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THE MANDATORY DISCLOSURE SYSTEM AND FOREIGN FIRMS

Joel Seligman†

Abstract: This Article examines the disclosure requirements for foreign and domestic securities imposed by the Securities and Exchange Commission, paying special attention to the balance between investor protection and the free flow of capital internationally. As the world economy becomes increasingly global, foreign issuers and their governments, who in the past have had to meet more stringent requirements to issue their securities in the United States, are pushing for less restrictive treatment. This Article describes the progress that has been made towards this end.

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I. INTRODUCTION

The Securities and Exchange Commission (SEC) enforces seven federal securities laws1 which generally address four regulatory topics: (1) the obligations of businesses to comply with disclosure, insider trading, tender offer, and antifraud provisions; (2) the regulation of broker-dealers; (3) the regulation of securities markets; and (4) the regulation of investment

† Dean, Samuel M. Fegtly Professor of Law, University of Arizona College of Law; J.D. (Harvard); A.B. (University of California, Los Angeles).

companies and investment advisers. In the United States, each state also enforces a separate form of securities regulation. State securities law is more limited in scope than federal regulation, but does address: (1) businesses issuing new securities; (2) broker-dealers and investment advisers; and (3) antifraud remedies.

At its core, the primary policy of the federal securities laws involves the remediation of information asymmetries. This is most obviously true with respect to the mandatory disclosure system which compels business corporations and other issuers to disseminate detailed, generally issuer-specific, information when selling new securities to the public, and requires specified issuers to file annual and other periodic reports containing the same or similar information. This system was, in essence, a response to the failure of business firms to sufficiently disclose material information in the period preceding the enactment of the Securities Act of 1933 and Securities Exchange Act of 1934.

When foreign firms sell securities in the United States, they too are subject to the mandatory disclosure system, but they are subject to somewhat different requirements than domestic issuers.

II. THE INTEGRATED DISCLOSURE SYSTEM FOR DOMESTIC FIRMS

Section 5 of the Securities Act of 1933, in essence, provides that unless a registration statement is in effect, it is unlawful to sell securities to the public. There are several exemptions in sections 3 and 4 of that Act, notably the exemption in section 4(2) for transactions by an issuer not involving a public offering, the so-called private placement exemption.

Section 7 of the Securities Act provides, in substance, that the registration statement shall contain the information and be accompanied by the documents specified in Schedule A (or Schedule B in the case of securities issued by a foreign government or one of its political subdivisions), except that the Commission may, by rule, add to or subtract from the specified information and documents with respect to any class of issuers of

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2 For an 11 volume treatise focusing on the first three of these topics, see LOSS & SELIGMAN, supra note 1 (1989-1993). For a four volume treatise addressing investment companies and investment advisers, see TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS (1978-1980).

3 See 1 LOSS & SELIGMAN, supra note 1, at 29-152.

4 See Joel Seligman, The Historical Need for a Mandatory Corporate Disclosure System, 9 J. CORP. L. 1 (1983). See also 1 LOSS & SELIGMAN, supra note 1, at 171-229.

5 See 3 LOSS & SELIGMAN, supra note 1, at 1350-1389 (1989).

6 2 Fed. Sec. L. Rep. (CCH) ¶ 5501.
securities.\textsuperscript{7} The textual content of what is currently required in a registration statement today is specified in Regulation S-K; the SEC’s requirements are now specified in Regulation S-X.\textsuperscript{8}

It has been the Commission’s policy from the beginning to adapt the specifications of Schedule A to the circumstances of particular types of issuers by promulgating a substantial number of separate forms. For several examples, Form S-1 is the residual form to be used by commercial and industrial companies whenever no other form is authorized or prescribed; Forms S-2 and S-3 are truncated forms for eligible corporations under the integrated disclosure system; Form S-4 is for securities issued in business combination transactions.\textsuperscript{9}

The Securities Exchange Act of 1934 requires in addition that a registration form and periodic reports be filed by firms that satisfy specified criteria; most notably, these firms must have: (1) a security registered on a national securities exchange; (2) the firm itself must have total assets of US$5 million or more and a class of equity security held of record by 500 or more securities holders when its securities are not traded on a national securities exchange and are traded in the alternative over-the-counter market; or (3) a security registered under the Securities Act, unless and until the security is held by fewer than 300 persons.\textsuperscript{10}

Under the Securities Exchange Act, Form 10 is generally used for the registration of classes of exchange-listed or over-the-counter securities for issuers when no other form is prescribed.\textsuperscript{11} It bears a resemblance to the Securities Act’s residual form, Form S-1.

\textsuperscript{7} Similar flexibility marks \textsection{10}, 15 U.S.C. \textsection{77j} (1988), which provides that the statutory prospectus shall contain “the information contained in the registration statement” except for certain documents referred to in the schedules and subject to the Commission’s power to adopt rules adding, subtracting, and classifying. Additional authority is given to the Commission by \textsection{19(a)}, 15 U.S.C. \textsection{77s} (1988), the general provision on rulemaking, to define “accounting, technical, and trade terms” used in the Act and to prescribe the form in which required information shall be set forth and the methods to be followed in the preparation of accounts and financial statements.


\textsuperscript{9} Securities Act Forms can be found at 17 C.F.R. § 239 (1994) and 2 Fed. Sec. L. Rep. (CCH) ¶ 6001.


The basic annual report form, corresponding to Form 10 for registration, is Form 10-K. The disclosure requirements of Form 10-K, like those of the 1933 Act registration statements, are specified by Regulation S-K.

Every issuer required to file an annual report on Form 10-K (with a few exceptions) must file both a quarterly report on Form 10-Q within forty-five days after the end of its first three fiscal quarters and a “current report” on Form 8-K within fifteen days after the occurrence of specified events of an extraordinary character that have not been reported previously.

A separate annual report to shareholders is required by Rule 14a-3 before the annual election of the board of directors. There are currently over 13,000 issuers subject to these Securities Exchange Act requirements.12

Underlying both the 1933 and the 1934 Acts’ mandatory requirements is an “integrated disclosure system.” This system has two major aspects. First, it coordinates required disclosures under the 1933 Act and the 1934 Act, in light of an assumption of the efficient market hypothesis that information effectively disseminated to the public will be rapidly reflected in share prices regardless of the source of the data.13 This aspect of the system is responsible for streamlined registration forms, notably Forms S-2 and S-3, which can be used by registrants subject to the 1934 Act’s continuous disclosure obligations. Second, the system developed generic disclosure items for both the 1933 Act registration, and the 1934


13 The applicability of the efficient market hypothesis to an integrated disclosure system was considered in several releases. In one release, the Commission observed:

[T]he concept of integration also proceeds from the observation that information is regularly being furnished to the market through periodic reports under the Exchange Act. This information is evaluated by professional analysts and other sophisticated users, is available to the financial press and is obtainable by any other person who seeks it for free or at nominal cost. To the extent that the market accordingly acts efficiently, and this information is adequately reflected in the price of a registrant’s outstanding securities, there seems little need to reiterate this information in a prospectus in the context of a distribution.


Act registration and continuous reporting by adding Regulation S-K (non-financial items) to the existing Regulation S-X (financial items). Previously required disclosures under the two Acts had been developed independently of each other.

The integrated disclosure system was adopted in 1982. Amendments to Form S-3 were adopted in 1992. There are two general types of eligibility requirements for Form S-3. First, there are registrant requirements. American companies, most significantly, must have reported under the 1934 Act for the past twelve calendar months. Second, there are transaction requirements. A company satisfying the registrant requirements may use Form S-3 for primary cash offerings, if it has at least US$75 million in voting stock held by non-affiliates. Form S-3 can also be used in offerings of nonconvertible debt or preferred stock, investment grade asset-backed securities, specified secondary offerings, and specified rights offerings, dividend or reinvestment plans, or conversions or warrants.

A company filing Form S-3 is required only to file a brief registration statement primarily describing the securities issuance and recent material changes and then to incorporate by reference: (1) its latest Form 10-K annual report, (2) quarterly and monthly reports filed since the end of the fiscal year covered by the annual report, and (3) if capital stock is to be registered and the same class is registered under the 1934 Act, a description of the class of securities that is contained in a registration statement filed under the 1934 Act, including amendments or reports filed to update the description.

Form S-2 is available to companies that have reported under the 1934 Act for at least thirty-six months, but has no transaction requirements such as the US$75 million in voting stock held by nonaffiliates requirement for Form S-3 primary stock offerings. In addition to the information required to be disclosed by Form S-3, a registrant filing on Form S-2 either (1) must accompany the prospectus together with its latest annual report to security holders, certain information required by the Form 10-Q quarterly report, certain financial information required by Regulation S-X, if the data are not in the annual report to security holders, and material changes since the fiscal year included in the annual report to security holders and not elsewhere described, or (2) must directly furnish information comparable to that described, or (2) must directly furnish information comparable to that

provided in the annual report to security holders. In either case, the more
detailed information in the Form 10-K annual report is incorporated by
reference into the prospectus.

Form S-1 endures as the residual form available for the registration of
securities "for which no other form is authorized or prescribed, except that
this form shall not be used for securities of foreign governments or political
subdivisions thereof." Form S-1 requires disclosure of virtually every item
in Regulation S-K.

Regulation S-K in summary, encourages voluntary disclosure of
forward looking information (such as earnings projections) and security
ratings in Item 10. There are then mandatory requirements to disclose
specified information about the business of the issuer (Items 101-103); its
securities (Items 201-202); financial information (Items 301-304); man-
agement and certain security holders (Items 401-404); and the registration
statement and prospectus (Items 501-512). Item 601 lists required exhibits
to filings. Items 701-702 provide for "miscellaneous" disclosures
concerning unregistered securities and indemnification of officers and
directors. Item 801 specifies certain additional industry guides for a few
specified industries.16

III. OFFERINGS FROM A FOREIGN COUNTRY INTO THE UNITED STATES

A. The Foreign Integrated Disclosure System

Throughout much of its history the Commission did not have special
registration forms for offerings by foreign private issuers.17 As Chairman
Garrett stated in 1974, "There have never been enough such offerings to
seem to require this."18 In recent years, however, American investment in
foreign securities has increased dramatically.19 In 1973, former SEC

16 For discussion of Regulation S-K, see 2 LOSS & SELIGMAN, supra note 1, at 620-687. In 1992,
the Commission adopted a parallel Regulation S-B to apply to certain small business issues. There are also
separate requirements for partnership rollup transactions in Regulation S-K Items 901-915.
17 Indeed, initially, Schedule B was added to the Securities Act of 1933 because the primary concern
with foreign issuers was with foreign governments.
18 Is the SEC a Barrier to New York's Role in International Finance?, Sec. Reg. & L. Rep. (BNA)
No. 257, at D-I (June 19, 1974).
19 By late 1993, the Commission could report substantial recent experience with foreign issuers' participation in United States public and private securities markets:

In the last three years, more than 350 foreign companies have registered approximately $95 billion of securities with the Commission. In the last year and a half, approximately 140 foreign
Chairman Manuel Cohen, among others, was persuaded that an international securities market was a concept "whose time ha[d] come."20

One Commission response to this development was the adoption of a foreign integrated disclosure system. This required the Commission to balance the goal of investor protection, its "primary mandate," with the "free trade goal" of "facilitating the free flow of capital among nations."21 The Commission, at the same time, recognized "that United States investors, if they are so inclined, can invest in foreign securities directly in foreign markets. Therefore, discouraging registration may not be in the public interest because the disclosure in the foreign market may be less than that required in filings with the Commission . . . ."22

The foreign integrated disclosure system is limited to issuers that annually file Form 20-F.23 This Form is available to non-Canadian foreign companies that have entered the U.S. public market for the first time, bringing the total number of foreign companies reporting with the Commission to 559, representing 40 countries. Since the adoption of Rule 144A in April 1990, 184 foreign companies have raised capital in Rule 144A transactions, including 12 companies that later made their initial entry into the U.S. public market.


private issuers registering under the Securities Exchange Act or filing an annual report under that Act.

The term “foreign private issuer” is defined in Rule 405 to mean:

any foreign issuer other than a foreign government except an issuer meeting the following conditions: (1) More than 50 percent of the outstanding voting securities of such issuer are held of record either directly or through voting trust certificates or depositary receipts by residents of the United States; and (2) Any of the following: (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States.\(^{24}\)

Each foreign private issuer using Form 20-F must file a report within six months after the end of the fiscal year covered by the annual report.\(^{25}\) In its primary financial statements, a foreign private issuer must make statements in the currency of the country in which it is incorporated or organized, except that a different currency may be used if three conditions are met: (1) the other currency is the currency of the primary economic environment in which the operations of the issuer and its subsidiaries are conducted, (2) there are no material exchange restrictions or controls relating to that currency, and (3) the issuer publishes its financial statements for all of its shareholders in the other currency.\(^{26}\) Dollar-equivalent financial statements (“convenience translations”) may be presented for the most recent fiscal year and any subsequent interim periods.\(^{27}\)


\(^{25}\) See Instruction A(b) to Form 20-F, 5 Fed. Sec. L. Rep. (CCH) ¶ 29,701.


\(^{27}\) Convenience translations must use the exchange rate as of the most recent balance sheet involved in the filing unless a rate as of a more recent practicable date is materially different. Id. Rule 3-20(b), 17 C.F.R. § 210.3-20(b) (1994), 6 Fed. Sec. L. Rep. (CCH) ¶ 69,161.

Form 20-F permits foreign private issuers to prepare financial statements in accordance with either Item 17 or 18. These Items are identical in paragraphs (a), (b), and (c): (a) In essence, foreign private issuers, with specified exceptions, must furnish financial statements for the same years, together with the same schedules and accountants' certificates that would be required if the registration statement were on Form 10 or the annual report on Form 10-K. (b) The content of the financial statements must be substantially similar to the content of financial statements that comply with generally accepted accounting principles ("GAAP") in the United States and Regulation S-X. (c) The financial statements must be prepared according to GAAP in the United States or another comprehensive body of accounting principles; but if another body of comprehensive principles is employed, there must be a discussion of the material variations, including quantification of each material variation in tables or in notes.\footnote{28}

There are two textual differences between Items 17 and 18. First, Instruction 3 to Item 17 permits registrants to prepare financial statements that do not comply with the "categories of activity" disclosure requirements otherwise specified in Item 1 of Form 20-F and Financial Accounting Standards Board Statement No. 14; Item 18 does require compliance with United States line-of-business disclosure requirements.\footnote{29} Second, Item 18 in paragraph (c)(3) expressly requires "[a]ll other information required by United States generally accepted accounting principles and Regulation S-X unless such requirements specifically do not apply to the registrant as a foreign issuer." There is no counterpart paragraph in Item 17. This means that Item 18 requires certain items that Item 17 does not, including pension information and various supplemental information as well as segment information.\footnote{30} Most securities offerings on Form F-1, F-2, or F-3 require

\footnote{28} Items 17(c)(2)(i)-(iii) and 18(c)(2)(i)-(iii) of Form 20-F specify the form in which income statements, balance sheets, and issuers in hyperinflationary economies should prepare reconciling items.

Rule 4-01(a)(2) permits foreign private issuer financial statements to be prepared according to a comprehensive body of foreign GAAP if a reconciliation to United States GAAP and Regulation S-X is also filed "except as stated otherwise in the applicable form." At a practical level, this means that Item 18 will require reconciliation to United States GAAP of segment, pension, and various supplemental information that Item 17 does not. "It can be argued that requiring an Item 18 reconciliation in all filings would be too great an impediment for foreign issuers to enter the United States markets which could thereby deprive United States investors of many investment opportunities." Securities Act Release No. 6360, supra note 19, at 84,648.

\footnote{29} For discussion of United States line of business disclosure requirements, see 2 LOSS & SELIGMAN, supra note 1, at 639-46.

\footnote{30} See Securities Act Release No. 6360, supra note 22, at 84,648. Form 20-F does not include a supplementary disclosure item comparable to Item 302 of Regulation S-K. This is of significance only to
Form 20-F disclosures that employ Item 18, with exceptions permitting Item 17 disclosures on each of these Forms for specified rights offerings, dividend or interest reinvestment plans, and securities offered upon the conversion of outstanding securities or upon the exercise of warrants, and a further exception for nonconvertible "investment grade" debt on Form F-3.

Another major difference between the mandatory disclosure system for foreign and domestic private issuers concerns disclosure of conflicts of interest. Items 11-12 of Form 20-F permit foreign private issuers to disclose aggregate remuneration and aggregate options to purchase securities of the class being registered unless the registrant discloses to its shareholders or otherwise these data for individually named directors and officers. Item 13 similarly specifies that data concerning material transactions with officers, directors, control persons, and any of their spouses and relatives need be disclosed only if made public in reports to shareholders or otherwise. These requirements significantly compromise the more demanding conflict of interest requirements found in Items 402 to 404 of Regulation S-K. 31

As with the integrated disclosure system for domestic issuers, there are three basic forms in the foreign integrated disclosure system for foreign private issuers. The most exclusive Form is F-3. To be an eligible registrant, an issuer (1) must have a class of securities registered pursuant to section 12(b) or 12(g) of the 1934 Act or be required to file reports pursuant to section 15(d) of that Act and have filed annual reports on Form 20-F; and (2) must have been subject to the requirements of section 12 or 15(d) and filed all material required by the 1934 Act for at least twelve months and have filed all required reports in a timely manner during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement. In addition, (3) since the end of the last fiscal year for which certified financial statements were included in a report filed under the 1934 Act, neither the registrant nor any of its subsidiaries may have (a) failed to pay any dividend or sinking fund installment on preferred stock or (b) defaulted on any debt installment or long term lease rental if the defaults in the aggregate were material to the financial position of the registrant; and

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(4) the aggregate worldwide market value of the voting stock held by nonaffiliates of the registrant must equal at least US$75 million.

An eligible registrant may use Form F-3 for (1) primary cash offerings, but only if the registrant's latest filing on Form 20-F complied with the more demanding Item 18 financial statement requirements; (2) nonconvertible "investment grade" debt securities; (3) secondary offerings; or (4) offerings to current security holders, specifically rights offerings, dividend or interest reinvestment plans, and securities offered upon the conversion of outstanding securities or upon the exercise of warrants.

Employing the same approach as Form S-3, Form F-3 incorporates, by reference, the registrant's latest Form 20-F and otherwise generally requires only transaction-related data. 32

Form F-2 somewhat relaxes the eligibility requirements of Form F-3. Both Forms require the registrant (1) to have a class of security registered pursuant to section 12(b) or 12(g) of the 1934 Act, or (2) to be subject to the reporting provisions of section 15(d), and to be filing annual reports on Form 20-F. But, there is a significant difference: Form F-3 requires a registrant to have filed all material required by the 1934 Act for at least thirty-six months (including timely filing for at least twelve months) and to satisfy a US$75 million worldwide "float" test. In contrast, Form F-2 requires a registrant either (1) to have been subject to the requirements of section 12 or 15(d) and to have filed all material required by section 13, 14, or 15(d) for at least thirty-six months including (timely filing for at least twelve months), or (2) to have a US$75 million worldwide float of voting stock unless the securities being registered are nonconvertible, "investment grade debt securities." All Form F-2 filings except for specified rights offerings, dividend or interest reinvestment plans, and securities offered upon the conversion of outstanding securities or upon the exercise of warrants require the registrant’s latest filings on Form 20-F to comply with Item 18. The primary difference in the disclosure requirements of Forms F-3 and F-2 is that Form F-2 requires the latest Form 20-F not only to be incorporated by reference but also to be delivered to potential investors.

Form F-1, like S-1, is the residual form. It may be employed by any foreign private issuer eligible to use Form 20-F. Each registrant filing on Form F-1 must furnish the information required by Part I of Form 20-F, including Item 18, with the exception of rights, dividend or reinvestment

plans, or securities issued upon the conversion of outstanding securities or upon the exercise of warrants, which may instead use Item 17.33

There is also a special Form F-6 for American Depositary Receipts ("ADRs"). An ADR is a negotiable receipt usually issued by a U.S. bank, which certifies that a stated number of shares of a foreign private issuer have been deposited in the bank or in its foreign affiliate or correspondent. Form F-6 is available if: (1) the ADR holder may withdraw the deposited securities at any time (subject to a few mechanical exceptions); (2) the deposited securities are offered pursuant to a 1933 Act registration or in transactions that would be exempt if effected in the United States; and (3) the issuer of the deposited securities reports under the 1934 Act (or the securities qualify for the insurance company exemption in section 12(g)(2)(G)). Because the underlying security will be either registered on another 1933 Act form or exempt from registration, the disclosures required by Form F-6 are terse. Essentially all that needs to be provided is a description of the ADR as specified by Item 202(f) of Regulation S-K, an explanation whether the foreign issuer furnishes public reports under Rule 12g3-2(b) or the periodic reporting requirements of the 1934 Act, and certain specified exhibits and undertakings.35

In 1994, the Commission adopted significant changes in its accounting treatment of foreign issuers. The Commission explained earlier:

Foreign private issuers currently are required to provide either a statement of cash flows prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") or information that is substantially similar to U.S. GAAP in a separate statement of cash flows or in a footnote to the

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33 For an essay in support of the proposition that the SEC's requirement that foreign issuers reconcile their financial disclosure to United States GAAP has impeded internationalization of United States markets and prevented United States shareholders from realizing full value on foreign investments, with a suggestion that the SEC should review the usefulness of reconciled data and approve the listing of certain foreign securities on an experimental basis, see McLaughlin, Listing Foreign Stocks on U.S. Exchanges: Time to Confront Reconciliation?, 24 REV. SEC. & COMMODITIES REG. 91 (1991).

34 In 1991, the Commission published a lengthy concept Release concerning ADRs and solicited comments on several fundamental questions such as: Are any changes necessary or appropriate to the registration process? See American Depositary Receipts, Securities Act Release No. 6894, [1990-91 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740 (May 23, 1991).

registrant’s financial statements. Under the proposals, the Commission would accept without reconciliation a cash flow statement prepared in accordance with International Accounting Standards No. 7, “Cash Flow Statements,” as amended (“IAS 7”).

IAS 7 was amended in October 1992, as part of the International Accounting Standards Committee’s Improvement Project. While there are differences between a cash flow statement prepared in accordance with IAS 7 and one prepared in accordance with U.S. GAAP, most of the differences relate to classification and are readily apparent. The remaining differences would not significantly impact an investor’s understanding of cash flows. As the informational content of a cash flow statement prepared in accordance with IAS 7 would not be significantly different from a cash flow statement prepared in accordance with U.S. GAAP, the Commission believes statements prepared in accordance with IAS 7 should provide an investor with adequate information regarding cash flows without the need for additional information or modification.36


The Commission also adopted amendments to Form 20-F that will permit first time registrants to reconcile required financial statements and selected financial data for only the two most recently completed fiscal years and any required interim periods. Simplification of Registration and Reporting Requirements for Foreign Private Companies, Securities Act Release No. 7053, [1993-94 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,331, at 85,206 (Apr. 19, 1994).

The Commission also adopted amendments (1) forgoing required reconciliation of an acquired business unless it exceeds a 30% significance level based on the registrant’s investment, assets, and pretax income, id. at 85,206; (2) streamlining the required reconciliation when a foreign registrant uses pro rata consolidation in circumstances that would not be permitted under United States generally accepted accounting principles, id. at 85,207, and (3) eliminating the requirements in Rules 12-02 to 12-08 to furnish supplemental financial schedules as part of the reconciling information, id. at 85,207.

There were several other related changes and proposals:

(1) The Commission adopted Rule 135c, a new safe harbor parallel to existing Rule 135, for offshore offerings and private placements such as those under Regulation S and Rule 144A. This safe harbor is limited to reporting companies and foreign companies that have obtained a Rule 12g3-2(b) exemption. The information permitted by Rule 135c generally parallels that which is allowed under Rule 135. Id. at 85,208.

(2) Rule 139 was also amended to allow broker-dealers to distribute information, opinions, or recommendations with respect to securities eligible for Form F-3 that could not satisfy the 12 month reporting history condition. Id.

(3) The Commission separately adopted amendments to Regulation S-X and Form 20-F to allow foreign issuers with operations in hyperinflationary economies flexibility in the selection of the reporting

Compliance with the reporting, proxy, and insider trading provisions of the Securities Exchange Act is required by section 12(a) of registrants whose securities are traded on a national securities exchange, and by section 12(g) and Rule 12g-1 of registrants that are "engaged in ... a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce" and that (1) have total assets exceeding US$5 million and (2) have a class of equity security (other than an exempted security) held of record by 500 or more persons. As part of the Securities Acts Amendments of 1964, Congress enacted section 12(g)(3), which permits the Commission to exempt any security of a foreign issuer, including any certificate of deposit for such a security, from section 12(g) "if the Commission finds that such exemption is in the public interest and is consistent with the protection of investors."

currency used in Commission filings and to streamline reconciliation requirements for these foreign private issuers. Securities Act Release No. 7054, supra note 23 (proposal); Securities Act Release No. 7117, supra note 23 (adoption).

(4) In a separate Release, the Commission adopted amendments that would extend recently adopted accommodations for foreign issuers to domestic issuers that are required to provide financial statements for significant foreign equity investors or acquired foreign businesses. These include proposals to address (1) the age of financial statements, (2) the nature of reconciling information, (3) thresholds for providing such reconciliations, and (4) elimination of certain financial statements that both domestic and foreign issuers are currently required to include in annual reports and registration statements filed with the Commission. Financial Statements of Significant Foreign Equity Investors, Securities Act Release No. 7055 [1993-94 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,333 (Apr. 19, 1994) (proposal); Financial Statements of Significant Foreign Equity Investors, Securities Act Release No. 7118, Fed. Sec. L. Rep. (CCH) ¶ 72,444 (Dec. 13, 1994) (adoption).


37 Exchange Act §§ 12(a), (g), 15 U.S.C. §§ 78l(a), 78l(g); Rule 12g-1, 5 Fed. Sec. L. Rep. ¶ 26,826.

38 In 1963, the Commission's first draft of 12(g) as submitted to an industry liaison committee contained no exemption for foreign securities, though it would have given the Commission power to exempt foreign securities because of the difficulties of enforcement. See generally Richard M. Phillips & Morgan Shipman, An Analysis of the Securities Acts Amendments of 1964, 1964 DUKE L.J. 706, 754-762 (1964); Richard M. Buxbaum, Securities Regulation and the Foreign Issuer Exemption: A Study in the Process of Accommodating Foreign Interests, 54 CORNELL L. REV. 358 (1969); Richard A. Stephens, Reevaluation of Disclosure Requirements for Foreign Issuers: Securities Exchange Act of 1934, 45 GEO. WASH. L. REV. 494 (1977). The Commission accepted the committee's suggestion that this might result in disruption of the market for foreign securities while the Commission was considering the question of exemption. See 1 Investor Protection, Hearings on H.R. 6789, H.R. 6793, S. 1642 Before Subcomm. on
The Commission, in order to give itself time to study the problems involved in the coverage of foreign securities, temporarily exempted all foreign securities and certificates of deposit relating to them by Rule 12g3-1 until November 30, 1965. In November 1965, the Commission proposed a series of rules and forms reflecting the results of a study and the improvement it had found in the reporting of financial and economic information by foreign issuers. The proposed rules and forms would have affected not only foreign private issuers required to register under section 12(g), but also those with securities listed on an American exchange and those subject to the reporting requirements of section 15(d). The proposals would have had the following effects:

1. Because the registration of ADRs would have provided an investor with no significant information concerning the deposited securities or their issuers, and because the deposited securities would have had to be registered in any event whenever there would have been enough receipt holders to require registration of the receipts, ADRs would have been exempted from section 12(g) outright.

2. So would any class of securities of a foreign issuer with fewer than 300 holders resident in the United States.

3. North American issuers would have been treated precisely like U.S. issuers. This would have represented a continuation of the policy of treating those issuers like domestic companies as far as the 1934 Act is concerned—a policy "based upon the similarity between business and

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41 See Rule 12g5-1(b)(1), 5 Fed. Sec. L. Rep ¶ 26,830.
accounting practices in those countries and those in the United States, as well as upon the greater familiarity of nationals of such countries with U.S. requirements."

(4) All other foreign private issuers registering only under section 12(g) would have been permitted, in lieu of answering the items in a special registration form applicable to foreign private issuers listing on an American exchange, to supply certain information, documents, and reports that were (a) distributed to their security holders in practice, or (b) made public by the requirement of a foreign stock exchange on which their securities were traded, or (c) required by law to be made public abroad. And all foreign private issuers, whether registered under section 12(b) in connection with an exchange listing or registered under section 12(g) or subject to the reporting requirement under section 15(d), would have filed periodic information made public abroad in lieu of the annual reports required of domestic and other North American issuers.

(5) Certain foreign securities, though registered, would have been exempted from the proxy and insider trading provisions of the 1934 Act.

(6) A new rule under section 15(c)(1) would have required a broker or dealer to disclose to a customer that the issuer of the security being acquired had not been registered under section 12(g), if the issuer’s name had been included on a current list published by the Commission. Furthermore, U.S. "marketmakers" in securities included in the list would have been required by another new rule under section 17(a) of the Exchange Act to furnish to the Commission certain information concerning the issuers that came to their attention.

This set of proposals created a considerable furor. Both the Canadian and British governments objected to the State Department that the rules would violate international law. This was the conclusion reached also by the Committee on International Law of the Association of the Bar of the City of New York concerning foreign corporations without securities either listed or publicly offered in the United States. That committee quoted Chief Justice Marshall’s admonition that “an act of Congress ought never to

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44 Id. at 253.
be construed to violate the law of nations if any other possible construction remains.  

Among the many comments received by the Commission were not only suggestions that there would be technical difficulties in superimposing the requirements of the proposed rules on existing laws in the country of incorporation, but also complaints that application of the Exchange Act to foreign issuers would have the effect of retarding the adoption of improved corporate and securities laws abroad.  

In April 1967, the Commission adopted a considerably revised set of rules and forms. The new rules and forms reflected the Commission’s view that the continuing improvement in the quality of the information now being made public by foreign issuers, together with the improvement which may reasonably be expected to result from recent changes and current proposals for change in relevant requirements, warrants the provision of an exemption from section 12(g). The exception is for those foreign companies which have not sought a public market for their securities in the United States through public offering or stock exchange listing, and which furnish the Commission with information published abroad by the foreign companies pursuant to law or stock exchange requirements or which they send to their security holders. 

Under this revised scheme:

(1) American Depositary Receipts are exempted from section 12(g) outright as originally proposed.  

(2) Any class of securities of a foreign issuer (which is defined by Rule 3b-4 to mean a foreign government or political subdivision, a foreign national, or a corporation or other organization incorporated or organized under the laws of a foreign country) is likewise exempted, if it has fewer

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49 Rule 12g3-2(c), 5 Fed. Sec. L. Rep. (CCH) ¶ 26,829.
than 300 holders resident in the United States. The exemption continues until the next fiscal year end at which the 300 figure is exceeded.\textsuperscript{50}

(3) All other foreign private issuers except those that are essentially U.S. companies are exempted from the Securities Exchange Act by 12(g), if specified information is furnished to the Commission.\textsuperscript{51} The information that must be furnished to the Commission in order to obtain the exemption is limited to whatever during the last fiscal year has been made public by the issuer pursuant to the law of the country of its domicile, or in which it is organized, or by a stock exchange on which its securities are traded, or has been distributed to its security holders. Rule 12g3-2(b)(3) states that the information required to be furnished is information material to an investment decision such as "the financial condition or results of operations; changes in business; acquisitions or dispositions of assets; issuance, redemption or acquisitions of their securities; changes in management or control; the granting of options or the payment of other remuneration to directors or officers; and transactions with directors, officers or principal security holders."

The information may be furnished either by the issuer itself or by a government official or agency of the country of its domicile or organization.\textsuperscript{52} An English translation, or substantially equivalent English version, must be furnished only if one has been prepared, in which event the information or document in the original language may be omitted. The furnishing of any information or document is not an admission for any purpose that the issuer is subject to the statute.

The specified information, together with a list identifying it and stating when and by whom it is required to be made public or filed with a foreign exchange or distributed to security holders, must be furnished not later than the date on which a registration statement under section 12(g) would otherwise have to be filed. In addition, information of the specified categories that is made public during each subsequent fiscal year must be furnished "promptly" after it is made public, and a revised list reflecting any changes in the kind of information required to be published as specified in the list originally supplied must be furnished "promptly" after the end of any fiscal year in which the changes occur.\textsuperscript{53} Presumably for psychological reasons, it is required that the information furnished under section 12(g) be "promptly" filed. The purpose of this promptness requirement is to ensure that the information is available to potential investors as soon as possible. The requirement for promptness also serves to prevent the issuer from withholding information that might be material to an investment decision in an effort to avoid the disclosure requirements of the Securities Exchange Act.

\textsuperscript{50} Rule 12g3-2(a), id.
\textsuperscript{51} Rule 12g3-2(b), id.
\textsuperscript{52} Id.
\textsuperscript{53} Rules 12g3-2(b)(1)(iii)-(iv), id.
reasons, the Commission shifted from the special registration procedure it had originally proposed to the technique of a conditional exemption.

(4) In 1983, the Commission closed a loophole in its 1934 Act registration requirements by amending Rule 12g3-2 to provide that both securities traded on a national securities exchange and those traded in the NASDAQ over-the-counter quotation system would be required to register. Previously, foreign securities did not need to register if they were traded in NASDAQ without section 12 registration through use of the information supplying exemption of Rule 12g3-2. The Commission justified this amendment as consistent with its general approach that more demanding registration procedures could be applied to foreign private issuers whose securities were voluntarily traded in a United States market:

    In the past, foreign securities could be included in NASDAQ without the participation of the issuer; at present, however, the consent of the issuer is required before a foreign security can be quoted in NASDAQ. Accordingly the Commission believes that foreign securities included in NASDAQ should be regarded prospectively as voluntarily seeking U.S. trading markets, and hence should be denied the information-supplying exemption.

The section 12 registration requirement applied equally to foreign securities traded directly or in ADR form. At the same time, the Commission was sensitive to the overwhelming opposition to the rule change articulated by a large number of commentators. The Commission took the unusual step of applying the revisions prospectively, and indefinitely "grandfathering" securities traded in NASDAQ before October 5, 1983.

(5) Foreign private issuers listed on a United States stock exchange are required to register by section 12(b) of the 1934 Act. Foreign government issuers are afforded an exemption from the proxy and insider trading

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56 Id.
provisions of the 1934 Act. Non-Canadian foreign private issuers, however, are subject to the Foreign Corrupt Practices Act, and their registered equity securities are subject to the 1934 Act's tender offer provisions.

(6) The 1983 revision treated Canadian securities traded in NASDAQ differently from non-Canadian securities. Canadian securities quoted in NASDAQ on October 5, 1983, were entitled to an exemption from the twelve registration requirements but only until January 2, 1986. Since that date, all Canadian securities traded in NASDAQ have been required to register.

Generally, Canadian securities issuers are treated the same as domestic issuers. Canadian issuers listed on a national securities exchange, like domestic issuers, must register on Form 10 pursuant to section 12(b) and file periodic reports on Forms 10-K, 10-Q, and 8-K.

(7) The Commission decided not to adopt special rules with respect to brokers and dealers dealing in foreign securities, as it had originally proposed. But, it did say that in order to apprise brokers, dealers, and investors of the unavailability of information in the United States with respect to certain foreign issuers, it would from time to time issue lists of the kind it had published in August 1966, showing which issuers had furnished information voluntarily to the Commission. It added that, although no sanction would attach to any broker or dealer by reason of transactions in securities neither registered nor exempt, "the Commission expects that brokers and dealers will consider this fact in deciding whether they have a reasonable basis for recommending these securities to customers."

C. Offerings from the United States into a Foreign Country

Offerings can be made also in other countries—Canada figures prominently here—from the United States. Quite apart from the question of the applicability of the Canadian or other foreign counterparts of the SEC statutes, a question arises concerning the applicability of section 5 of the

59 See 10 LOSS & SELIGMAN, supra note 1, at 5022 (1993).
60 id. at 2161-262 (1990).
Securities Act when the inevitable use is made of the mails or the channels of foreign commerce in effecting offers, sales, or deliveries from the United States into the foreign country. The silence of the statute with respect to this problem suggests that the 1933 Act applies in all its universality. In the case of an offering made by an American corporation in both the United States and Canada, there will, of course, be registration. The practical question in that case concerns the applicability of those aspects of the 1933 Act that have to do with the method and time of making offers, sales, and deliveries. The answer is undoubtedly in the affirmative. Whether or not a Canadian court would entertain a statutory action for rescission or damages if personal jurisdiction over the defendant could be obtained in Canada, perhaps through some sort of substituted service, there is no reason to doubt that Canadian buyers could sue a U.S. corporation in the U.S. courts. Nor is there any reason to question the applicability of the fraud provisions of the 1933 and 1934 Acts to sales effected from the United States into a foreign country.

The troublesome question occurs in the case of an offering which is made exclusively to persons outside the United States, but which, whether it originates inside or outside the United States, involves some use of the U.S. mails or the channels of interstate or foreign commerce. To address this type of question, the Commission adopted Regulation S in 1990.

Regulation S as adopted has four provisions: (1) a general statement in Rule 901; (2) definitions in Rule 902; (3) an issuer safe harbor in Rule 903; and (4) a resale safe harbor in Rule 904. The general statement in Rule 901 employs a “territorial approach” in defining the terms “offer,” “offer to sell,” “sell,” “sale,” and “offer to buy” to include offers and sales that occur within the United States, and to exclude offers and sales that occur outside the United States. Both the issuer safe harbor in Rule 903 and the resale safe harbor in Rule 904 begin with two identical general conditions: “(a) The offer or sale shall be made in an offshore transaction. (b) No directed selling efforts shall be made in the United States by the issuer, a distributor,
any of their respective affiliates, or any person acting on behalf of any of the foregoing."66

An offshore transaction is defined in Rule 902(i)(l) to mean a transaction in which no offer is made to a person in the United States, provided that (A) the buyer, when the buy order originates, is outside the United States or reasonably believed by the seller to be outside the United States, or (B) the transaction is executed through the facilities of a designated offshore securities market as defined in Rule 902(a).67

“Directed selling efforts” are defined in Rule 902(b)(1) to mean:

any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered in reliance on this Regulation S. Such activity includes placement of an advertisement in a publication with a general circulation in the United States that refers to the offering of securities being made in reliance upon this Regulation S.68

68 There are several exceptions in Securities Act Rule 902(b):
Rule 902(b)(2) excepts advertisements required to be published under United States or foreign law.
Rule 902(b)(3) excepts contacts with persons excluded from the definition of “U.S. person” by Rule 902(o)(7) (development banks) or persons holding accounts excluded from the definition of United States person by Rule 902(o)(2) (essentially discretionary accounts, other than estates or trusts, held by a United States dealer or fiduciary).
Rule 902(b)(4) excepts certain “tombstone” advertisements, if they appear in publications less than 20% of whose circulation is in the United States.
Rule 902(b)(5) excepts prospective investor bona fide visits to U.S. real estate, plants, or other facilities.
Rule 902(b)(6) excepts U.S. distribution of a foreign broker-dealer’s quotations by a third-party system that distributes such quotations primarily in foreign countries as long as (i) securities transactions cannot be executed between the foreign broker-dealers and persons in the United States through the system, and (ii) the issuer, distributors, their respective affiliates, foreign broker-dealers, and system participants do not initiate contacts with U.S. persons or persons within the United States beyond the contacts exempted under Rule 15a-6, the SEC’s exemption for foreign broker-dealers.
The Regulation S adoption Release listed activities that could reasonably be expected to condition the market to include:

[a]ctivities such as mailing printed material to U.S. investors, conducting promotional seminars in the United States, or placing advertisements with radio or television stations broadcasting into the United States or in publications with a general circulation in the United States, which discuss the offering or are otherwise intended to condition, or could reasonably be expected to condition, the market for the securities purportedly being offered abroad . . . \(^{69}\)

The Commission did not intend an “isolated, limited contact” in the United States to constitute directed selling efforts that could result in loss of a safe harbor for the entire offering. Nor did the Commission intend generally to inhibit routine advertising and corporate communications. Preliminary Note 7 to Regulation S adds:

Nothing in these rules precludes access by journalists for publications with a general circulation in the United States to offshore press conferences, press releases and meetings with company press spokespersons in which an offshore offering or tender offer is discussed, provided that the information is made available to the foreign and United States press generally and is not intended to induce purchases of securities by persons in the United States or tenders of securities by United States holders in the case of exchange offers.\(^{70}\)

Similarly, Regulation S will not interfere with activities conducted outside the United States that are legal and customary in the foreign jurisdiction.\(^{71}\)

The issuer safe harbor in Rule 903(c) then contains additional conditions distinguishing among various classes of securities:

1. Securities of foreign issuers with no substantial U.S. market interest for their securities, securities offered and sold in overseas directed offerings, securities backed by the full faith and credit of a foreign

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\(^{69}\) Securities Act Release No. 6863, \textit{supra} note 65, at 80,668.

\(^{70}\) Securities Act Release No. 6863, \textit{supra} note 65, at 80,685.

\(^{71}\) Securities Act Release No. 6863, \textit{supra} note 65, at 80,670.
government, and securities offered and sold under specified employee benefit plans may be sold solely in compliance with the Rules 903(a)-(b) regarding offshore transaction and no directed selling efforts conditions. In each instance this safe harbor is justified by the likelihood that securities of foreign entities that do not have a substantial U.S. interest in their securities "may be expected to flow back or remain in their major or home market, and are not likely to flow into the United States following an offshore offering."72 "Foreign issuers with no 'substantial U.S. market interest' are eligible to rely on the first category of the issuer safe harbor, whether or not they are reporting under the Exchange Act, have securities listed on a U.S. exchange or quoted on NASDAQ, or sponsor an American Depositary Receipt ("ADR") facility."73

"Substantial U.S. market interest" is defined in Rule 902(n)(1) with respect to a class of an issuer's equity securities to mean:

(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 percent 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 percent 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.

With respect to an issuer's debt securities, Rule 902(n)(2) specifies that "substantial U.S. market interest" means:

(i) its debt securities and the securities described in Rule 903(c)(4)(i) and (ii), in the aggregate, are held of record by 300 or more U.S. persons;

(ii) $1 billion or more of: the principal amount outstanding of its debt securities, the greater of liquidation

72 Securities Act Release No. 6863, supra note 65, at 80,672.
73 Securities Act Release No. 6863, supra note 65, at 80,674.
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preference or par value of its securities described in Rule 903(c)(4)(i), and the principal amount or principal balance of its securities described in Rule 903(c)(4)(ii), in the aggregate, is held of record by U.S. persons; and

(iii) 20 percent 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 903(c)(4)(i), and the principal amount or principal balance of its securities described in Rule 903(c)(4)(ii), in the aggregate, is held of record by U.S. persons.

Under Rule 903(c)(1)(i), the issuer must be a foreign issuer that reasonably believes at the outset of the offering that:

(A) there is no substantial U.S. market interest in the class of securities to be offered or sold (if equity securities are offered or sold);

(B) there is no substantial U.S. market interest in its debt securities (if debt securities are offered or sold);

(C) there is no substantial U.S. market interest in the securities to be purchased upon exercise (if warrants are offered or sold); and

(D) there is no substantial U.S. market interest in either the convertible securities or the underlying securities (if convertible securities are offered or sold).

Rule 902(f)(1) defines “foreign issuer” to mean any issuer that is “(i) a foreign government; (ii) a national of any foreign country; or (iii) a corporation or other organization incorporated or organized under the laws of any foreign country.” However, under Rule 902(f)(2), an issuer other than a foreign government is not deemed a “foreign issuer” when:

(i) more than 50 percent of the outstanding voting securities of such issuer is held of record by persons for whom a U.S. address appears on the records of the issuer, its transfer agent, voting trustee, depositary, or person performing similar functions; and

(ii) any of the following factors are present:
(A) the majority of the executive officers or directors of the issuer are U.S. citizens or residents;
(B) more than 50 percent of the assets of the issuer are located in the United States; or
(C) the business of the issuer is administered principally in the United States.

Rule 903(c)(1)(ii) also permits securities to be offered or sold with no conditions other than those in Rules 903(a)-(b) when the securities are offered and sold in an “overseas directed offering.” Rule 902(j) defines “overseas directed offering” to mean:

(1) an offering of securities of a foreign 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
(2) an offering of non-convertible debt securities, or securities described in Rule 903(c)(4)(i) or (ii), of a domestic 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, provided that the principal and interest of the securities (or par value, as applicable) are denominated in a currency other than 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.

The adoption Release added:

Of particular importance in the concept of ‘overseas directed offering’ is the requirement that such offerlings be ‘directed’ at a single country. Where the foreign issuer, a distributor, any of their respective affiliates, or a person acting on behalf of any of the foregoing, knows or is reckless in not knowing that a substantial portion of the offering will be sold or resold outside
that country, the offering will not qualify as an overseas directed offering.74

(2) Securities of all domestic issuers that file reports under the Exchange Act are entitled to the Rule 903(c)(2) safe harbor as long as they comply with both Rules 903(a)-(b) and specified additional restrictions. First, “offering restrictions” must be implemented. Rule 902(h) defines “offering restrictions” to mean:

(1) each distributor agrees in writing that all offers and sales of the securities prior to the expiration of the restricted period specified in Rule 903(c)(2) or (3), as applicable, shall be made only: in accordance with the provisions of Rule 903 or Rule 904; pursuant to registration of the securities under the Act; or pursuant to an available exemption from the registration requirements of the Act; and

(2) all offering materials and documents (other than press releases) used in connection with offers and sales of the securities prior to the expiration of the restricted period specified in Rule 903(c)(2) or (3), as applicable, shall include statements to the effect that the securities have not been registered under the Act and may not be offered or sold in the United States or to U.S. persons (other than distributors) unless the securities are registered under the Act, or an exemption from the registration requirements of the Act is available.

Second, the Rule 903(c)(2) safe harbor requires compliance with “transactional restrictions.” The offer or sale, if made before the expiration of a forty day “restricted period,” is not made to a “U.S. person or for the account or benefit of a U.S. person (other than a distributor).”75

74 Securities Act Release No. 6863, supra note 65, at 80,674. Rule 903(c)(1)(iv), 2 Fed. Sec. L. Rep. (CCH) ¶ 5924, permits securities to be offered or sold with no conditions other than those in Rules 903(a)-(b) when the securities are offered to employees of the issuer or its affiliates under a foreign employee benefit plan, if specified conditions are satisfied.

75 Rule 903(c)(2)(iii), 2 Fed. Sec. L. Rep. (CCH) ¶ 5924.

“U.S. person” is defined in Rule 902(o). The adoption Release adds: “U.S. residency rather than U.S. citizenship is the principal factor in the test of a natural person's status as a U.S. person under Regulation S. Thus, for example, a French citizen resident in the United States is a U.S. person.” Securities Act Release 6863, supra note 61, at 80,676.
A further "transactional restriction" in Rule 903(c)(2)(iv) applies when each distributor selling securities to a distributor, a dealer (as defined in Section 2(12) of the Act) or a person receiving a selling concession, fee, or other remuneration in respect of the securities sold, prior to the expiration of a 40-day restricted period, sends a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to a distributor.

The adoption Release separately discussed ADRs:

[T]he Regulation as adopted focuses on the sale by a depositary of ADRs representing securities of the class distributed. Such sales are permitted if (1) the ADRs represent securities acquired by the depositary prior to the distribution, or (2) the depositary determines by examination of the certificate or other evidence that the security to be deposited is not subject to a restricted period and was neither borrowed nor deposited with the intention that it be replaced with securities subject to the restricted period.76

The general approach in Rule 902(c)(2) is to protect against an indirect U.S. unregistered public offering during the period the market is most likely to be affected by selling efforts abroad. "In the event flowback of reporting issuers' securities does occur after the restricted period, the information relating to such securities publicly available under the Exchange Act generally should be sufficient to ensure investor protection."77

(3) Rule 903(c)(3) establishes a residual category that includes nonreporting U.S. issuers and equity securities of nonreporting foreign issuers with a substantial U.S. market interest in their equity securities. All Rule 903(c)(3) securities must comply with Rules 903(a)-(b) and implement offering restrictions.

With respect to debt securities, there are two additional conditions:

"Restricted period" is defined generally in Rule 902(m) to mean a period that begins to run on the latter of the date of the closing of the offering or the date the first offer of the securities to persons other than distributors is made. id. at 80,677.

"Distributor" is defined in Rule 902(c) to mean "any underwriter, dealer or other person who participates, pursuant to a contractual arrangement, in the distribution of the securities offered or sold in reliance on this Regulation S."

76 Securities Act Release 6863, supra note 65, at 80,678.
77 Id. at 80,675.
(A) the offer or sale, if made prior to the expiration of a 40-day restricted period, is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and

(B) the securities are represented upon issuance by a temporary global security which is not exchangeable for definitive securities until the expiration of the 40-day restricted period and, for persons other than distributors, until certification of beneficial ownership of the securities by a non-U.S. person or a U.S. person who purchased securities in a transaction that did not require registration under the Act.\(^7\)

The debt security restrictions recognize that debt securities are generally sold in institutional markets and that flowback is less likely with debt securities than with equities.\(^7\)\(^9\) The same restrictions apply to nonconvertible, nonparticipating preferred stock and asset-backed securities.\(^8\)

With respect to equity securities, Rule 903(c)(3)(iii) applies a one year—rather than a forty day—restricted period and specifies four additional conditions:

(1) the purchaser of the securities (other than a distributor) certifies that it is not a U.S. person and is not acquiring the securities for the account or benefit of any U.S. person or is a U.S. person who purchased securities in a transaction that did not require registration under the Act;

(2) the purchaser of the securities (other than a distributor) agrees to resell such securities only in accordance with the provisions of this Regulation S, pursuant to registration under the Act, or pursuant to an available exemption from registration;

(3) the securities of a domestic issuer contain a legend to the effect that transfer is prohibited except in accordance with the provisions of this Regulation S; and

\(^7\)^9 Securities Act Release 6863, supra note 65, at 80,679.
(4) the issuer is required, either by contract or a provision in its bylaws, articles, charter or comparable document, to refuse to register any transfer of the securities not made in accordance with the provisions of this Regulation S; 
Provided, however, that if the securities are in bearer form or foreign law prevents the issuer of the securities from refusing to register securities transfers, other reasonable procedures (such as a legend described in Rule 903(c)(3)(iii)(B)(3) of this rule) are implemented to prevent any transfer of the securities not made in accordance with the provisions of this Regulation.

Distributors selling either debt or equity securities before the expiration of the relevant restricted period are required to send a confirmation or other notice to purchasers who are distributors, dealers, or persons receiving remuneration in connection with the sale.81

Regulation S concludes with a resale safe harbor in Rule 904. That Rule permits an offer or sale by any person other than the issuer, a distributor, or any other of their respective affiliates (with the significant exception of a person who is solely an officer or director) to be deemed to occur outside the United States if (a) the offer or sale is made in an offshore transaction, (b) there are no directed selling efforts in the United States, and (c) specified additional conditions are met.

D. Simultaneous Offerings in the United States and Abroad

If the present trend toward internationalization of the securities markets continues, it ultimately will become commonplace for securities to be distributed simultaneously in the United States and abroad. Nonetheless, this has proven so far to be the least developed aspect of U.S. extraterritorial securities regulation. As a first step toward the encouragement of multinational securities offerings, the Commission in February 1985, published a summary of a staff survey comparing the distribution systems and statutory and regulatory requirements of the United Kingdom and certain provinces

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of Canada with those in the United States for foreign issuers registering securities on Form F-1.82

The staff survey found several material differences:

- Canada and the United States were reported to have similar underwriting methods. Underwriting methods in the United Kingdom were strikingly different from those used in the United States and Canada.
- Substantial differences exist among the United Kingdom, Canada, and the United States with respect to required disclosure relating to the nature and character of the issuer, its business, and its management.
- Basic differences exist among the United Kingdom, Canada, and the United States in each jurisdiction's generally accepted accounting principles and in the requirements to reconcile financial statements of foreign issuers.
- Comparatively the United States has the most comprehensive liability provision concerning the sale of securities.

The Commission then requested comments on two conceptual approaches that would encourage multinational securities offerings. The first, or reciprocal approach, would require an agreement among the United States, Canada, and the United Kingdom (and potentially could be expanded to other jurisdictions) to adopt a system by which an offering document used by an issuer in its own country would be accepted for offerings in each of the other countries on the assumption that certain minimum standards were met. The primary advantage of the reciprocal approach is its simplicity. It basically accepts the offering documents of each of the participating countries. The basic disadvantage, particularly to United States investors, is that it would almost certainly provide less information than Commission enforcement of its current foreign issuer forms.

The alternative or common prospectus approach would require all three countries to agree on disclosure standards for an offering document that could be used in two or more of the participating countries. This approach, by harmonizing disclosure standards, would likely result in

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greater standardization than the reciprocal approach and would permit
greater ease of comparability of information between companies from
different countries. On the other hand, it is uncertain that a multinational
agreement could be negotiated and how it would handle such questions as
the review of filed documents (that is, whether a document filed in two or
more jurisdictions would be reviewed in each jurisdiction or only one).

In 1991, the SEC adopted a multijurisdictional disclosure system thus
far limited to Canada. Specifically, the Commission adopted rules, forms,
and schedules to facilitate both cross-border offerings of securities and
continuous reporting by specified Canadian issuers.

The Commission stated at the outset of its lengthy adoption Release
that "[w]hile Canada is the partner . . . in this inaugural multijurisdictional
disclosure initiative, . . . the Commission is continuing its work with securi-
ties regulators of other countries with a view toward extending the multiju-
risdictional disclosure system." This has proven to be a slow process. The United States has a larger
number (and larger percentage) of individual investors than any other
nation. Its securities law requirements are generally more demanding
because of the weaker ability of individual investors to bargain for the type
of information that in the United States is mandatorily disclosed.

At the same time, however, as other national securities markets
evolve, the ability of the SEC or Congress to insist on our securities regula-
tory requirements has lessened. It is inevitable neither that U.S. or foreign
issuers sell securities in the United States, nor that U.S. investors buy here.
Ultimately, the trend towards internationalization of securities transactions
may pose a type of "Hobson's choice" for U.S. securities regulation: either
protect individual investors by insisting on maintenance of traditional stan-
dards, with the risk that U.S. securities issuers will increasingly sell abroad
and foreign issuers will not sell here, or lessen the stringency of U.S. man-
datory requirements, with greater risks for individual investors. But this
type of choice so far has resulted in only limited significant changes in the
mandatory disclosure system. It is, as yet, uncertain whether foreign issuers
will generally comply with the more demanding U.S. disclosure require-
ments to secure access to our markets or the United States will need to

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83 Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting
(CCH) ¶ 84,812 (June 21, 1991).
84 Id. at 81,862.
sacrifice standards to ensure securities trading will remain here. Until this uncertainty is resolved, the evolution of a full multijurisdictional disclosure system will continue to proceed slowly.