although criticism of the Dodd-Frank Act reforms has been much broader, the Volcker Rule in particular has been criticised by industry and other commentators, including important members of the Trump administration. In June 2017, the US Treasury Department issued a report calling for significant reforms to the Volcker Rule, and this was followed by a notice issued by the Office of the Comptroller of the Currency (OCC) seeking public comment as to how the Volcker Rule should be revised.<sup>31</sup> In addition, in July 2017, the Federal Reserve and two other banking agencies announced that they would not propose to take action until July 2018 in respect of certain ‘qualifying foreign excluded funds’ (which, though not covered funds under the Volcker Rule, might be deemed to be directly subject to Volcker Rule restrictions because they are considered affiliates of non-US banking organisations).<sup>32</sup> Nonetheless, it is significant that the OCC, which regulates national banks, was not joined in its initiative by the other bank regulators or agencies, such as the Federal Reserve Board or the Federal Deposit Insurance Corporation. Indeed, since the publication of the OCC notice, Federal Reserve Chairman Yellen, among others, have publicly questioned the wisdom of tinkering with reforms designed to secure the stability of the US financial system. It is too early to predict the extent, if any, to which the Volcker Rule will be affected by the Trump administration.

### **III OUTLOOK AND CONCLUSIONS**

After several years of extensive SEC and other rule-making largely driven by the Dodd-Frank Act, the election of President Trump suggests the post-financial crisis regulatory reform era has ended. At the same time, while the posture of the new administration is clear, there have not been many substantive changes to the rules. Furthermore, there has already been some opposition to deregulation by both regulators and politicians. It is unclear at this stage the extent to which regulatory burdens will be lowered by the new administration and whether there will be a less active approach to enforcement of existing rules by the SEC and other

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31 See Department of the Treasury, *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (June 2017), available at <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>; see also OCC, *Notice Seeking Public Input on the Volcker Rule* (2 August 2017), available at <https://occ.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf>.

32 Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, *Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act* (21 July 2017), available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf>.



enforcement bodies, but in any case the United States continues to be a key market for prospective issuers of debt and equity securities, not least because of its continued market stability, depth and liquidity.

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