Introduction

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1. Background

The US capital markets are the largest and most liquid in the world, and accordingly they attract companies from around the world seeking capital. Those international companies are referred to in the language of the US securities laws as 'foreign private issuers' – that is, non-US issuers of securities from the private sector. Although they are attracted by the abundance and variety of capital available in these markets, they must be prepared to bear the costs of accessing them. These costs include complying with the requirements of US securities laws. While these requirements may seem daunting, they are not insurmountable.

As of mid-2010, there were approximately 950 foreign private issuers from over 50 countries registered with the US Securities and Exchange Commission (SEC). During the period from 2006 to mid-2010, they raised approximately $97.5 billion in the US capital markets through registered public offerings of securities.[1] In addition, during that same period, approximately $1.8 trillion was raised by foreign private issuers through private unregistered placements of securities in the US capital markets.[2] In the following pages, we set out a guide to the regulation of foreign private issuers in the United States.

The following recent developments in US securities regulations should spark the interest of such issuers:

- amendments to Exchange Act Rule 12g3-2(b), which exempts the securities of qualifying issuers from registration with the SEC, allowing issuers to post the relevant information to their own websites instead of submitting it to the SEC;
- the elimination of the requirement to reconcile financial statements prepared in accordance with International Financial Reporting Standards (IFRS) with generally accepted accounting principles (GAAP) in the United States; and
- the simplification of the rules for deregistering securities from the Exchange Act reporting system and for delisting from a US national securities exchange.

In this book we also explore such controversial new developments as:

1 SEC Division of Corporation Finance, International Registered and Reporting Companies Market Summary (December 31 2009); Committee on Capital Markets Regulation, Update Competitiveness Measures Q2 2010 "Relative Size of the Private Rule 144A and Public Equity Markets" (September 22 2010).

2 US Private Placements Quarterly Review, Thomson Reuters Deals Intelligence (2006–2010).

- an economic cost-benefit analysis of the Sarbanes-Oxley Act – especially Section 404, which mandates internal controls over financial reports;
- the likely consequences of the Dodd-Frank Act of 2010, with its estimated 243 rule-making mandates and expansive delegation of authority by Congress to federal regulatory agencies; and
- more aggressive securities law enforcement by the SEC, especially the Foreign Corrupt Practices Act and such proceedings as SEC v Goldman Sachs.

This book covers the three types of securities – equity, debt and hybrid – issued in the United States by foreign private issuers that may be either publicly offered after registration with the SEC or privately placed without such registration.

1.1 US securities law framework

The SEC is a regulatory agency of the federal government that administers a number of statutes of US securities laws.[3] The two major statutes regulating securities are:

- the Securities Act of 1933, which principally governs capital-raising transactions involving the offer or sale of securities by issuers or underwriters; and
- the Securities Exchange Act of 1934, which principally addresses trading and markets, as well as reporting and other ongoing activities of publicly traded companies and broker/dealers.

On several occasions the US Congress has amended the statutes that comprise the federal securities laws to address perceived problems. Examples of amendatory legislation that are covered in some detail in this book are:

- the Private Securities Litigation Reform Act of 1995;
- the Sarbanes-Oxley Act of 2002; and
- the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

In this book we discuss recent developments in US federal securities laws in the context of a general review of the effects of SEC regulation and practice, with a particular focus on foreign private issuers (as defined below).

US securities laws define 'security' as:

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement …, or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[4]

The US Supreme Court has stated that the definition is "quite broad" and is

3 The SEC's website can be found at www.sec.gov. The website contains current and basic materials, including EDGAR filings.

4 Securities Act § 2(a)(1).

intended to include "the many types of instruments that in our commercial world fall within the ordinary concept of a security", including "stocks and bonds, along with the countless and variable schemes devised by those that seek the use of the money of others on the promise of profits".[5] Thus, the US securities laws define 'security' in both specific terms (eg, stock, bond, note, debenture) and general terms (eg, any investment contract or "instrument commonly known as a 'security'").

2. Regulation of foreign private issuers

2.1 Definition

The Securities Act and the Exchange Act use the term 'issuer' to describe any corporation or other person that issues or proposes to issue a security.[6] The regulations under both acts use the term 'foreign private issuer' to describe an issuer that is a citizen of a foreign country or a corporation or other organisation incorporated or organised under the laws of a foreign country (other than the foreign government itself and its political subdivisions).[7]

There is an exception to this definition for any company for which more than 50% of its outstanding voting securities are held by US residents and that either:

- has more than 50% of its assets located in the United States;
- is primarily governed by US officers or directors; or
- is principally administered in the United States.

In any of those cases, such a company is treated as a US domestic issuer. In calculating US resident holdings, shares of record held by brokers and other nominees but owned beneficially by a US resident are counted as owned by a US resident.[8] New SEC rules allow foreign private issuers to assess their status as such once per year on the last business day of their second fiscal quarter.[9]

2.2 Advantages of qualifying as a foreign private issuer

There is no general exemption from the US securities laws for foreign private issuers. If their securities are offered or traded in the United States, foreign private issuers need to concern themselves with the relevant laws.

The globalisation of the securities markets has led the SEC to accommodate foreign private issuers in several ways. For example:

- the SEC distinguishes between offshore securities offerings and those that are likely to have an impact on the US securities markets; under Regulation S, offshore offerings are exempt from Securities Act registration;
- if a foreign private issuer does not have securities listed on a US national securities exchange and has not registered an offering under the Securities

5 *Marine Bank v Weaver*, 455 US 551, 555–556 (1982).
6 Securities Act § 2(a)(4); Exchange Act § 3(a)(8).
7 Securities Act Rule 405; Exchange Act Rule 3b-4(c).
8 See Securities Act Rule 405 and Exchange Act Rule 3b-4(c) (both referring to Exchange Act Rule 12g3-2(a) for the method of computing ownership).
9 See SEC Release Nos 33-8959 and 34-58620, "Foreign Issuer Reporting Enhancements" (September 23 2008).

Act, the issuer may be able to avoid entering into the Exchange Act reporting system by furnishing home-country information on its website under exemptive Rule 12g3-2(b);

- if a foreign private issuer does enter into the Exchange Act reporting system, it may prepare its financial statements in accordance with US GAAP; principles that are generally accepted in its home country, subject to reconciliation to US principles; or IFRS as promulgated by the International Accounting Standards Board. In the latter case, so long as the accompanying auditor's report states that the financial statements are in compliance with IFRS there is no need for reconciliation to US principles;[10]
- a foreign private issuer has a longer period of time to file its Exchange Act annual reports than its US counterparts;[11]
- a foreign private issuer is exempt from a number of Exchange Act requirements applicable to US reporting companies, including:
  - those contained in the proxy rules;
  - the provisions of Section 16 for reports by officers and directors of their securities transactions and short-swing profit recovery; and
  - current and quarterly interim reporting obligations;[12]
- the SEC provides exemptions from Securities Act registration and the tender offer rules of the Exchange Act for business combinations, acquisitions and other transactions that are essentially foreign – that is, that involve foreign private issuers with limited numbers of US security holders;[13]
- the SEC has revised its foreign private issuer disclosure requirements under the Securities Act and the Exchange Act to conform to the international standards endorsed by the International Organisation of Securities Commissions;[14]
- the SEC has tailored some of its rules to the special circumstances of foreign private issuers and indicated it would continue to review their situation in its rule-making following the adoption of the Sarbanes-Oxley Act, even though this act did not exempt foreign private issuers from its requirements;
- many provisions for securities disclosure in the newly adopted Dodd-Frank Act expressly exempt or do not apply to foreign private issuers; and

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10 Form 20-F, Item 17(c). Note, however, that in 2008 the SEC modified Item 17 of Form 20-F to:
- eliminate the option for certain foreign private issuers to omit segment data from their US financial statements (effective for fiscal years ending on or after December 15 2009); and
- provide a limited reconciliation option with US GAAP (effective for fiscal years ending on or after December 15 2011).

See note 9.

11 In 2008, the filing deadline for foreign private issuers was accelerated from six months to four months after fiscal year-end (effective for fiscal years ending on or after December 15 2011). See note 9 and General Instruction A(b) to Form 20-F. For accelerated and large accelerated domestic filers the deadline is 75 days after fiscal year-end; for non-accelerated domestic filers it is 90 days. See General Instruction A to Form 10-K.

12 Exchange Act Rule 3a12-3(b) (Proxy statements and Section 16 provisions) (upheld in *Schiller v Tower Semiconductor Ltd*, 449 F.3d 286 (2d Circuit June 1 2006)); Exchange Act Rule 13a-11(b) (Current reporting obligations); Exchange Act Rule 13a-13(b) (Interim reporting obligations).

13 SEC Release No 33-7759, "Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings" (October 22 1999).

14 SEC Release No. 33-7745, "International Disclosure Standards" (September 28 1999).

- the SEC recognises that foreign private issuers may make new and different disclosures when they enter the US markets. They are invited to discuss compliance questions with the SEC's Office of International Corporate Finance if they plan to offer securities in the United States or plan to list on a US national securities exchange.[15]

3. Becoming subject to US securities regulation

A foreign private issuer may become subject to the same ongoing reporting requirements of the US federal securities laws as a US company:

- It may engage (or its existing security holders may engage) in a public offering of securities in the United States that requires registration under the Securities Act.
- It may have its securities listed on a US national securities exchange and, as a consequence, have to register the securities under the Exchange Act.
- It may have to register under the Exchange Act if its equity securities become owned by a sufficient number of US investors, unless it invokes the special foreign private issuer exemption of Rule 12g3-2(b).

Following any such Securities Act or Exchange Act registration, the issuer will enter into and remain indefinitely in the Exchange Act's periodic reporting system.

3.1 Securities Act of 1933

As mentioned above, the Securities Act[16] regulates the offer and sale of securities in public transactions. Speaking broadly, an issuer's offer or sale of its securities to the public in the United States requires:

- the filing of a registration statement with the SEC under the Securities Act;
- clearance of the registration statement by the staff of the SEC (unless review is dispensed with by the staff or by SEC rule); and
- distribution of a prospectus that contains extensive business and financial information regarding the issuer.

SEC rules specifically prescribe the contents of the registration statement and prospectus.

Registration of a public offering under the Securities Act subjects the issuer to the periodic reporting requirements of the Exchange Act, thus essentially continuing the type of public disclosure required in a Securities Act registration statement and prospectus.[17]

There are a number of exemptions from the requirement to register US securities offerings under the Securities Act. Some apply to certain types of securities (eg, commercial paper that meets certain standards)[18] and others apply to certain types of transactions, listed here:

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15 SEC, Division of Corporation Finance: International Reporting and Disclosure Issues, III-B (May 1 2001).
16 15 USC § 77a, *et seq*.
17 Exchange Act § 15(d).
18 Securities Act § 3(a)(3).

- **Private placements** – a major transactional exemption for issuers is the so-called 'private offering' or 'private placement' exemption, which accounts for a large portion of US securities transactions. In such a transaction, a group of sophisticated investors (eg, insurance companies, investment funds, banks and other institutions) may be treated as private (ie, non-public) investors that do not need the protection of the Securities Act; and an offering confined to such a group – if not accompanied by any general solicitation or general advertising – need not be registered.
- **Rule 144A** – offerings through securities firms, acting as initial purchasers, that are directed at 'qualified institutional buyers', are specifically exempted from Securities Act registration by the SEC's Rule 144A.
- **Offers to employees** – the offer and sale of securities to employees by an issuer is not subject to the reporting requirements of the Exchange Act.

An issuer making an exempt offering does not automatically become subject to the periodic reporting provisions of the Exchange Act, as would be the case with an issuer making a registered public offering. However, an exempt offering may only defer these ongoing reporting obligations. As discussed below, resales may trigger them.

The acquisition of a publicly held company made, in whole or in part, through shares of a foreign private issuer constitutes an offering to any US shareholders of the acquired company and, depending on the number of US shareholders, may require registration under the Securities Act.[19] As discussed in "International offerings with US participants", certain M&A transactions involving foreign private issuers whose US shareholders do not hold more than 10% of the subject class (as calculated in accordance with the SEC's rules) are exempt from Securities Act registration. The acquisition of a closely held US company for shares of a foreign private issuer may also constitute an offer to the public and require registration under the Securities Act. However, these transactions can frequently be structured as a private offering. The observations made above regarding Exchange Act reporting apply here too.

There are two circumstances under which a sale to the public by an existing holder of an issuer's securities (a so-called 'secondary offering') may require registration under the Securities Act, similarly to a 'primary' public offering. Unless exempted under the conditions discussed in Chapter III below:

- registration will be required where such public sale is made by an affiliate of the issuer – that is, a person who "controls, or is controlled by, or is under common control with" the issuer; and
- the sale must be registered if the holder acquired the securities in an unregistered transaction from the issuer (or an affiliate) with a view to their distribution to the public – even if the selling security holder is not an affiliate of the issuer – thus making the seller an underwriter within the broad definition of that term in the Securities Act.

19 Securities Act Rule 145 Preliminary Notes.

Any such registration would involve an issuer registration statement identical, with regard to issuer business and financial disclosure, to a registration statement for an issuer public offering, and would similarly subject a non-reporting issuer to the Exchange Act reporting system.

3.2 Securities Exchange Act of 1934

As mentioned above, the Exchange Act[20] governs the secondary trading of securities after their initial issuance and offering. Issuers become subject to the reporting requirements of the Exchange Act in three principal ways:

- through a registered public offering under the Securities Act,;
- by listing a class of securities on a national securities exchange; or
- by exceeding a certain threshold number of equity security holders and total assets.

(a) Securities Act registration

Registration of a public offering of securities under the Securities Act requires the issuer to enter the Exchange Act reporting system by registering under that Act as well.

(b) Listing on national securities exchanges

An issuer wishing to list a class of its securities on a US national securities exchange, such as the New York Stock Exchange or NASDAQ Stock Market, must register the security under the Exchange Act by filing the appropriate registration statement with the SEC.[21] Although an Exchange Act registration statement is not the same as the registration statement required by the Securities Act in connection with an issuer's public offering and is not distributed in the fashion of an offering prospectus, it contains comparable business and financial information, is subject to SEC staff review and is publicly available. If filed at or about the time of a public offering under the Securities Act, it is often simplified by the incorporation of required business and financial information by reference to the Securities Act registration statement.

An Exchange Act registration will subject the issuer to the ongoing periodic reporting requirements of that act,[22] if it has not already become subject to such requirements through Securities Act registration. In addition, listing will bring the issuer under various requirements of the exchange on which it lists.

The conditions to a foreign private issuer listing on a US national securities exchange will depend upon meeting the eligibility requirements of the particular exchange. Typically, these will include having a minimum number of publicly held shares and meeting specified minimum financial criteria.

(c) Exceeding the threshold number of equity security holders

Even if an issuer has never registered an offering under the Securities Act and has not

20 15 USC § 78a, *et seq.*
21 Exchange Act § 12(b); Exchange Act Regulation 12B (Rules 12b-1 – 12b-37).
22 Exchange Act § 13(a).

listed its securities on a US national securities exchange, it may have accumulated a number of shareholders that is sizeable enough to require Exchange Act registration under a separate provision of that act.

The Exchange Act requires the registration of an equity security of an issuer under that act if:

- in the case of a foreign private issuer, the class of security is held by at least 500 persons, of which at least 300 are resident in the United States; and
- the issuer has over $10 million in total assets.[23]

The application to register must be filed within 120 days of the end of the first fiscal year in which the issuer reaches the threshold.[24] In calculating whether there are 300 or more US holders, a foreign private issuer must include US resident beneficial owners of shares held of record by nominees.[25] Unregistered resales of equity securities that are originally issued outside the United States or in private or other exempt offerings within the United States may in time result in a foreign private issuer reaching this 300-holder level, especially where significant US market interest in the issuer develops.

A foreign private issuer may invoke exemptive Exchange Act Rule 12g3-2(b), discussed in "Periodic reporting requirements", to avoid such registration and subsequent Exchange Act reporting obligations. Under this exemption the issuer is required to make public electronically an English language version of its home country reports in lieu of filing periodic Exchange Act reports with the SEC.

If a foreign private issuer does not resort to Rule 12g3-2(b), Exchange Act registration and subsequent periodic reporting requirements will be the same as where a class of security is issued in a registered public offering or listed on a US national securities exchange.

23 Exchange Act § 12(g); Exchange Act Rules 12g-1 and 12g3-2.
24 Exchange Act § 12(g).
25 Exchange Act Rules 12g3-2(a) and 12g5-1.