U.S. Regulation of the International Securities and Derivatives Markets, § 3.01, INTRODUCTION

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 3.01 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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In the early 1990s, when the first edition of this book was published, many foreign companies, [1] including many large companies, sought to undertake public offerings or exchange listings or otherwise access the public capital markets in the United States. This phenomenon continued and even accelerated for many years.

However, more recently, and especially since the passage of the Sarbanes-Oxley Act in 2002, there have been at least four major shifts in the way that foreign companies and investors consider global capital pools and flows and global financial markets. These shifts all affect the U.S. capital markets. First, the locus of capital has become far more diversified across the globe, with important potential investors located throughout the world, in Europe, Asia, the Middle East and Latin America, as well as North America. As a result, accessing capital in the United States is less important than it used to be. Second, and related to the first, exchanges and markets outside the United States have become deeper and more liquid, in Asia and Latin America as well as Europe. So for at least some foreign issuers, a U.S. listing may not add a major additional source of liquidity, and for investors, at least some local markets outside the United States provide sufficient liquidity to support their investment. In these cases, the additional liquidity, if any, provided by U.S. markets or exchanges (or other major international markets, such as London) is therefore no longer necessary. Third,

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investors perceive that global accounting, financial and other disclosure standards and trading market quality and integrity have improved in many markets to the point where, as in the case of market liquidity, a listing in the United States, and compliance with its standards, is no longer essential. There is a view that, with global institutional investor pressure and vigilance, local markets outside the United States are not only sufficiently deep and liquid but also sufficiently open and honest to support significant investment. And fourth, at the same time as the advantages to foreign companies of accessing U.S. markets have become less clear, heightened U.S. regulatory burdens, initiated by the Sarbanes-Oxley Act and the Dodd-Frank Act, have increased the apparent disadvantages of accessing the U.S. capital markets in a manner that requires registration or reporting under the U.S. securities laws, and the resultant entanglements with U.S. regulations.

The Sarbanes-Oxley Act reflects the U.S. approach to regulating foreign issuers present in or wishing to access the U.S. market—that is, national treatment. The same rules apply to domestic and foreign issuers. With very limited exceptions, there is no deference to the regulatory requirements of the home country in the case of foreign issuers, whether or not there is a conflict with the home country regulatory regime.

An alternative to the national treatment model is mutual recognition or a finding of equivalency, in which case the United States as host country would rely on, and defer to, the regulatory requirements of the home country. As we discuss in Chapter 13, the United States implemented a Multi-Jurisdictional Disclosure System with Canada, implementing mutual recognition between the two countries. Canadian and U.S. companies as a result can use their home country disclosure documents when raising capital in the host country and can comply with the periodic disclosure requirements of the home country.

However, the United States has not pursued this approach with Europe or other key markets with respect to capital raising, [2] except insofar as it revised the requirements applicable to foreign issuers in Form 20-F, incorporating international standards, and it allowed foreign issuers to use International Financial Reporting Standards in connection with listings or capital raising. Rather, the United States continues to set and revise the ground rules for access to the U.S. capital markets and generally does not defer to the home country. [3]

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While the environment has changed dramatically both within and outside the United States, a foreign company's determination as to whether and how to approach the U.S. markets, as always, depends principally on the company's objectives. These objectives can include one or more of the following:

- raising capital in the United States (separately or as part of a larger global offering);
- entering the U.S. public market to facilitate the use of its securities as consideration for an acquisition from U.S. securityholders;
- obtaining a U.S. exchange listing [4] to broaden its trading market, especially where its local market cannot support global trading or does not satisfy investors' standards;
- taking a less extreme step to broaden its trading market by facilitating over-the-counter trading in the United States; or
- seeking to obtain valuations or analyst coverage that may accompany listing on a U.S. exchange.

The various choices open to foreign issuers can be taken one-at-a-time; they can be viewed as possible incremental steps towards accessing the U.S. markets; and no one choice precludes a different choice in the future.

The principal source of capital in the United States and globally for most foreign issuers, as for most U.S. issuers, is institutional investors. In recent years,

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against the backdrop of the changes in U.S. and global markets described above, foreign issuers that have an adequate local market and seek to raise capital in the United States have in a majority of cases attracted U.S. institutional investors in private offerings without a U.S. listing or extending their offering to the U.S. public market. That approach, which does not require registration of an offering of securities with the SEC or ongoing compliance with U.S. reporting requirements, is described in Chapter 7. In the case of an unregistered private offering accompanying a non-U.S. offering, the issues relating to the non-U.S. offering are discussed in Chapter 8. Any of the other options for accessing the U.S. markets enumerated above, other than facilitating over-the-counter trading in the United States, [5] requires registration of the issuer's securities under the Exchange Act and, in the case of a public offering in the United States, the registration of the transaction with the SEC under the Securities Act.

The relative benefits of accessing the U.S. public markets have become fact-specific and require analysis of the circumstances of particular issuers and particular offering strategies. There is a clear perception that in some cases the benefits do not justify the burdens. [6] Consistent with the market changes enumerated above, a few factors do appear to be noteworthy, including the following:

- Accessing the U.S. public markets and registering securities under the Exchange Act involves a number of complex steps. The legal and regulatory risks and burdens to which a company and certain of its officers become subject by virtue of Exchange Act registration are significant and have increased in recent years.

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- As noted above, global institutional investors have been increasingly willing to invest in securities of issuers from certain markets that do not have a U.S. listing, or even any secondary listing in an international market center. [7]

- Significant numbers of high-tech foreign issuers continue to undertake public offerings and list in the United States and register under the Securities Act and the Exchange Act. [8]
- There seems to be a general consensus, although not unanimity, that valuations remain higher for companies with U.S. listings. [9]

As to the first point, U.S. disclosure and accounting requirements are more onerous in most cases than the requirements imposed by the foreign company's domestic regulator or market. Moreover, the effort and expense required to list or publicly offer securities in the United States can be significantly greater than for listings or public offerings in other markets. Furthermore, there is no assurance that creating an ADR program in the United States—even a listed program—will actually result in significant U.S. trading or that securities offered in the United States will stay there and not flow promptly back into the home market (assuming the issuer has a home market listing as well), thus frustrating an issuer's possible goal of expanding its shareholder base through the creation of an active U.S. secondary market. Once public, additional disclosure or other obligations not in effect at the time of the offering may be imposed, as exemplified by the Sarbanes-Oxley Act. Finally, there is a general belief among many that the litigation, enforcement and liability risk that accompanies U.S. offerings or listings is higher than in other jurisdictions.

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The acuteness of the burdens of Exchange Act registration increased with the enactment of the Sarbanes-Oxley Act, the consequences of which included the following: [10]

- significant changes in the regulation of independent auditors and the environment for audits;
- addition of significant disclosure requirements;
- requirements for the assessment by management and attestation by independent auditors of the effectiveness of internal control over financial reporting; [11]
- imposition of new independence standards and requirements on audit committees; and
- increased attention on the responsibility of principal executive officers and principal financial officers for the disclosure and controls of their companies. [12]

In addition and of particular significance for foreign issuers, the U.S. Congress in passing the Sarbanes-Oxley Act made essentially no provision for foreign issuers and gave the SEC essentially no particular authority to treat foreign issuers differently in making rules to implement the Sarbanes-Oxley Act. As a result, while the SEC did make some significant concessions for foreign issuers (for example, in crafting the requirements for audit committees), the basic contours of the Sarbanes-Oxley Act and the rules thereunder apply to foreign as well as U.S. issuers. Perhaps most importantly, the Sarbanes-Oxley Act may have led to the realization for the first time among foreign issuers generally that the U.S. legal and regulatory system, and the political system in particular, could impose new and greater requirements on foreign issuers than their home or other jurisdictions. Both the additional requirements and the psychological impact of the passage of the Sarbanes-Oxley Act have affected the calculus of foreign issuers in deciding whether to access the U.S. public markets.

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The Dodd-Frank Act, while some of its provisions provided exemptions for foreign issuers, also imposed some additional requirements on foreign issuers. For example, foreign issuers are subject to the conflict minerals and resource extraction payments disclosure requirements imposed by Dodd-Frank as discussed in Chapter 4. On the other hand, foreign issuers are exempt from compensation committee adviser rules applicable to U.S. companies. The SEC has completed rulemaking or has proposed rulemaking relating to nearly all Dodd-Frank imposed mandates. [13]

While the Sarbanes-Oxley Act and the Dodd-Frank Act have added to the burdens of foreign issuers in the U.S. public markets, it is also true that the SEC has taken steps that could alleviate some of the burdens for foreign issuers that access the U.S. public markets. In particular, first, the SEC in March 2007 adopted amendments to its rules making deregistration for foreign issuers under the Exchange Act considerably less onerous. [14] The SEC clearly intends not only to make it easier for a foreign issuer to deregister and leave the public markets of the United States, but also seeks to make it more attractive for a foreign issuer to enter the U.S. public markets by making it easier for it to leave if the entrance is not successful in achieving the issuer's aims. [15]

Second, the SEC in 2007 adopted amendments to its rules under which it would accept from foreign companies financial statements prepared under International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (the "IASB") without requiring reconciliation to United States generally accepted accounting principles ("U.S. GAAP"). [16] As discussed in § 4.05[1], these reconciliation requirements were in the past among the most onerous burdens for foreign companies accessing the U.S. public markets. [17]

Finally, in June 2005, the SEC adopted the most significant changes in decades to the securities registration and public offering rules under the Securities Act (the "Securities Offering Reforms"). [18] The reforms build on the existing integrated disclosure and shelf registration systems to achieve the SEC's goals

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of modernizing and liberalizing the securities offering and communications processes without compromising investor protection. The reforms have accomplished the following:

- facilitated greater availability of information to investors and the market;
- eliminated barriers to open communications;
- reflected the increased importance of electronic dissemination of information, including the use of the Internet;
- made the capital formation process more efficient; and
- clarified the timing of disclosure liability. [19]

The SEC's reforms were also motivated by its desire to attract a greater volume of transactions by both U.S. and foreign issuers to the U.S. public market through registration. By providing greater flexibility for registered offerings, the reforms aim to reduce reliance on unregistered offerings, particularly unregistered offerings to large institutional investors facilitated by Rule 144A under the Securities Act.

One cornerstone of the reforms was the creation of a new category of issuers referred to as "well-known seasoned issuers" or "WKSIs." A WKSI, as discussed in more detail in § 3.02[3][a][ii], is in general terms a company that has been reporting on a timely basis under the Exchange Act for one year and has public market float not held by affiliates of its common equity of at least $700 million or the foreign currency equivalent. [20] An issuer meeting the requirements for WKSI status, including a foreign issuer, is eligible for "automatic shelf registration," a simpler and more flexible registration process that assures that registered offerings can proceed without SEC review. The ease of market access under automatic shelf registration significantly exceeds that available elsewhere in the global capital markets To the extent that public offerings under automatic shelf registration provide advantages for foreign issuers, this factor may become part of the calculus for a foreign company as to whether it should enter the U.S. public markets and especially, if it is already registered and reporting under the Exchange Act, whether it should maintain that status. [21]

In 2013, Congress passed the Jumpstart Our Business Startups Act (the "JOBS Act"). The JOBS Act is intended to facilitate capital formation in a

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variety of ways—including by making the IPO process less burdensome for "emerging growth companies" ("EGCs"), a new class of issuer including currently private companies with annual revenues of less than $1 billion. [22] The JOBS Act provides relief from some SEC disclosure requirements for an EGC's IPO and for its ongoing reporting for up to five years. The most important relief for foreign issuers is that (a) an EGC is permitted to provide only two years (rather than three) of audited financial statements, and only those two years (rather than five) as selected financial data, in its IPO, and (b) an EGC does not have to provide an independent audit of its assessment of its internal control over financial reporting.

The JOBS Act provides for SEC review of an IPO registration statement of an EGC to remain confidential until 15 days before the road show begins. The SEC already allows confidential review for a foreign issuer that meets certain requirements, [23] and that practice continues for a foreign issuer that meets those requirements and does not file as an EGC. The JOBS Act also permits certain pre-filing and post-filing communications with investors by an EGC, or by a person authorized to act on the EGC's behalf, to determine whether such investors have an interest in a contemplated securities offering. [24]

Notwithstanding these recent developments, given the increased commercial and regulatory quality of non-U.S. markets and the ability of foreign issuers to reach U.S. institutional investors successfully without accessing the U.S. public markets, the extent to which foreign issuers, in particular those outside the technology sector, list on U.S. exchanges and access the U.S. public markets has declined since it peaked in 2001. [25]

Nonetheless, foreign companies continue to make initial offerings and list on exchanges in the United States and maintain such listings, with U.S. exchanges ranking third behind Asia-Pacific exchanges and European exchanges in terms of funds raised in global IPOs in 2015 and the first three quarters of 2016. [26] Although the number of foreign reporting companies continues to

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decline, especially following the adoption of the rules easing requirements for deregistration, the majority of foreign companies that were reporting companies under the Exchange Act at the time of the adoption of the Sarbanes-Oxley Act continue to be Exchange Act reporting companies. [27]

For those foreign companies seeking access to U.S. trading markets, public secondary trading of equity securities [28] in the United States takes place in two principal types of markets: (i) the securities exchanges (the New York Stock Exchange ("NYSE") [29] and Nasdaq, [30] and various regional or other smaller stock exchanges), and (ii) over-the-counter ("OTC") markets including the "electronic bulletin board" operated by FINRA (the "OTC Bulletin Board") [31] and a separate

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OTC market for which certain price information is reported in the "pink sheets." [32]

Listing securities on an exchange requires the issuer's participation and compliance with the relevant listing requirements (including eligibility criteria) of the exchange. [33] It also involves the preparation and filing with the SEC of a registration statement under the Exchange Act, a substantial document setting forth information and financial statements required by detailed SEC rules. Registration under the Exchange Act also triggers requirements to comply with the Sarbanes-Oxley Act and the Dodd-Frank Act. [34] The listing process is discussed in § 3.03, and exchange listing rules applicable to listed foreign issuers are discussed in Chapter 5.

Commencement of secondary trading in the pink sheet OTC market can be accomplished more easily. There are no listing requirements for securities to trade in the pink sheets, and a foreign issuer need not register such securities under the Exchange Act so long as it is exempt from the registration requirements

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of the Exchange Act pursuant to Rule 12g3-2(b) thereunder by, among other things, making available on its website in English certain information. [35] Trading can even start without the issuer's involvement. [36]

A foreign company can go further than facilitating secondary market trading and carry out a public offering to raise capital in the public markets in the United States. This step involves registration of the offering under the Securities Act. Usually, in the case of an equity offering, the securities will at the same time be listed on an exchange, and the listing is subject to a registration requirement under the Exchange Act, which involves a technically separate step that is procedural but not substantive.

If a foreign issuer, particularly one that is already public in another market, follows the two-step process of doing a listing first, followed by a public offering, the existence of the listing will reduce the time pressure on the offering process, and if sufficient time elapses between the two steps, the company may become eligible to use short-form Securities Act registration statements for its offerings. [37] These short-form registration statements incorporate by reference the information about an issuer that is filed with the SEC under the Exchange Act as a consequence of listing and thus facilitate Securities Act registration. The company may also become eligible to use shelf registration, which substantially expedites the offering process, or automatic shelf registration, which goes further to permit immediate U.S. public market access. [38] Securities Act registration of a public offering in the United States is discussed in this Chapter 3, and related disclosure and accounting issues are discussed in Chapter 4.

Footnotes

1 Unless otherwise indicated, references to foreign companies or foreign issuers in this book refer to "foreign private issuers" as such term is defined under the Securities Act and the Exchange Act. A corporation incorporated or organized under the laws of a foreign country is a "foreign private issuer" unless (i) more than 50% of its outstanding voting securities are directly or indirectly owned by residents of the United States and (ii) (a) the majority of its executive officers or directors are U.S. citizens or residents, (b) more than 50% of its assets are located in the United States, or (c) its business is administered principally in the United States. *See* Rule 405 under the Securities Act and Rule 3b-4 under the Exchange Act. For discussion of the application of the definition of "foreign private issuer" in certain circumstances, *see* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Exchange Act Rules, Questions 110.02–110.08 (Dec. 8. 2016).

As a result of the reference in clause (i) above to the "indirect" ownership of voting securities, an issuer is required to take account of beneficial ownership reports provided to it or publicly filed (in the United States or other jurisdictions) and to "look through" the record ownership of brokers, dealers, banks and nominees located in the United States, in the issuer's home jurisdiction or in the primary trading market for the issuer's securities to determine the residency of their client beneficial owners. These brokers, dealers, banks or other nominees may be unwilling or unable to provide information about their client accounts, and if the issuer is unable to obtain this information after reasonable inquiry or if the cost of obtaining it is unreasonable, the issuer may assume that the beneficial owners are resident in the jurisdiction where the nominee has its principal place of business. *See* SEC Release No. 33-7745 (Sept. 28, 1999). If a foreign company does not qualify as a "foreign private issuer," it is subject to the provisions of the U.S. securities laws applicable to U.S. issuers.

2 The United States has entered into an agreement with Australia utilizing mutual recognition not in the context of capital raising but rather regulation of financial intermediaries. It provides broker-dealers and stock exchanges access to cross-border investors relying on home country regulation, but it has not been taken advantage of by any market participants.

3 The European Union ("EU"), in contrast, has been more open to regulatory approaches that include elements of mutual recognition. The EU does not rely solely on national treatment in addressing non-EU issuers and other institutions; rather, if the EU finds the regime of a home country "equivalent," it is willing to defer to the home country regime, though activity taking place in an EU jurisdiction will be subject to the liability standards of that jurisdiction. If equivalency is not established, then the national treatment model applies. Equivalency may be important in implementing Brexit, if the United Kingdom ceases to remain a member of the EU single market. A determination of equivalency in particular areas, largely on the basis of UK regulatory structures put in place while the United Kingdom was part of the EU, could give the United Kingdom access to the single market in those areas. The outcome remains altogether uncertain, however, as does the prospect that an equivalency-based mutual recognition regime between the EU and the United Kingdom could provide an impetus for the United States to explore such a regulatory approach in the future.

4 The principal U.S. markets for foreign issuers have been the New York Stock Exchange, discussed in §

3.03[2][b], and Nasdaq, discussed in § 3.03[2][c]. Until 2006, Nasdaq was an automated inter-dealer quotation system, and was not registered as a national securities exchange under the Exchange Act. However, on January 13, 2006, the SEC approved the application of Nasdaq to register the Nasdaq Stock Market LLC, a wholly owned subsidiary of Nasdaq, as a national securities exchange. SEC Release No. 34-53128 (Jan. 13, 2006). Furthermore, on June 30, 2006, the SEC approved certain changes to the rules of the NASD, the predecessor of the Financial Industry Regulatory Authority, Inc. ("FINRA"), to reflect Nasdaq's separation from the NASD (and now FINRA) as a result of its status as a national securities exchange. On August 1, 2006, Nasdaq began operating as an exchange in Nasdaq-listed securities and, on February 12, 2007, it began operating as an exchange in non-Nasdaq listed securities. Exchange registration gives Nasdaq its own Self Regulatory Organization, or SRO, license. *See* SEC Release No. 34-54084 (June 30, 2006).

5 Facilitating such trading generally involves the establishment of an unlisted American Depositary Receipt program. As discussed in § 3.04[1], ADR programs are formally created, and the ADRs are issued, by commercial banks acting as depositaries. Frequently, where an issuer sponsors an ADR program, the depositary bank may agree to bear part of the expense. ADR programs can also be established by a broker-dealer without the issuer's involvement (so-called "unsponsored programs"). Such programs and their impact on issuers are also discussed in § 3.04.

6 *See* Craig Doidge *et al.*, *The U.S. Listing Gap*, Fisher College of Business Working Paper No. 2015-03-07 (2015); Nicholas Calcina Howson, *et al.*, *Reverse Cross-listings – The Coming Race to List in Emerging Markets and an Enhanced Understanding of Classical Bonding*, 47 CORNELL INT'L L.J. 607 (2014); Marlin R.H. Jensen, *et al.*, *When IPOs Migrate*, 4 ACAD. OF ECON. & FIN. J. (2013). Additionally, there seems to be little dispute that the largest and highest profile global offerings, such as large state privatizations, have proceeded without U.S. listings and Exchange Act registration, even while they are accompanied by offerings to U.S. institutional investors. *See* Christopher Hung Nie Woo, *United States Securities Regulation and Foreign Private Issuers: Lessons from the Sarbanes-Oxley Act*, 48 AM. BUS. L.J. 119 (2011); *see also Interim Report of the Committee on Capital Markets Regulation*, 29–38 (Nov. 30, 2006).

7 For example, the state privatizations of Industrial & Commercial Bank of China and Bank of China proceeded with no listing in the United States, and these offerings also had no listing in London, but only in Hong Kong. In 2010, the $22.1 billion initial public offering ("IPO") of Agricultural Bank of China Ltd. proceeded with listings only in Hong Kong and Shanghai. Similarly, the $7.4 billion IPO of the Postal Savings Bank of China in 2016 and the $4.5 billion IPO of Nets A/S opened with listings only in Hong Kong and Nasdaq Copenhagen, respectively. Each of these offerings included a significant placement to U.S. institutional investors and to other global institutional investors. In recent years, Latin American issuers have also increasingly opted for local initial public offerings with a significant placement to the U.S. institutional investors but without registration in the United States.

8 For example, the $25 billion IPO of the Chinese ecommerce company Alibaba, the largest IPO to date, listed on the NYSE.

9 *See* Nicholas Calcina Howson, *et al*. *Reverse Cross-listings – The Coming Race to List in Emerging Markets and an Enhanced Understanding of Classical Bonding*, 47 CORNELL INT'L L.J. 607 (2014); Christopher Hung Nie Woo, *United States Securities Regulation and Foreign Private Issuers: Lessons from the Sarbanes-Oxley Act*, 48 AM. BUS. L.J. 119 (2011).

10 The JOBS Act, discussed below, provides some lessening of the burdens introduced by the Sarbanes-Oxley Act for certain smaller issuers.

11 As discussed in § 5.04[2][a], Note 140 the requirement for an auditor attestation has been eliminated for smaller companies, including smaller foreign companies, by the Dodd-Frank Act.

12 The Sarbanes-Oxley Act is discussed in Chapter 5, *see* § 5.04[2] (describing the requirements for internal control over financial reporting and related required officer certifications), § 5.02[2] (setting out the independent audit committee obligations imposed by § 301 of the Sarbanes-Oxley Act on issuers with securities listed on a U.S. national securities exchange) and § 5.03 (detailing provisions of the Sarbanes-

Oxley Act regulating auditor independence, auditor reports to audit committees, expanded disclosure of principal accountants' fees and audit committee actions and the retention of records relevant to audits and reviews).

13 *See generally* Chapter 4 for descriptions of these provisions.

14 *See* SEC Release 34-55540 (Mar. 27, 2007). *See* § 4.11[2][a] for a discussion of requirements for termination of Exchange Act registration under Rule 12h-6 under the Exchange Act; *see also* Rule 12h-6).

15 Christopher Cox, SEC Chairman, Opening Statements at the SEC Open Meeting (Dec. 13, 2006); *see also* SEC Release No. 34-55540 (Mar. 27, 2007). *See also* Steven M. Davidoff, *Rhetoric and Reality: A Historical Perspective on the Regulation of Foreign Private Issuers*, 79 U. OF CINCINNATI L. REV. 619, 635–37 (2010).

16 *See* SEC Release 33-8879 (Dec. 21, 2007).

17 *See* Steven M. Davidoff, *Rhetoric and Reality: A Historical Perspective on the Regulation of Foreign Private Issuers*, 79. U. OF CINCINNATI L. Rev. 619, 639–43 (2010).

18 SEC Release No. 33-8591 (July 19, 2005) (the "Securities Offering Reform Release"); *see also* SEC Release No. 33-8501 (Nov. 3, 2004); SEC Release No. 33-7606 (Nov. 3, 1998), as amended by SEC Release No. 33-7606A (Nov. 13, 1998).

19 The SEC's actions relating to liability as part of these reforms are discussed in § 11.03. The other aspects of these reforms are addressed principally in § 3.02.

20 A WKSI also cannot be an "ineligible issuer." *See* §3.02[3][a][ii].

21 While the Securities Offering Reforms did facilitate initial public offerings to some degree, the greatest advantages accrued to large issuers, U.S. and foreign, that are already public in the United States.

22 The JOBS Act defines an EGC as an issuer with total annual gross revenues of less than $1 billion during its most recent financial year. An issuer that was an EGC as of the first day of that financial year will remain an EGC until (i) the last day of the financial year five years after its initial public offering, (ii) the last day of the financial year in which it has annual gross revenues of $1 billion or more, (iii) it has issued more than $1 billion in nonconvertible debt during a three-year period, or (iv) it is a "large accelerated filer" (generally, a company with a public float of at least $700 million that has been publicly reporting for at least one year). By its terms, the JOBS Act generally applies equally to domestic and foreign EGCs.

23 *See infra* Note 69 and accompanying text.

24 *See* § 3.02[3][b][iv].

25 *See* SEC, Division of Corporation Finance, International Registered and Reporting Companies (Dec. 31, 2015).

26 In 2015, U.S. exchanges accounted for 17% of funds raised in global IPOs, compared to 46% for Asia-Pacific Exchanges and 35% for European exchanges. In the first three quarters of 2016, U.S. exchanges accounted for 17% of funds raised in global IPOs, compared to 53% for Asia-Pacific exchanges and 25% for European exchanges. *See* Ernst & Young, *Global IPO Trends 2015 Q4* (2015) and Ernst & Young, *Global IPO Trends 2016 Q3* (2016).

27 As of December 31, 2015, 923 foreign companies from 53 countries were periodically reporting to the SEC under Exchange Act requirements, whereas only 434 foreign companies were reporting to the SEC in 1990. *See* SEC, International Registered and Reporting Companies (Dec. 31, 2015). The 923 foreign companies represent a decline from the high of 1,344 in 2001. The number had hovered at around 1,200 from 2003 to 2006. As of November 1, 2016, a search of the SEC's Electronic Data Gathering and Retrieval system ("EDGAR") shows that 503 foreign companies had filed notices of deregistration since the March 2007 changes to deregistration.

28 For a discussion of special considerations relating to the registration of debt securities, *see* § 3.05.

29 An issuer wishing to list equity securities on the NYSE can choose from three NYSE markets: NYSE, NYSE MKT and NYSE Arca. Listings on the NYSE are for large- and medium-sized companies. NYSE MKT supports small-cap companies with less strenuous criteria. *See* § 3.03[2][b] for a description of the listing

criteria for NYSE and NYSE MKT. NYSE Arca is an all-electronic exchange that primarily lists exchange-traded notes, funds and other products.

30 An issuer wishing to list equity securities on Nasdaq can choose from three Nasdaq markets: Nasdaq Global Select Market ("Nasdaq/GSM") Nasdaq Global Market and Nasdaq Capital Market. Listings on the Nasdaq/GSM are for large- and medium-sized companies, with Nasdaq Global Markets and Nasdaq Capital Market listings available for smaller companies. The requirements to list on the Nasdaq Global Market and Nasdaq Capital Market are less difficult to meet than current NYSE requirements, especially with respect to the requirements for inclusion of shares of common stock of foreign issuers (or ADRs representing such shares) in the Nasdaq Capital Market.

31 In connection with its becoming a national securities exchange, Nasdaq separated from the NASD (the predecessor of FINRA), which is a self-regulatory organization that had originated Nasdaq and had later been its parent. *See* SEC Release No. 34-53128 (Jan. 13, 2006); SEC Release No. 34-54084 (June 30, 2006). As part of the plan of separation from the NASD, Nasdaq sold its interest in the OTC Bulletin Board to the NASD and only offers certain technological services and operational support, while FINRA (as the successor to the NASD) has full responsibility for all other matters. *See* SEC Release No. 34-54084 (June 30, 2006); NASD/Nasdaq Trade Reporting Facility Frequently Asked Questions (FAQs) (Feb. 14, 2007). The OTC Bulletin Board permits FINRA members that are market-makers to view, enter, update and display quotations, solicitations for quotations and indications of interest for particular OTC securities that are not traded on any national securities exchange. Brokers for investors wanting to trade in securities quoted on the OTC Bulletin Board generally contact one of the listed market-makers in the securities. *See* SEC Release No. 34-38456 (Mar. 31, 1997). *See* FINRA Rules, Rule 6500, FINRA MANUAL.

32 The pink sheets, which are now distributed electronically by OTC Markets Group Inc. and were originally named for the color of the paper on which OTC quotes were distributed, display quotes from broker-dealers for OTC shares. For OTC corporate debt, OTC Markets Group Inc. distributes "yellow sheets." As with the OTC Bulletin Board, brokers for investors wishing to trade generally contact one of the listed market-makers.

For a discussion of the SEC's rules governing "alternative trading systems" and "internal broker-dealer systems" adopted in response to the creation of Internet-based alternative electronic trading systems for secondary trading, *see* § 14.10[1].

33 The OTC Bulletin Board does not impose substantive requirements on an issuer seeking to obtain a quotation for a class of securities. However, in contrast to issuers whose securities are quoted in the pink sheets, issuers must generally be subject to and current with the reporting requirements of the Exchange Act. These issuers tend to be smaller, and so the various accommodations for smaller companies may apply.

34 *See* §§ 3.02[1][b] and 4.04 for a discussion of Form 20-F, the Exchange Act registration statement for foreign issuers. Such registration requirements, as well as periodic reporting and certain other requirements to which a company becomes subject as a result of Exchange Act registration, including those obligations imposed on companies by the Sarbanes-Oxley Act and the Dodd-Frank Act, are also discussed in Chapter 4 and Chapter 5.

In 1994, the SEC adopted Rule 3a12-11 under the Exchange Act, and amended certain rules under the Exchange Act, in order to reduce previous regulatory distinctions between debt securities listed on a national securities exchange and those traded in the OTC market. SEC Release No. 34-34922 (Nov. 1, 1994). The changes simplified registration procedures under the Exchange Act for listed debt securities and exempted listed debt securities from the borrowing restrictions and proxy rules of the Exchange Act (other than the antifraud rules and certain other rules that relate to the transmission to beneficial owners of proxy and consent materials and information statements).

In 2006, the SEC permitted NYSE member organizations to trade debt securities on the NYSE that are not registered under § 12(b) of the Exchange Act, but are issued by NYSE-listed companies or their wholly owned subsidiaries and that meet certain other conditions. *See* SEC Release No. 34-54766 (Nov. 16, 2006); SEC Release No. 34-54767 (Nov. 16, 2006); SEC Release No. 34-55496 (Mar. 20, 2007). The NYSE Bonds market provides trading opportunities for a wide variety of debt, including corporate, foreign issuer, non-U.S. dollar denominated and municipal debt.

35 *See* the discussion regarding Rule 12g3-2(b) under the Exchange Act in § 4.02[3][a][iv].

36 ADR issuers must comply with SEC Rule 10b-17 (requiring timely notice to FINRA of certain corporate actions, including dividends, stock splits, reverse splits, name changes, mergers, acquisitions, dissolutions, bankruptcies or liquidations, at least 10 days prior to the record date). Issuers who fail to report such corporate actions in the required time may be subject to fines up to $5,000. *See* FINRA's Notice to Member 10-38. ADR depositaries, as the ADR issuers, comply with this requirement when they seek OTC listing.

37 The short-form registration statement for foreign issuers is Form F-3. *See* § 3.02[1][b] for a discussion of the eligibility requirements.

38 *See* Rule 415 under the Securities Act and the eligibility requirements for the use of Form F-3. Shelf registration, including "automatic shelf registration," is discussed in § 3.02[2][C].

U.S. Regulation of the International Securities and Derivatives Markets, § 3.02, REGISTERED PUBLIC EQUITY OFFERINGS IN THE UNITED STATES

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 3.02 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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A foreign company making a public offering in the United States must, like a U.S. issuer, register the securities being offered under the Securities Act. An issuer becomes subject to the reporting requirements of the Exchange Act as a consequence of the registered public offering, [39] regardless of whether it lists on

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an exchange, although it must separately register under the Exchange Act if it does list on an exchange. [40] Filing a registration statement under the Securities Act or registering securities under the Exchange Act (in connection with a Securities Act filing or on its own) also triggers the applicability of the Sarbanes-Oxley Act and the Dodd-Frank Act. [41]

[1] Overview of Registration Under the Securities Act

[a] General Statutory Scheme

Any offer or sale of securities must be registered with the SEC under §5 of the Securities Act, unless an exemption is available. With limited exceptions, no exemption is available for U.S. public offerings. Accordingly, public offerings must be registered to comply with § 5 of the Securities Act. Registration is accomplished by filing a registration statement with the SEC, which must become effective before sales can be made.

As a practical matter, the offering process can be divided into three stages, because of the provisions of § 5 of the Securities Act. The first stage is the "quiet period," which is the period after the decision to proceed with an offering has been taken but before the registration statement is filed. The second stage is the "waiting period" between filing and effectiveness of the registration statement, and the third stage is the "post-effective period" after the registration statement becomes effective. [42] Various rules govern what kind of offers may or may not be

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made during each of the three stages. Violations of restrictions on offers during each stage are sometimes referred to as "gun-jumping."

As noted above, and as discussed more fully in §3.02(2)(c) below, because shelf registration statements of WKSIs are automatically effective, there is no second stage for WKSIs in most cases. Further, as a result of exceptions from many of the pre-filing offering restrictions for WKSIs, the concerns for WKSIs regarding pre-filing activities are much reduced.

The Securities Act defines "offer" as including "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value." [43] Because "offer" is defined so broadly, the issuer, the underwriters and all others involved in the process must be careful to distinguish between permissible communications and illegal offers and not engage in communications and activities that might be viewed as impermissibly affecting the market for the securities to be offered. Any unusual publicity about the issuer or the proposed offering made in, or, in some cases, accessible in, the United States in advance of the filing or between the filing and its effective date may be viewed by the SEC as impermissible because it is likely to stimulate public interest in these securities and thus precondition the market. Publicity can be a significant issue in a global offering with a U.S. tranche, primarily because other jurisdictions do not impose such strict limitations.

The registration statement sets out extensive information about the business and financial condition of the issuer and about the offering in accordance with detailed SEC rules. [44] While the SEC does not formally approve the contents of a registration statement or prospectus (and indeed it is a criminal offense to state that the SEC has given such approval), [45] and does not make any determination of the merits of the offering, the SEC staff does review almost all registration statements of issuers that have not filed previously under either the Securities Act or the Exchange Act. As part of that review process, the staff provides comments about disclosure that it believes is not in compliance with the SEC's rules or is otherwise unclear, incomplete, insufficient or unsubstantiated.

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The following sections set forth the basic procedures and considerations for SEC registration, including forms, timing and prospectus delivery.

[b] Registration Forms

Foreign companies [46] generally file their Securities Act registration statement on one of two SEC forms: [47] Form F-1 (a so called "long-form" registration statement) or F-3 (a so called "short-form" registration statement). [48] Each form requires the disclosure about an issuer that is called for by Form 20-F. [49] *****************In addition, each form also requires information regarding the nature and terms of the particular offering. [50] The principal difference between the forms is the amount of information that may be incorporated by reference from Exchange Act reports.

Form F-1 allows eligible registrants to incorporate by reference their Form 20-F filed prior to the effective date of the Form F-1 and any specified Form 6-K s submitted to the SEC prior to that effective date. Form F-1, however, does not permit incorporation from subsequently filed documents. Registrants eligible for the backward incorporation by reference permitted under Form F-1 must have filed all required reports under the Exchange Act for a period of 12 months (or such shorter period as they have been subject to those requirements) and have filed an annual report on Form 20-F with the SEC. Therefore, initial public offerings in the United States and any follow-on offerings before a registrant's first annual report has been filed are required to be on Form F-1 without the benefit of any incorporation by reference. [51]

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Form F-3 allows both backward incorporation by reference and forward incorporation of any Form 20-F s or Form 6-K s filed or submitted to the SEC after the effective date of the Form F-3. [52] This not only expedites preparation of the Form F-3 but also facilitates keeping it current after its effective date, which is important in connection with shelf-registration. [53]

Qualification to use Form F-3 depends upon whether the issuer meets certain conditions and the length of time that it has been filing periodic reports under the Exchange Act. [54]

A foreign company generally may register securities on Form F-3 if (i) it has been required to file reports with the SEC for at least 12 months (provided that all reports required to be filed have been filed in a timely fashion) and has filed at least one annual report on Form 20-F, (ii) its common stock held by nonaffiliates has an aggregate worldwide market capitalization (or "public float") of at least $75 million and (iii) it has not defaulted on certain payments. [55] The public float requirement is not applicable if at least one class of the issuer's common equity is listed on a national securities exchange and it does not sell more than one-third of its public float over the 12-month period (including the current sale). [56]

The public float requirement also is not applicable if the issuer is issuing nonconvertible securities, other than common equity, and (i) has issued (as of a date within 60 days prior to the filing of the registration statement) at least $1

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billion over the prior three years in nonconvertible securities, other than common equity, in primary offerings for cash (not through exchange offers) registered under the Securities Act; (ii) has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of nonconvertible securities, other than common equity, issued in primary offerings for cash (not through exchange offers) registered under the Securities Act; (iii) is a wholly-owned subsidiary of a WKSI; [57] or (iv) is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI [58]

The public float requirement also is not applicable for use of Form F-3 in connection with secondary offerings, certain rights offerings, dividend or interest reinvestment plans, conversion of convertible securities and the exercise of warrants. [59]

In addition to incorporation of information by reference to Exchange Act reports, a Form F-3 must also provide information regarding material changes in the foreign company's business and financial condition that have occurred since the end of the fiscal year covered by the Form 20-F incorporated by reference in the registration statement, [60] as well as regarding significant business acquisitions, changes in accounting principles, corrections of previous accounting errors and material dispositions of assets outside the normal course of business, if that information is not contained in filings (or Form 6-K submissions) under the Exchange Act incorporated by reference. [61]

Financial statements included in an annual report on Form 20-F may not suffice to meet the requirements of the Securities Act. In particular, if the financial statements in the annual report on Form 20-F are not sufficiently current to comply with the requirements of Item 8 of Form 20-F, current financial statements must be included in the prospectus or an amended Form 20-F. [62]

The fee for filing a registration statement under the Securities Act (other than an automatic shelf registration statement) is a percentage of the estimated maximum aggregate offering price of the securities being registered. [63] No registration fees are due when an automatic shelf registration statement on Form S-3 or F-3 is initially filed by a WKSI. Instead, WKSIs are allowed to pay the necessary filing fee at the time of each shelf takedown (*e.g.*, when the prospectus supplement is filed) or at any time prior to each takedown. [64]

[c] Timing Considerations

Depending in large part upon whether it has previously offered its securities publicly in the United States or listed its securities on a U.S. stock exchange, an issuer may require a considerable amount of time and planning to prepare a registration statement under the Securities Act. The issuer is generally responsible in the first instance for the preparation of its registration statement, with the assistance of its counsel and independent accountants.

For an issuer that has not previously prepared a Securities Act or Exchange Act registration statement, the length of time required to compile the necessary information and draft the registration statement often depends on the amount of work needed to prepare audited consolidated financial statements. The financial statements—which can require substantial restatement and revision of the issuer's normal financial statements—generally must include audited statements of income, cash flows and statements of changes in equity for the three most recent fiscal years and audited balance sheets as of the end of the three most recent fiscal years, in each case audited in accordance with generally accepted auditing standards in the United States. [65] For foreign issuers, these financial statements, and any required financial statements for interim periods, generally must be in

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accordance with U.S. GAAP or IFRS as issued by the IASB or reconciled to U.S. GAAP. [66] The registration statement must also include certain income statement and balance sheet items for five years. [67] An EGC is also permitted to provide only two years (rather than three) of audited financial statements, and only those two years (rather than five) of selected financial data, in its IPO registration statement. [68] This accounting work can take months to prepare, [69] especially when the foreign issuer does not already report under IASB-adopted IFRS.

In certain cases, foreign companies may submit draft registration statements to the SEC on a confidential basis: (1) a foreign government registering its debt securities; (2) a foreign private issuer that is listed or is concurrently listing its securities on a non-U.S. securities exchange; (3) a foreign private issuer that is being privatized by a foreign government; or (4) a foreign private issuer

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that can demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction. [70] Under the JOBS Act, EGCs may also submit a draft IPO registration statement for confidential SEC review.

The staff insists that confidential submissions by foreign issuers be substantially complete to be eligible for review and that the financial statements be current at the time of submission (although as in the case of formal filings, an estimated price range and size of offering is not required at that time). The staff has indicated that it will expect the auditor's report to be signed and dated at the time the draft registration statement is first submitted, unless special arrangements have been agreed in advance with the Office of International Corporate Finance.

If a registration statement is confidentially submitted to the SEC and commented upon in this manner, the preliminary prospectus will typically be distributed upon the first public filing of the registration statement after all SEC comments have been incorporated.

Upon the first public filing, issuers must also file publicly the first confidential submission and all amendments thereto. The SEC makes all comment and response correspondence publicly available no earlier than 20 business days after it has declared a registration statement effective.

For foreign issuers that qualify as EGCs and choose to take advantage of any of the benefits available to EGCs, the confidential filing process should follow the rules and SEC guidance provided in connection with the implementation of the JOBS Act, which differ in some respects from the guidance for confidential submissions by foreign issuers. For example, EGCs must publicly file confidential submissions at least 15 days before commencing a road show.

Once a registration statement has been filed, it may be reviewed by the staff, [71] who will give their comments in writing. [72] Not all filings are reviewed.

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However, a filing will almost always be selected for review if it is an initial public offering or other first filing by the issuer, and chances of review of later filings are heightened if there has been a material change in the issuer's business or structure or financial condition. [73] While the period of SEC review may vary widely, the SEC staff will generally take about one month to review and comment initially. [74] Depending on the nature and extent of the comments, it should generally be possible to respond to them within a week or two. Responses to the SEC's comments are generally incorporated into an amendment to the registration statement, which is accompanied by a letter explaining the amendment and otherwise addressing the comments. Successive rounds of comments may be made by the SEC staff, although generally with shorter review times than the initial comments. Once the comments have been addressed to the satisfaction of the reviewers, the registration statement, as amended, will be declared effective on a date selected by the issuer. [75]

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In the United States, in initial public offerings and other heavily marketed offerings it is customary to distribute the preliminary prospectus widely to prospective investors. In such cases, where the issuer anticipates that the staff will review a registration statement and may have extensive comments, particularly in the case of initial public offerings, it generally makes a "quiet filing" when the confidential submission process described above is not available; it files the registration statement with the preliminary prospectus but does not widely distribute the prospectus or commence marketing efforts until one or more rounds of SEC staff comments have been received and addressed. The preliminary prospectus generally does not contain pricing and certain other information relating to the offering not available or not determined at the time of filing, but is otherwise generally complete.

After the comment process is completed and, in the case of an initial public offering involving confidential review, the registration statement containing the form of preliminary prospectus is filed publicly and the preliminary prospectus, which will now include the price range and offering size, [76] is distributed to investors, executive officers of the issuer and representatives of the underwriters typically participate in road shows, arranged between institutional investors and management at which the preliminary prospectus is made available and management responds to questions. The transmission of electronic road shows, which are presentations by video or Internet, is permitted, provided that conditions regarding use of a free writing prospectus applicable to electronic road shows are satisfied. [77] During this marketing period, the underwriters obtain indications of interest regarding the securities being marketed. [78] This is commonly referred to as "bookbuilding." [79]

At the conclusion of this bookbuilding period (which may last from a few days to several weeks), the lead underwriters negotiate the share price and size

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of the offering with the issuer and/or selling shareholders based on the indications of interest and other relevant factors. [80] In a public offering of shares that are already listed on a securities exchange, pricing is usually based on the quoted share price or a formula related to that price. After the share price and offering size are set, the underwriting agreement is signed. [81]

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In the case of initial public offerings and other registration statements that do not follow delayed-offering procedures under shelf registration, [82] the amendment to the registration statement containing the final prospectus may be filed and declared effective by the SEC on request either before or after the pricing of the securities. In the former case, which is far more common, the amendment will be filed and the registration statement declared effective without information in the prospectus about the public offering price and the composition of the underwriting syndicate. The offering must be priced within 15 business days after effectiveness. [83] In the latter case, the amendment is known as a "pricing amendment" and contains a final prospectus that includes the pricing and underwriting information previously omitted from the preliminary prospectus.

If the securities of a foreign company will, when sold, be listed on a national securities exchange, the issuer and the underwriters may decide to time the pricing of the securities so that they trade first at the opening of business on the U.S. exchange. Alternatively, the pricing of newly issued securities that are also being listed on an overseas exchange that is expected to be the primary trading market may be timed so that they trade first on that overseas exchange, where the trading will benefit from greater liquidity. In any event, in light of the time

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differences between trading hours on U.S. and overseas markets, having the registration statement declared effective prior to pricing, either by using shelf registration where available or by utilizing Rule 430A, provides the greatest flexibility.

If there is a need to update the disclosure about the issuer or make any corrections to the information in the preliminary prospectus, participants in a registered securities offering need to assess whether such updates or corrections arising since the date of the most recent preliminary prospectus circulated to potential investors should be included in a new preliminary prospectus or, more likely, a free writing prospectus, which, in either case, would be circulated to investors prior to pricing. [84] Consideration should also be given to the length of time between conveyance of the corrected or updated information to investors and the pricing of the securities offering during which investors would be able to process the updated disclosure.

After effectiveness, and as soon as possible after pricing, relevant pricing terms and any other material changes are conveyed to investors, usually orally in the case of equity securities (or through a term sheet in the case of debt securities), the form of which has usually been pre-agreed between the issuer and the underwriters. The underwriters generally confirm their sales orally, followed by a written confirmation of sale that is required by SEC regulations to include specific information. [85] The final prospectus (including the pricing information) is filed with the SEC within two business days of pricing.

In purely domestic U.S. transactions, the closing typically occurs three or four business days later, while in U.S. offerings by non-U.S. issuers, the closing sometimes does not occur until five or more business days later. [86] Regardless of the length of the settlement period, the closing is subject to certain conditions being met, including the delivery of legal opinions and accountants' negative comfort letters and the absence of material adverse changes in the issuer's business or serious disruptions in the financial markets.

[d] Requirements Regarding Disclosure in the Preliminary Prospectus of Price Range and Estimation of Number of Shares to be Sold

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If the registrant is not an SEC-reporting company prior to filing the registration statement, Item 501(b)(3) of Regulation S-K requires the preliminary prospectus first "circulated," or distributed to the market, to contain an estimated price range (which, according to SEC staff guidance, cannot be wider than $2 (if the maximum price is $10/share or less) or 20% of the high end of the estimated range (if the maximum price is greater than $10/share) and an estimated maximum size of the offering. [87] With respect to foreign registrants that are listed in their home country prior to filing, the SEC staff has often permitted such registrants to provide share price information for the home market as of a recent date in lieu of the price range information referred to above. Filings during the period when comments are received and responded to and prior to the circulation of the preliminary prospectus and marketing customarily do not carry a price range or final estimated offering size. [88]

If the registrant is an SEC-reporting company prior to filing a registration statement, it is not required to include a price range or indicative offering size in the preliminary prospectus.

[e] Requirements Regarding Prospectus Delivery

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[i] *General Framework*

Underwriters are required to deliver preliminary prospectuses to prospective purchasers in initial public offerings. Delivery to such purchasers must take place at least 48 hours prior to sending them confirmations of sale. [89]

Section 5 of the Securities Act requires that a final prospectus containing all required information must precede or accompany the confirmation of sale sent to each purchaser and must be sent prior to the delivery of securities. [90] This requirement is deemed to be satisfied as long as the final prospectus is filed with the SEC by the required filing date provided in Rule 424 under the Securities Act [91] or the issuer has made a good faith and reasonable effort to file such a prospectus within the required time under Rule 424, and if the issuer has not timely filed the prospectus, the issuer files the prospectus as soon as practicable thereafter. [92] This allows settlement and delivery of securities to investors with only a

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confirmation from the underwriter (which is often electronic) and no delivery of a final prospectus.

Section 4(a)(3) of the Securities Act and Rule 174 thereunder impose a prospectus delivery requirement in certain cases on dealers that are not underwriters. The requirement applies in the case of sales by dealers of unsold allotment securities. [93] Section 4(a)(3) also contains a general prospectus delivery requirement for secondary market sales by dealers for 40 days after the later of the *bona fide* offering date and the effective date of the registration statement (90 days for an issuer that has not sold securities pursuant to an effective prior registration statement). Rule 174 eliminates or reduces this requirement in most cases in connection with registered offerings. In particular, (i) it eliminates the requirement for issuers that are reporting companies immediately prior to the effectiveness of the registration statement, (ii) it eliminates the requirement for offerings pursuant to shelf registration statements except with respect to the first *bona fide* offering off the shelf, and (iii) it reduces the requirement from 40 (or 90) to 25 days in the case of offerings of securities listed on a U.S. national securities exchange. The result of this regulatory framework is generally to require prospectus delivery by dealers in the case of unsold allotment securities at any time and in the case of initial public offerings for 25 days in the case of securities listed on a national securities exchange and for 90 days in the case of securities not so listed. Dealers may rely on SEC filing under Rule 172 to satisfy their delivery requirement (other than for blank check companies), so that no prospectus need be delivered if the filing requirements of Rule 172 are satisfied. [94]

[ii] *Electronic Document Distribution*

The SEC expressly permits the Internet to be used for the dissemination of mandatory disclosure documents in a U.S.-registered offering. [95] The same liability rules apply to documents distributed electronically as to documents distributed in paper form. SEC rules provide that electronic access to certain mandatory

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disclosure documents satisfies the delivery obligation. [96] In order for electronic delivery to satisfy the SEC's requirements for the delivery of other mandatory disclosure documents (such as a preliminary prospectus in an initial public offering), the SEC requires either evidence of actual receipt of the documents by the investor [97] or a combination of the following:

- notice that a document is available electronically;
- access to the Internet or to the electronic medium employed; and
- consent to delivery through the electronic medium employed.

To satisfy the first element, notice, an investor should receive written notice of electronic delivery of the particular required document, unless an issuer or market intermediary can otherwise establish that delivery has been made. If the document is physically delivered or delivered by electronic mail, that communication itself, because it permits certification of receipt, should be sufficient notice. If the document is posted on a website, however, separate advance notice is necessary. Moreover, messages posted to an investor's account on a broker-dealer's website do not fulfill the notice requirement. [98]

To satisfy the second element, access, the electronic medium employed for delivery should not be so burdensome to use as to prevent access. [99] In addition, to demonstrate access either there should be an adequate opportunity for the recipient to retain a permanent record of the electronic information—by printing or downloading, for example—or the recipient should have ongoing electronic

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access equivalent to personal retention. [100] Thus, information posted on a website for only a brief period of time is unlikely to constitute adequate access, and a document made available by posting on the Internet, through on-line services, or by similar means should be accessible for as long as the delivery requirement for that document applies. [101] Finally, to establish access, an investor must be provided with a paper version of the document if the investor exercises its prerogative to revoke its prior consent to electronic delivery or merely requests a supplemental paper copy. [102]

Information on a website is deemed part of a prospectus only if an issuer or person acting on behalf of an issuer (including an intermediary with delivery obligations) acts to make the website part of the prospectus. Close proximity of information on a website to a prospectus does not, by itself, make that information an "offer to sell," "offer for sale" or "offer" within the meaning of the Securities Act, although it may result in the documents being delivered together. Regardless of proximity to the prospectus, website content should be reviewed in its entirety to determine whether it contains information that is inconsistent with the prospectus or otherwise may raise liability concerns. Hyperlinks to or from a website may make the hyperlinked information part of the prospectus and are generally avoided.

To satisfy the third element, consent, an investor should be apprised of the specific type of electronic medium to be used, the potential costs associated with electronic delivery, the duration of the consent and the documents for which consent will be effective and the fact that the consent is revocable at any time. Consent will not be deemed to have been obtained merely by an investor's failing affirmatively to object when notified of proposed electronic delivery. [103]

Investors may consent to electronic delivery telephonically, as long as a record of the call is retained. The record must indicate the breadth of the consent and the electronic media to be used. Further, such consent must be obtained in a manner that ensures its authenticity.

An investor may provide global consent to electronic delivery covering all documents of multiple issuers, so long as the consent is adequately informed. In such cases, particular care must be taken to ensure that the investor understands

that it is providing a global consent to electronic delivery. [104] Where an investor has provided its global consent, its right to revoke in connection with a global consent may be limited to an "all issuers or none" basis. Although the consent must specify the electronic media to be used, it need not specify the medium to be used by any particular issuer. A global consent need not identify the issuers it covers and may permit additional issuers to be added later without further consent.

When an issuer offers securities to its own employees, the requirements for electronic delivery will be deemed to be satisfied (i) when an employee uses the issuer's electronic mail system to execute his or her duties or (ii) where an employee can be expected to receive through alternate means e-mail messages sent to employees.

In 2001, the SEC for the first time (and so far the only time) declared effective a registration statement providing that the issuer would communicate with investors only through the Internet. [105] This registration statement was submitted to the SEC by The American Life Insurance Company of New York with respect to its proposed issuance of variable annuity contracts. The related SEC releases reflected important departures from the prior SEC pronouncements regarding the electronic delivery of materials insofar as the SEC did not require that American Life provide notice of website postings or provide paper versions of any documents posted on the Internet with respect to the annuities in question.

Other than with respect to its adoption of Rule 172, the SEC has not extended the American Life decision to other contexts involving delivery of preliminary prospectuses. The SEC noted that its American Life decision "reflects the particular facts and circumstances applicable here" and should not be read "as predetermining the outcome in any other circumstance." [106] Indeed, the SEC could seek to distinguish this ruling on the basis of the nature of the securities involved. [107] Nevertheless, the SEC did indicate that it had revisited its past

pronouncements on electronic delivery in light of the Electronic Signatures in Global and National Commerce Act [108] and was reviewing whether these previous pronouncements should be modified. Future SEC action in this area may, as in the past, be taken through interpretive guidance.

[2] Shelf Registration

[a] Overview

A shelf registration statement is used to register future offerings without the need to provide details regarding those offerings at the time the shelf becomes effective. Once a shelf registration statement has become effective, securities can be publicly offered and sold under it (referred to as a "taking down" securities "off the shelf") without further approval from the SEC.

Compared with conventional registration procedures, shelf registration presents significant advantages in terms of an issuer's ability to consummate an offering quickly to take advantage of market opportunities. Having an effective registration statement on file allows immediate communications with prospective investors without raising "gun-jumping" considerations (although the issuer must comply with free writing prospectus requirements for any writing [109]). Except for disclosure in a prospectus supplement of material recent developments insofar as they have not previously been disclosed in a filing under the Exchange Act that is incorporated by reference, the description of the issuer (and any guarantor) will have been completed in advance of the offering and will be included (or incorporated by reference) in the base prospectus included as part of the already effective registration statement. [110] Because the shelf registration statement is already effective, an offering can ordinarily be made without delay

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for review or action by the SEC. An underwriting agreement can be signed and sales of securities to investors made and confirmed immediately (although, in practice, a preliminary prospectus supplement is generally prepared and used, it is not required to be filed until after such use).

A shelf registration statement can register sales of new securities by their issuer (a "primary shelf"), resales of outstanding securities by their owners (a "secondary shelf") or a combination of the two. A foreign issuer that is eligible to use Form F-3 for primary offerings may file a shelf registration statement on that form regardless of whether the offerings being registered are to be made on an immediate basis, a delayed basis or a continuous basis. [111] Shelf registration can be used for secondary offerings of securities whether or not the issuer of those securities would be eligible to use Form F-3 for a primary offering. [112]

A shelf registration statement generally expires three years (subject to a limited extension) [113] after the initial effective date of the registration statement. As a result, new shelf registration statements must be filed every three years, with unsold securities and unused fees carried forward to the new registration statement. [114] The three-year expiration rule, however, does not apply to secondary-only [115] or acquisition shelf registration statements that are not automatic shelf registration statements. [116]

The unallocated or "universal" shelf registration process allows issuers to register, and pay a fee for, an aggregate dollar amount of securities of different classes on a single shelf registration statement. [117] While entities that are not

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WKSIs must specify the particular classes of securities they are registering, the registration fee is not allocated among those classes at the time of filing and the classes may include both debt and equity securities. For each offering of securities off that shelf registration statement, the prospectus supplement lists the amount and class of securities being offered, and the value of the offering is subtracted from the total dollar amount of securities registered. [118] As an additional option, a WKSI may elect to pay the necessary filing fee at the time of each shelf takedown rather than prepaying fees. [119]

[b] General Procedures

A shelf registration statement contains a basic prospectus, usually referred to as a "base prospectus," providing the same information regarding the issuer that is included in a conventional prospectus, including information incorporated by reference from the issuer's most recent annual report on Form 20-F and subsequent filings under the Exchange Act. The base prospectus, however, usually contains only a general description of the types of securities that could be offered "off the shelf" and of the various ways in which such securities could be distributed. In order to have maximum flexibility, a company may provide in general terms for the issuance of many different types of securities. In addition, provision may be made for several different means of distribution, such as firm commitment or "best efforts" underwritings, agency placements and direct sales.

To comply with the Trust Indenture Act, if debt securities are registered the company must also file, as exhibits, forms of the trust indentures under which those securities are to be issued. [120]

Rule 430B under the Securities Act permits information that is unknown or not reasonably available to be omitted from a base prospectus in delayed offerings and later included in a prospectus supplement, an Exchange Act report incorporated by reference or a post-effective amendment. Market practice has generally been to use a prospectus supplement. The prospectus supplement for each specific offering would generally include terms of the securities being offered, the pricing, the plan of distribution (including any underwriting or sales arrangements) and, if necessary, disclosure of material recent developments concerning the issuer not included in incorporated documents. Rule 430B also provides that issuers eligible to use Form S-3 or F-3 for primary offerings may in certain circumstances described below omit information about the identities of

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selling securityholders and the amount of securities to be sold by such holders. [121] The prospectus supplement must be filed with the SEC, but no SEC action is required with respect to the prospectus supplement.

Rule 430B provides that information contained in a prospectus supplement will be deemed part of the related registration statement. Rule 430C codifies similar provisions relating to shelf registrations by issuers not eligible to use Form S-3 or F-3 for primary offerings. As a result, prospectus supplements will be considered part of the related registration statement for purposes of liability under § 11 of the Securities Act as of the dates described below.

The date on which the information in a prospectus supplement will be deemed to be part of the related registration statement for purposes of § 11 liability of issuers and underwriters only will be determined as follows:

- for supplements filed in connection with most shelf takedowns, under Rule 430B, the earlier of the date that the supplement is first used [122] and the date and time of the first contract of sale of securities to which the supplement relates; [123] and
- for other supplements filed under Rule 430B or 430C, as applicable, as of the date the prospectus supplement is first used.

Rule 430B creates a new effective date for most delayed offerings for purposes of shelf registration statement liability under § 11 for issuers and underwriters. That effective date is the date a prospectus supplement filed in connection with the takedown is deemed part of the registration statement. [124] The undertakings included in Item 512 of Regulation S-K require issuers to agree to this § 11 liability as of the dates described above.

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The updating of the effective date based on use of prospectus supplements for § 11 liability purposes, however, does not apply to directors or signing officers of the issuer or to auditors or other experts. Unless a registration statement is updated by a prospectus supplement filed to provide updating information pursuant to § 10(a)(3) of the Securities Act or by a prospectus supplement reflecting fundamental changes in the information set forth in the registration statement, a prospectus supplement filing will not create a new effective date for directors or signing officers of the issuer. [125] Similarly, the effective date for auditors and other experts will not change with the filing of a prospectus supplement, unless the prospectus supplement (or any Exchange Act report incorporated by reference into the prospectus or registration statement or any post-effective amendment) contains new audited financial statements, a new report or opinion or other information requiring the filing of a new consent under § 7 of the Securities Act.

Many foreign issuers use a shelf registration statement to facilitate a medium-term note ("MTN") program. In this case, the issuer and the placement agent(s) for the program prepare a prospectus supplement that covers the entire projected amount of MTNs to be issued and describes the general terms of the MTNs and the particulars of the distribution arrangements. As individual MTNs are sold, definitive maturity, interest rate and pricing information is detailed in a pricing supplement "sticker," which either is affixed to the cover of the prospectus supplement or comprises a separate sheet. [126] For shelf registration purposes the sticker is a separate prospectus supplement and, like other prospectus supplements, is filed with the SEC without any need for SEC action. [127] As discussed above, it is also deemed to be part of the registration statement and triggers a new effective date.

Foreign governmental issuers that use Schedule B [128] may also file shelf registration statements if they have had an effective registration statement in the United States, and have not defaulted on payments of principal or interest within the last five years. [129] In the case of securities that are guaranteed by a foreign government, the SEC staff has occasionally permitted the issuer to file a shelf

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registration statement on the basis that the related government had satisfied this "seasoning" requirement, even though the issuer itself had not. [130]

[c] Automatic Shelf Registration

As a result of the Securities Offering Reforms, WKSIs [131] can use a more flexible version of shelf registration, called "automatic shelf registration," for filings on Form S-3 or F-3. [132] Automatic shelf registration statements and post-effective amendments become effective immediately upon filing, without SEC staff review that would delay effectiveness, [133] and are deemed filed on the proper form. [134] These provisions effectively ensure that under automatic shelf registration there are no SEC staff regulatory obstacles, in particular no risk of delay because of SEC review, to immediate access to the U.S. public markets.

Under the rules, WKSIs can register an unspecified amount of securities to be offered, without indicating whether the securities will be sold in primary

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offerings or secondary offerings on behalf of selling securityholders. Further, under Rule 430B under the Securities Act, automatic shelf issuers are permitted to omit from the base prospectus not only information that is unknown or not reasonably available to the issuer, but also the following additional information: (i) whether the offering is a primary or secondary offering, (ii) the description of the securities, other than the name or class of the securities, (iii) the names of any selling securityholders, and (iv) any plan of distribution. Omitted information may be incorporated by reference to Exchange Act reports [135] or be contained in the prospectus or prospectus supplement that is deemed to be part of the registration statement.

Issuers may register classes of securities without allocating the mix of securities registered among the issuer, eligible subsidiaries or selling securityholders. [136] Rule 413(b) under the Securities Act also permits WKSIs to add new classes of securities or securities of an eligible subsidiary to an automatic shelf registration statement at any time before the sale of those securities by filing an automatically effective post-effective amendment, as described above, to register an unspecified amount of the new class of security. Additional information about the new class, including additional disclosures, may be included in the amendment, a prospectus supplement or Exchange Act report incorporated by reference. New issuers and new guarantors may also be added by filing an automatically effective post-effective amendment. [137]

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An issuer that qualifies for WKSI status based only on its aggregated registered nonconvertible securities other than common equity can only register nonconvertible securities other than common equity on an automatic shelf registration statement, unless that issuer is also eligible to register a primary offering of its securities on Form S-3 or F-3, in which case it can register any offering of its securities for cash using automatic shelf registration. [138]

Under the rules, no fees are due when an automatic shelf registration statement is initially filed. Instead, WKSIs are allowed, but not required, to pay the necessary filing fee at the time of each shelf takedown (*e.g.*, when the prospectus supplement is filed) or at any time prior to each takedown. If an issuer elects to take advantage of this "pay-as-you-go" filing fee approach, the cover page of each prospectus supplement filed should include a fee table presenting the calculation of the registration fee. Fees must be actually paid within the time required for filing the related prospectus supplement under Rule 424, but a four business day cure period has been provided in Rule 456(b)(1)(i) under the Securities Act for issuers who make a good faith effort to timely pay the fee. As is the case under the rules applicable to all issuers, the amount of the filing fee is calculated based on the fee schedule in effect at the time of payment (*i.e.*, upon filing if paying fees in advance or at the time of a takedown if paying-as-you-go) in accordance with Rule 457 under the Securities Act, and thus the fee amount may vary depending on the time of payment. [139]

[3] Rules Governing Communications

[a] The Communications Regime

[i] *Overview of Rules Governing Prohibited and Permitted Communications During the Three Offering Stages*

Section 5 of the Securities Act and related rules impose varying restrictions on the types of communications that can be made during each of the three stages in the offering process: the quiet period, the waiting period and the post-effective period. [140] The release of a communication during the offering process would violate § 5 if it constitutes an impermissible "offer" (a term that has broad meaning in the Securities Act). [141] A communication does not violate § 5 if it falls

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within a safe harbor excluding it from the definition of "offer" under § 2(a)(3) of the Securities Act, doesn't otherwise constitute an offer or is a permissible offer.

Communications in violation of § 5 (so-called "gun-jumping") could cause the SEC to delay the proposed offering, or, upon completion of the offering and sale, could give purchasers a strict liability right to rescind their purchases. Even communications that are released in compliance with U.S. securities laws may prompt the SEC in certain circumstances to require the inclusion of the publicly-released information into the registration statement, thereby subjecting the offering participants, including the issuer, to Securities Act liability for the content of such communications. Because of these concerns, offering participants must pay careful attention to the issuer- or offering-related publicity released during the offering process. Publicity issues in the context of a global offering with a U.S. component are particularly complicated, primarily because other jurisdictions do not impose as strict limitations as the United States.

In connection with the Securities Offering Reforms, the SEC acknowledged that the previous regulatory scheme unnecessarily hindered communications that would be helpful to investors and provided different classes of investors unequal access to information. [142] In addition, the SEC recognized that the distinction between permissible communications and illegal offers violating § 5 of the Securities Act is not clear and requires a "facts and circumstances" analysis and discourages the disclosure of truthful information that can be useful to the market. To reduce the uncertainty and promote the dissemination of more information regarding offerings to all investors, the reforms liberalized many of the restrictions on communications prior to and during offerings.

[ii] *Categorization of Issuers Under Securities Offering Reforms*

A determination as to whether a communication constitutes an impermissible offer and the related SEC regulatory regime is based on several factors, including the timing of the communication, the nature of the communication and the status of the issuer (*i.e.*, whether it is a WKSI, a "seasoned issuer," an "unseasoned issuer," a non-reporting company, an ineligible issuer or an EGC).

The Securities Offering Reforms created new categories of issuers, the most significant of which is a WKSI. [143] A WKSI is generally a company that,

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within 60 days of the determination date described in the next paragraph, (i) meets the registrant requirements of Form S-3 or F-3, including having timely filed its Exchange Act reports for the preceding 12 calendar months, and (ii) either (1) has a worldwide market value of its voting and nonvoting common equity held by nonaffiliates of at least $700 million [144] or (2) (x) has issued in the preceding three years at least $1 billion aggregate principal amount of registered nonconvertible securities, other than common equity, in primary offerings for cash [145] and (y) registers only nonconvertible securities, other than common equity (unless the issuer also meets the $75 million public float requirement of Form S-3 or F-3). [146], [147]

The determination date for WKSI status of an issuer is the later of (i) the time of filing of the issuer's most recent shelf registration statement and (ii) the time of the issuer's most recent annual amendment to a shelf registration statement, which typically occurs at the time of filing the issuer's most recent annual report on Form 10-K or 20-F (or the time by which the report should have been filed if not filed by the applicable due date). In addition, to qualify as a WKSI,

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the issuer may not fall within the category of "ineligible issuers" described below.

Other categories of issuers created by the Securities Offering Reforms include "seasoned issuers" (issuers eligible to use Form S-3 or F-3 to register a primary offering of securities), [148] "unseasoned issuers" (issuers that are required to file reports under §§ 13 or 15(d) of the Exchange Act, but do not satisfy the requirements of Form S-3 or F-3 for a primary offering of its securities) [149] and "non-reporting issuers" (issuers that are not required to file reports under § 13 or § 15(d) of the Exchange Act, including issuers that voluntarily file Exchange Act reports).

Issuers that fall within specified "bad boy" or certain other specified categories are ineligible to qualify as WKSIs and, therefore, are not eligible for automatic shelf registration, discussed in § 3.02[2][c]. In addition, ineligible issuers may not use free writing prospectuses, except that ineligible issuers other than blank check companies, shell companies and penny stock issuers may use free writing prospectuses that are limited to descriptions of the terms of the offered securities or the offering. [150]

Ineligible issuers include:

- issuers that are not current in their Exchange Act reports (as of the relevant date of determination), [151] other than reports on Form 8-K filed to disclose (i) entry into or termination of a material definitive agreement, (ii) creation, acceleration or increase of a direct financial obligation or off-balance sheet

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  arrangement, (iii) costs associated with an exit or disposal plan, (iv) a material charge for impairment of assets, (v) nonreliance on previously issued financial statements due to an error in such financial statements, or (vi) with regard to asset-backed securities, any informational or computational material, a change in credit enhancement or other external support, or any update of material pool characteristics; [152]
- blank check companies, shell companies (other than a business combinationrelated shell company) and penny stock issuers (in each case, at any time over the past three years (including predecessors));
- limited partnerships offering and selling their securities (other than in a firm commitment underwriting);
- issuers that have filed for bankruptcy or insolvency or that have had an involuntary bankruptcy petition filed against them (if the case is not dismissed within 90 days) or the conversion of a bankruptcy case to

a voluntary proceeding within the past three years; [153]

- an issuer or any entity that was at the time a subsidiary of an issuer [154] that was convicted within the past three years of a felony or misdemeanor described in § 15(b)(4)(B) of the Exchange Act, such as larceny, making of false reports or robbery;
- issuers the registration statements of which are, or within the past three years have been, the subject of refusal or stop orders under the Securities Act; or
- issuers (or their subsidiaries) that within the past three years have been made the subject of a judicial or administrative decree or order finding a violation of the antifraud provisions of the federal securities laws or requiring the cessation of violations of the antifraud provisions of the federal securities laws, or prohibiting certain conduct or activities regarding the antifraud provisions of the federal securities laws. [155]

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For purposes of WKSI status, ineligible issuer status is determined at the time of determination of WKSI status. The date of determination as to whether an issuer is an ineligible issuer for purposes of eligibility to use free writing prospectuses is either (i) the time of filing the corresponding registration statement or (ii) for offerings registered pursuant to Rule 415, the earliest time after filing the corresponding registration statement at which the issuer or another offering participant makes a *bona fide* offer of the securities registered. [156]

[iii] *Safe Harbors for Permitted Communications During Any Offering Period*

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[A] Safe Harbor for Release of Factual Business Information by All Issuers

As part of the Securities Offering Reforms, the SEC adopted a nonexclusive safe harbor from "gun-jumping" violations that permits ongoing communication of regularly released "factual business information" at any time during the offering process by or on behalf of all issuers (other than investment companies and business development companies). [157] This protection essentially codifies the SEC's view that factual communications do not violate § 5 of the Securities Act. [158] Under Rules 168 (for reporting issuers) and 169 (for non-reporting issuers) under the Securities Act, factual business information is defined to include the following types of information: [159]

- factual information about the issuer or its business or financial developments or other aspects of its business (for all issuers);
- advertisements of, or other information about, the issuer's products or services (for all issuers);
- dividend notices (only for reporting issuers); and
- information set forth in any report or other materials that a reporting issuer files with, or furnishes to, the SEC under the Exchange Act (only for reporting issuers). [160]

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Factual business communications are not be required to be filed with the SEC.

To qualify for the protection of the safe harbor, the issuer must have previously released the same type of information in the ordinary course of its business, and the timing, manner and form in which the information is released or disseminated must be materially consistent with past disclosure. For non-reporting issuers, the information must also be intended for persons, such as customers or suppliers, other than in their capacity as investors or potential investors, and it must be released by employees or agents of the issuer who have historically provided such information. [161] The rules do not establish or require any minimum time period to satisfy the regularly released condition, but the Securities Offering Reform Release provides that the issuer must have some "track record" of releasing the particular type of information, which could include only one previous release. [162] Communications containing information about a registered offering or information disseminated as part of the offering activities do not qualify for this safe harbor. [163] Factual business information generally does not include predictions, projections, forecasts or opinions with respect to the valuation of a security. [164] In addition, the rules provide that the safe

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harbor is not available for any communication that is part of a plan or scheme to evade the requirements of § 5 of the Securities Act.

In practice, issuers may release customary shareholder reports, advertise their products, issue press releases concerning material business developments and respond to legitimate unsolicited requests for factual information about their affairs. However, until the offering of the company's securities in the United States has been completed, it would be inadvisable for a foreign company to (i) schedule a meeting or call with U.S. securities analysts or any similar group that would be unusual in light of past practices or in which it would be difficult to avoid questions and speculation about the offering of securities, (ii) engage in any public relations activities in the United States that are unusual in the light of past practices and the nature of the information being communicated or (iii) instigate, or cooperate in the preparation of, any press report in the United States regarding the company or its key officers that is unusual in light of past practices and the nature of the information being communicated. A company may also engage in its customary activities consistent with its past practices outside the United States with respect to publicity, disclosure and announcements. [165]

Notwithstanding the SEC's modernized and liberalized approach to communications, an illustration of the different national approaches to permissible levels of publicity is the level of advertising that has preceded many privatizations in Europe, which were preceded by full-scale television and press advertising campaigns and distributions of brochures describing the company and the offer process that were considered to be an integral part of the marketing efforts, even though offers technically could be made only on the basis of prospectuses that contained mandated disclosure. [166] In the United States, by contrast, even after the 2005 changes in communication rules, a more conservative approach should be taken to avoid violations of § 5 of the Securities Act and, even when permissible, because it is unlikely that offering participants and their counsel

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could become comfortable with such activities under the civil liability provisions of § 12(a)(2) of the Securities Act and Rule 10b-5 under the Exchange Act. [167]

[B] Safe Harbor for Release of Forward-Looking Information by Reporting Issuers

In recent years, Congress and the SEC have encouraged and, in some cases, required issuers to disclose forward-looking information that they judge would be useful to the market and investors. [168] Consistent with this development, Rule 168 under the Securities Act includes a safe harbor from gun-jumping violations that permits the ongoing communication of regularly released forward-looking information at any time during the offering process by or on behalf of reporting issuers only. [169] Rule 168 defines forward-looking information for purposes of the safe harbor to be limited to the following types of information: (i) projections of the issuer's revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items, (ii) statements about management's plans and objectives for future operations, including plans or objectives relating to the products or services of the issuer, (iii) statements about the issuer's future economic performance, including statements of the type contemplated by MD&A, and (iv) assumptions underlying or relating to any of the foregoing information. The safe harbor for forward-looking information is subject to the same conditions regarding consistency with past practice as apply to the safe harbor for factual business information released by reporting issuers. [170] In addition, as with the safe harbor for factual business information, the safe harbor for forward-looking information is not available for any communication that is part of a plan or scheme to evade the requirements of § 5 of the Securities Act.

[b] The Quiet Period: Before Filing a Registration Statement

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Except for communications by WKSIs and "test the waters" communications by EGCs, [171] offers made prior to the filing of a registration statement are violations of § 5 of the Securities Act. [172] However, certain forms of communications that might otherwise be considered to be "offers" are permissible during the quiet period, provided the applicable restrictions are complied with, as discussed below.

[i] *Bright Line Exclusion for Communications Made More than 30 Days Before Filing a Registration Statement*

Rule 163A under the Securities Act provides that a communication made by or on behalf of any issuer more than 30 days prior to the filing of a registration statement will not constitute an "offer" in violation of § 5. This nonexclusive safe harbor is only available for communications made "by or on behalf of" [173] the issuer (communications by an underwriter are not covered, even if authorized or approved by an issuer) that do not reference a securities offering that is or will be the subject of a registration statement and only if "reasonable steps" were taken by the issuer to ensure that a permissible communication is not redistributed or republished during the 30-day period prior to filing. [174]

[ii] *Certain Notices of Public Offering Pursuant to Rule 135*

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At any time prior to filing a registration statement, an issuer may publicly disclose that it intends to make a public offering of securities if certain conditions are met. Any such public announcement must state that the notice does not constitute an offer of any securities for sale, and it may contain no more information than the name of the issuer; the title, amount and basic terms of the securities proposed to be offered; the anticipated time of the offering; a brief statement of the manner and purpose of the offering; information on whether the issuer is directing the offering to only a particular class of purchasers; and any statements or legends required by the laws of any state or foreign country or administrative authority. [175] Underwriters may not be named. [176]

[iii] *Use of Free writing Prospectuses by WKSIs Before Filing a Registration Statement*

Rule 163 under the Securities Act permits WKSIs (or their agents or representatives, other than an underwriter or dealer) [177] to make unrestricted oral and written offers before filing a registration statement, but any written offer will be considered a free writing prospectus and will generally have to be filed upon filing a registration statement or amendment covering the securities. [178] These

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communications, while exempt from the gun-jumping restrictions, are subject to the liability standards applicable to offers, as well as the antifraud provisions of the federal securities laws. [179]

[iv] *Permitted "Test the Waters" Communications by EGCs*

The JOBS Act permits pre-filing and post-filing communications with institutional investors by an EGC, or by a person authorized to act on the EGC's behalf, to determine whether such investors have an interest in a contemplated securities offering. These communications may be oral or written, but may only be made to QIBs or institutional accredited investors. [180] Unlike written communications by WKSIs during the quiet period, written "test the waters" communications by EGCs are not required to be filed as free writing prospectuses.

The "test the waters" provisions of the JOBS Act are available to an EGC with respect to the offering of any security and are not limited to an IPO of common stock. An EGC engaging in "test the waters" communications in connection with an exchange offer or merger must comply with applicable regulatory requirements under the Exchange Act, such as filings required under Exchange Act Rules 13e-4(c), 14a-12(b) and 14d-2(b) for pre-commencement tender offer communications and proxy soliciting materials in connection with a business combination. An issuer must determine whether it qualifies as an EGC at the time it engages in "test the waters" communications, and SEC staff FAQs clarify that if a company engages in "test the waters" communications while it is an EGC and subsequently loses EGC status, the SEC will not view the "test the waters" communications as having violated § 5 of the Securities Act. [181]

Notwithstanding the changes introduced by the JOBS Act, both issuers and underwriters will be subject to potential federal securities law antifraud liability, including liability under § 12(a)(2) of the Securities Act and § 10(b) of the

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Exchange Act, for any oral or written communications that are permitted by the "test the waters" provisions of the JOBS Act. As part of its review of a registration statement, the SEC staff often requests copies of any materials used in "test the waters" communications.

[v] *Marketing-Related Considerations During the Quiet Period*

[A] Premarketing/Investor Education/Pilot Fishing

Premarketing is an umbrella term used to describe a range of activities undertaken by market participants prior to the formal launch of an offering of securities, including investor education initiatives (and underwriter sales force meetings in support of such initiatives), pilot fishing (also called presounding), "test the waters" communications by EGCs, pre-deal research and nondeal road shows. [182] Issuers conducting premarketing activities both inside and outside the United States also will have to consider local law requirements, including the Market Abuse Regulation in the European Union.

Premarketing is used for a variety of reasons, including to assess the depth of demand for a proposed offering, gather market feedback for a potential transaction structure or provide investors more opportunities to engage with management and learn about the issuer. Although premarketing activities were once more commonly a feature of European offerings, they are increasingly being used in U.S. offerings. Premarketing may be particularly important during periods of high market volatility, helping to minimize the chances of having to "pull" a deal after formal launch.

Premarketing activities are featured in a variety of transactions, including IPOs, U.S. registered follow-on equity offerings and equity and debt offerings under Rule 144A and/or Regulation S. In the context of U.S. registered offerings, premarketing activities in the United States during the quiet period are subject to the restrictions on communications discussed above and are generally limited to communications that fall within the safe harbors afforded by Rules 163A or 135 under the Securities Act, communications by WKSIs pursuant to Rule 163 under the Securities Act and "test the waters" communications by EGCs.

Investor education refers to meetings between research analysts (employees of the underwriters) and prospective investors (and without the participation of investment banking personnel) to discuss an issuer and its securities prior to

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the commencement of marketing. [183] Investor education meetings are designed to assist investors in better understanding the issuer and the offering and are not intended to market or make solicitations in respect of a proposed transaction. In the context of a U.S. registered offering, investor education meetings may only be conducted after a registration statement has been publicly filed and thus do not take place during the quiet period. *See* § 3.02[3][c][iii][A] for a discussion of investor education activities carried out after the public filing of a registration statement in the United States.

Pilot fishing refers to meetings between an issuer, investment bankers and potential investors prior to launch to discuss a proposed transaction to obtain feedback on appropriate benchmark offerings and valuation multiples to help bankers determine the range of valuations that would be appropriate to the planned offering. From the perspective of an issuer, pilot fishing is seen as a useful way to gain feedback about investor concerns and appropriate timing for a transaction before an offering is publicly announced. From the perspective of an investor, pilot fishing offers the opportunity to meet with management at an early stage of the process and to get better acquainted with the issuer ahead of formal launch.

In the context of U.S. registered offerings, pilot fishing activities in the United States during the quiet period are subject to the same restrictions on communications as discussed above with respect to investor education—that is, they can only be conducted after a registration statement has been publicly filed, [184] except that "test the waters" communications by EGCs may be made to QIBs and institutional accredited investors at any time. *See* § 3.02[3][b][v] for a discussion of pilot fishing activities carried out after the public filing of a registration statement in the United States. Pilot fishing communications with non-U.S. investors outside the United States may be permissible in global IPOs that include a non-U.S. registered portion of the offering. In addition, in a global IPO with a U.S. registered component, pre-deal research may be distributed outside the United States at any time, provided certain restrictions are complied with. [185]

[B] Side-by-Side Private Placements/Cornerstone Investors

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Premarketing considerations are implicated in the context of a side-by-side private placement and public offering. [186] In side-by-side private offerings, sophisticated, typically institutional investors that have a preexisting relationship with the issuer may agree to purchase shares in a private transaction at the same time as the public offering is executed. These investors are often called cornerstone investors. Outside the context of U.S. registered offerings, potential cornerstone investors are not unusual and typically are approached by investment bankers or by the issuer directly following a pilot fishing exercise (and need not have a preexisting relationship with the issuer). Typically discussions with potential investors for a side-by-side investment are started prior to the filing of a registration statement to maintain the ability of the parties to conduct the transaction on a private basis, [187] and those cornerstone investors will receive restricted shares (*i.e.*, shares that are not freely tradable) at closing. [188]

To aid in their investment decision, cornerstone investors benefit from the information shared through the pilot fishing exercise and, subject to signing a confidentiality agreement, are often given nonpublic information about the issuer (which is later made available to all investors through the prospectus disclosure), including, in the case of a U.S. registered offering, a draft registration statement. Normally, the cornerstone investor agrees to pay the offering price, which is still undetermined when the investor commits. The participation of a cornerstone investor, in the case of a U.S. registered offering, generally is disclosed in the registration statement, [189] and, as evidence of the issuer's ability to generate demand in the offering, can be an effective premarketing tool. A cornerstone investor generally enters into separate purchase arrangements with the issuer, allowing it to opt out of its commitment if the final disclosure document changes in a materially adverse way from the draft reviewed by the investor.

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In contrast to cornerstone investors, which have separate purchase arrangements with the issuer, an "anchor investor" may purchase a significant portion of an offering but applies for shares through the underwriters, the same as other institutional investors. Because they purchase through the underwriters after the registration statement is effective, anchor investors receive freely tradable shares. The involvement of anchor investors can help to generate demand in a bookbuilding process, but anchor investors are generally not named in the prospectus. [190]

[c] The Waiting Period: After Filing a Registration Statement

Communications by the issuer regarding the offering are also restricted during the period between the filing of the registration statement and its effectiveness, although the issuer may make oral [191] offers during this period, and written offers subject to certain conditions. Subject to certain exceptions (as discussed below), under the Securities Act written offers can only be made using the statutory prospectus, and under SEC rules in the case of a non-reporting issuer (*e.g.*, in the context of an IPO), only when the maximum number of shares and a price range for the offering are included on the front cover of the preliminary prospectus.

[i] *Rule 134*

Rule 134 under the Securities Act provides a nonexclusive safe harbor from the gun-jumping provisions for limited public notices about an offering made after any issuer files its registration statement. [192] The notices may include the following information:

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- information about an issuer and its business (including where to contact the issuer);
- information about the terms (but not the use of detailed term sheets) of the securities being offered, including:
    - the title of the securities (including a designation as to whether the securities are convertible, exercisable or exchangeable and as to the ranking of the securities);
    - information about final interest rates and yield to maturity information, including information on securities with comparable maturities and credit ratings, or if the final maturity, interest rate provisions or yield are not known, the probable final maturity, interest rate provisions or yield range, so long as, in each case where it is required, the prospectus includes a price range; [193] and
    - the price of the security or, if not known, the method of its determination or a *bona fide* estimate of the price range, in which case the registration statement must include the price range;
- a brief description of the intended use of proceeds of the offering;
- certain factual information about an offering, including underwriter information, the anticipated schedule of the offering and a description of marketing events, and the type of underwriting (if, in each case, this information is already disclosed in the prospectus), as well as the names of the underwriters and their additional roles, if any, within the underwriting syndicate (*e.g.*, lead book-running manager);
- a statement about the permissibility or status of the investment under Employee Retirement Income Security Act of 1974, as amended ("ERISA"); and
- factual information about procedures for account opening and submitting indications of interest and conditional offers to purchase (*e.g.*, a broker could inform investors of the procedural aspects of any auction or a directed share program) and procedures regarding directed share programs and other participation in offerings by officers, directors and employees of the issuer. [194]

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Rule 134 allows those providing notices in reliance on Rule 134 to include the uniform resource locator, or "URL" address to the statutory prospectus that notifies investors where they can obtain the statutory prospectus, which can also be satisfied by the inclusion of an active hyperlink to that prospectus. If a URL is not included, Rule 134 requires use of a prescribed legend (if a registration statement has not yet become effective) or the inclusion of the name and address of persons from whom a written prospectus for the offering may be obtained. In addition, communications soliciting indications of interest under Rule 134(d) are only permissible if a statutory prospectus (including a price range where required) is available. [195]

[ii] *Permitted "Test the Waters" Communications by EGCs*

As discussed above in § 3.02[3][b][iv], the JOBS Act provides exceptions from § 5 of the Securities Act that permit pre- and post-filing oral and written communications by EGCs to QIBs and institutional accredited investors. Under the "test the waters" provisions of the JOBS Act, issuers and their authorized representatives are permitted to gauge interest in a potential offering prior to establishing a price range for a preliminary prospectus. Section 105(c) of the JOBS Act expressly permits such communications to determine whether potential investors "might have an interest in a contemplated securities offering," but does not permit an issuer or its authorized representative to solicit binding orders from potential investors as part of these communications. The SEC staff has addressed the question whether, in the course of "test the waters" communications, prospective investors in EGC securities offerings can be asked for nonbinding indications of interest ("IOIs") before a preliminary prospectus has been made available to the broker-dealer personnel soliciting the nonbinding IOIs. [196] The question arises because Rule 15c2-8(e) under the Exchange Act prohibits solicitation of customer orders after a registration statement has been filed, unless a preliminary prospectus, which must include a price range, is made available to

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the broker-dealer personnel soliciting the orders. The SEC guidance distinguishes between solicitation of customer orders, which involves soliciting a commitment, and solicitation of nonbinding IOIs. Investment banking personnel can ask a potential customer how many shares the customer may be willing to purchase at a specific offering price, provided the potential customer is not then committed to purchase the securities.

[iii] *Marketing Considerations During the Waiting Period*

[A] Premarketing/Investor Education/Pilot Fishing

Premarketing [197] during the waiting period refers to communications made after the first public filing of the registration statement, but before all SEC comments on the registration statement have been cleared (in contrast, the "marketing" stage generally commences after launch of the transaction, that is to say, after all SEC comments have been cleared). [198] During the waiting period, premarketing activities are subject to the same restrictions on publicity governing other types of communications after filing of the registration statement. While oral communications are permissible, written communications are limited to statutory and free writing prospectuses, Rule 134 notices and "test the waters" communications by EGCs.

As a result of these restrictions on publicity, premarketing activities during the waiting period are generally limited to oral presentations by research analysts to prospective investors in investor education meetings, [199] oral presentations by investment bankers and the issuer to prospective investors in pilot fishing meetings, [200] "test the waters" communications by EGCs and, with respect to offerings outside the United States, pre-deal research distributed outside the United States.

As discussed above, investor education meetings between research analysts and prospective investors are designed to assist investors with price discovery and, more generally, to give investors a better understanding of the issuer and the offering. There is very little guidance from U.S. regulators regarding the various legal issues raised by investor education meetings. As a result, financial institutions typically have policies and procedures for investor education activities in various contexts. Investor education meetings may take place only after a registration statement is filed, but typically conclude before formal marketing has begun. Investor participation is generally restricted to a limited number of QIBs (in general not more than 20 or so accounts across all lead managers participating in the offering). Investor education meetings, which typically are private, one-on-one meetings with individual investors, are limited to oral communications in person, by telephone or via videoconference. Telephone calls are typically scripted and monitored. Pre-approved slideshows containing appropriate legends may be used. The information shared at investor education meetings must be factual in nature, neutral in tone and limited to information that is publicly available or contained in the registration statement. Material, nonpublic information is typically not disclosed, and views on specific valuations, price targets or financial projections are typically not expressed (and indications of interest are not sought). Orders must not be solicited or obtained at investor education meetings. Records of meetings are typically kept, including the date and time of meetings and the contact information of those who attended, and attendees generally receive the preliminary prospectus, once available.

During the waiting period, pilot fishing activities in the context of a U.S. registered IPO may take place in the United States. As with other forms of pre-marketing permitted during the waiting period, the information disclosed in the context of a pilot fishing exercise must be limited to oral communications. The limitations on numbers of investors, and use of approved, scripted materials in investor education meetings, discussed above, apply generally to pilot fishing activities.

In the context of a U.S. registered IPO, the distribution of pre-deal research in the United States is prohibited, except in the context of EGCs. [201] In a global IPO with a U.S. registered component, pre-deal research may be distributed outside the United States at any time, provided certain restrictions are complied with. [202]

If the issuer already has listed securities, premarketing becomes less practical since such efforts may require investors to be "wall-crossed" well in advance of a proposed offering. Wall-crossing refers to the practice whereby issuers who already have a shelf registration statement on file with the SEC confidentially premarket a public securities offering to a limited number of potential investors before announcing their intention to raise capital publicly. To mitigate selective disclosure concerns in these types of offerings, before an issuer engages in pilot fishing, it would require the potential investors to agree in

advance to maintain the confidentiality of issuer-related information provided to them and to agree not to trade until public announcement of the offering (or its abandonment). Because wall-crossed investors are potentially in possession of material nonpublic information, should the deal not proceed, these investors may need to be "cleansed" before they could trade in the issuer's securities. Cleansing is usually accomplished through the issuance of a press release that publicly discloses the material (previously) nonpublic information or by waiting a certain period of time, often called a "cleansing period," for the information to either be released or otherwise become stale.

[B] The Road Show

A road show is a presentation by senior management (usually accompanied by representatives from the lead underwriters) designed to market a forthcoming offering of securities. [203] Road shows are used by U.S. and foreign issuers to market offerings for equity, debt and convertible securities both in the context of registered offerings (*e.g.*, IPOs and follow-on offerings) and unregistered offerings (*e.g.*, offerings in reliance on Rule 144A or Regulation S).

Road shows are used for a variety of reasons. They can generate investor interest in an offering and help underwriters in their bookbuilding efforts. Road shows also give prospective investors an opportunity to learn about the issuer, the management and the reasons for the proposed offering. Road shows vary in their length of time. For IPOs, where issuers generally are less familiar to the investor community than reporting companies, road shows can last for up to two weeks. For other types of offering by more frequent issuers, a road show can be done in one or two days. Depending on the type of offering, frequent issuers may decide against organizing a road show, relying instead on a brief press release and investor calls as a means to market the offering.

Except for "test the waters" communications by EGCs and for WKSIs in a U.S. registered offering, a road show can begin only after the registration statement has been filed (and normally after all SEC comments have been cleared and a preliminary prospectus has been prepared). Road shows typically finish before the registration statement is declared effective. Although WKSIs are permitted to conduct a road show before filing of the registration statement, the issuer and its advisors will need to consider several issues before commencing the road show. First, the road show will be subject to liability under § 12(a)(2) of the Securities Act and Rule 10b-5 under the Exchange Act. Second, Regulation FD applies to

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WKSI road shows taking place before the filing of a registration statement. This means that material nonpublic information contained in the road show must be either removed or made publicly available (or, alternatively, the issuer may require recipients of the road show to expressly agree to keep it confidential). Third, the road show presentations (that are not oral presentations) will need to include a free writing prospectus legend. Because of these considerations, WKSIs generally wait until the registration statement has been filed before commencing the road show.

During the waiting period, oral offers are permitted and permissible written offers are limited to the preliminary prospectus and free writing prospectuses. Traditional road shows, consisting of live in-person presentations or meetings, are oral communications. A slide deck, videos, visual aids or other materials accompanying the live presentations are also oral communications, provided that any handouts distributed at the presentations are returned by the attendees at or before completion of the presentation. [204] A live stream of a road show presentation, live telephone conversation or broadcasts to overflow rooms at live road shows are also oral communications.

Under Rule 433 of the Securities Act, a road show that is a written communication is a free writing prospectus. [205] Under Rule 405 of the Securities Act, a "written communication" consists of any communication that is written, printed, a radio or television broadcast, or a graphic communication. [206] A "graphic communication" includes "all forms of electronic media, including, but not limited to, audiotapes, videotapes, facsimiles, CD-ROM, electronic mail, Internet Web sites, substantially similar messages widely distributed (rather than individually distributed) on telephone answering or voice mail systems, computers, computer networks and other forms of computer data compilation … [but] shall not include a communication that, at the time of the communication, originates live, in real-time to a live audience and does not originate in recorded form or otherwise as a graphic communication, although it is transmitted through graphic means." [207] Accordingly, recorded road shows (including live telephone calls, videos or webcast conferences that are recorded by the originating party), slides and other handouts distributed at the road show presentation but not collected from attendees at or before completion of the presentation, information posted on websites and all radio or television broadcasts (whether or not live). are written communications and, thus, free writing prospectuses.

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A road show that is a free writing prospectus will need to be filed with the SEC if it relates to the IPO of common equity or convertible equity securities by a non-reporting issuer *unless* at least one *bona fide* electronic road show (otherwise known as a retail road show) is made generally available to investors. [208] In practice, issuers make *bona fide* electronic road shows available to the public, and, as such, IPO road shows are rarely filed with the SEC.

All road shows, whether an oral or written communication and whether or not filed with the SEC, are subject to liability under § 12(a)(2) of the Securities Act and Rule 10b-5 under the Exchange Act. [209]

[iv] *Permitted Use of a Free Writing Prospectus*

[A] Overview

Before the adoption of the Securities Offering Reforms, written offers (other than by means of the preliminary prospectus), even those made after filing of the registration statement but before the registration statement was effective, were violations of § 5 of the Securities Act. To eliminate this outmoded prohibition and promote the dissemination of useful information, the SEC introduced the concept of the "free writing prospectus" in the Securities Offering Reforms and provided an exemption for written offers other than a preliminary prospectus that meet the conditions for use of a free writing prospectus. [210] These rules define a "free writing prospectus" as any written communication representing an offer to sell or a solicitation of an offer to buy securities that is or will be the subject of a registration statement that does not otherwise satisfy the statutory

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prospectus requirements. [211] Where a free writing prospectus is prepared by or on behalf of, [212] or used or referred to by, the issuer, it is defined as an "issuer free writing prospectus." Whether a particular communication is an offer will be determined, as was the case in the past, based on the particular facts and circumstances of the communication, and not all communications related to an offering will be an offer required to fall within the framework for free writing prospectuses.

Rule 164 under the Securities Act provides a nonexclusive safe harbor for the use of a free writing prospectus by an eligible issuer [213] or any other offering participant (including an underwriter or dealer) after an eligible issuer has filed a registration statement and the conditions set forth in Rule 433 under the Securities Act are satisfied. [214] Most ineligible issuers (and their offering participants) may use free writing prospectuses the contents of which are limited to descriptions of the terms of the offered securities and the offering. [215] Where Rule 164 applies, Rule 433 contains the eligibility, legend, [216] filing and record

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retention [217] requirements for using a free writing prospectus after a registration statement has been filed. [218]

Rule 433, which permits the use of a free writing prospectus, does not provide any line-item or other specific disclosure or informational requirements, other than a legend. The free writing prospectus will not have to be filed as part of the registration statement and, thus, will not be subject to liability under § 11 of the Securities Act. Moreover, the SEC has amended Rule 408 to make clear that a failure to include information from a free writing prospectus in a registration statement will not be considered, by itself, an omission of material information required to be included in the registration statement. Any free writing prospectus, regardless of whether it was filed, will be subject to liability under § 12(a)(2) of the Securities Act and Rule 10b-5 under the Exchange Act. [219]

Rule 433 prohibits a free writing prospectus from containing any information that "conflicts with" any information in the registration statement. Based on informal guidance from the SEC staff, the SEC's intention is to prohibit only free writing prospectuses that cannot be reconciled with the statutory prospectus. Accordingly, any free writing prospectus that makes clear it is correcting, updating or otherwise revising information in a statutory prospectus will be permitted (and, indeed, encouraged).

[B] Preliminary Prospectus Requirements for Non-Reporting and Unseasoned Issuers

Use of a free writing prospectus by seasoned issuers and WKSIs and related offering participants is not conditioned on actual delivery of a preliminary prospectus. Rule 433 under the Securities Act requires a free writing prospectus used in these circumstances to include the URL address of the SEC's website where the preliminary or base prospectus may be accessed. [220]

Use of a free writing prospectus by non-reporting and unseasoned issuers and related offering participants is permitted only if the most recent statutory

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prospectus accompanies or precedes the free writing prospectus. [221] The statutory prospectus would not have to be provided through the same medium as the free writing prospectus so long as it is provided at the required time. For electronic free writing prospectuses, this delivery requirement may be satisfied by including a hyperlink to the most recent prospectus. This ability to satisfy the delivery requirement by a hyperlink contrasts with the SEC's prior guidance that advance consent must be provided for electronic delivery, [222] and is an example of the manner in which the Securities Offering Reforms represented the beginning of an SEC effort to encourage and rationalize the use of electronic means of communications. Once an investor has been sent a preliminary prospectus, additional free writing prospectuses may be distributed to the investor without having to provide another statutory prospectus, unless there has been a material change to the information in the preliminary prospectus. After effectiveness and availability of a final prospectus, no earlier statutory prospectus may be provided, and offering material other than the final prospectus may be used only if accompanied or preceded by a final prospectus.

[C] Filing Conditions

Under Rule 433, issuers will generally be required to file free writing prospectuses on or before the date of their first use [223] under the following circumstances:

- Where a free writing prospectus is prepared by or on behalf of the issuer or used or referred to by the issuer—an "issuer free writing prospectus."
- Where a free writing prospectus prepared by or on behalf of or used by an offering participant other than the issuer contains material information about the issuer or its securities that has been provided by or on behalf of the

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  issuer— "issuer information"—that is not already contained or incorporated in the registration statement or a filed free writing prospectus. [224] This condition does not apply if the free writing prospectus contains information prepared on the basis of or derived from issuer information but not issuer information itself.
- Where a free writing prospectus prepared by or on behalf of or used by the issuer or any offering participant contains a description of the final terms of the issuer's securities or of the offering, after such terms have been established for all classes in the offering (in which case the free writing prospectus would have to be filed within two days after the later of (i) the date such terms became final for all classes and (ii) the date of first use). [225]

As discussed below, an important exception to the timing of filing a free writing prospectus relates to an independently prepared media publication, which is required to be filed within four business days after the issuer or offering participant becomes aware of its publication or first broadcast.

A free writing prospectus would not have to be filed by the issuer if it did not contain substantive changes from or additions to a previously filed free writing prospectus. In addition, a free writing prospectus used at the same time as a communication in a business combination transaction subject to Rule 425 under the Securities Act will not have to be filed if certain conditions imposed in connection with the rules applicable to business combination transactions are met. [226]

While the rules do not generally require that offering participants file free writing prospectuses that they prepare (*e.g.*, communications with proprietary underwriter information), a free writing prospectus prepared by an offering participant other than the issuer that is distributed in a manner reasonably designed to lead to its broad, unrestricted dissemination would require filing by that

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offering participant on or before the date of first use, unless it has already been filed. [227]

Rule 164 under the Securities Act permits an issuer or any other person to cure any immaterial or unintentional failure to file or delay in filing a free writing prospectus without losing the ability to rely on the safe harbor. The cure provisions are available if a good faith and reasonable effort was made to comply with the filing condition and the free writing prospectus is filed as soon as practicable after the discovery of such failure. Similarly, an immaterial or unintentional failure to include the specified legend in a free writing prospectus will not preclude reliance on the safe harbor so long as a good faith and reasonable effort was made to comply with the legending condition and the free writing prospectus is amended to include or correct the legend as soon as practicable after discovery of the omitted or incorrect legend. [228] In addition, a free writing prospectus including the correct legend would have to be retransmitted by substantially the same means as, and directed to substantially the same prospective purchasers to whom, the free writing prospectus was originally transmitted. [229]

[v] *Treatment of Certain Communications Under Free Writing Prospectus Rules*

[A] Media Publications

Rule 433 under the Securities Act provides for special treatment of free writing prospectuses that are independently prepared and published by the media. When issuers or offering participants provide issuer or offering-related information to the media, its publication or broadcast (in any format) will constitute a free writing prospectus if the written distribution of such information by the issuer or offering participant would constitute a written offer. Except for

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WKSIs, publication of such information prior to filing a registration statement would violate § 5 of the Securities Act, unless otherwise exempted.

For independently prepared media publications that are free writing prospectuses [230] and for which no payment is made or consideration given by or on behalf of the issuer or other offering participant, Rule 433 requires the issuer (or offering participant if appropriate) to file the publication with the required free writing prospectus legend within four business days after the issuer or offering participant becomes aware of its publication or first broadcast. For non-reporting and seasoned issuers, in these instances, the statutory prospectus would not be required to precede or accompany distribution of the free writing prospectus. [231]

[B] Offers on Websites

Rule 433 makes clear that an offer of an issuer's securities that is contained on an issuer's or offering participant's website, or hyperlinked by the issuer or offering participant from its website to a third-party website, is considered a written offer and, unless exempt, a free writing prospectus. In addition,

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the information on the hyperlinked website could be part of that free writing prospectus.

[C] Historical Information on an Issuer’s Website

Historical issuer information that is properly identified as such and located in a separate section of an issuer's website containing historical information (*e.g.*, archives) would not be considered an offer (and, therefore, is not a free writing prospectus) even if accessed at a later time—unless such information is used or referred to (by hyperlink or otherwise) in connection with an offering, including by incorporation by reference.

[D] Term Sheets

A free writing prospectus (or portion thereof) that contains only a description of the issuer's securities being offered or of the offering, regardless of who prepared or used it, will not be subject to filing unless it reflects the final terms of the securities being offered or the offering and until final terms have been established for all classes in the offering. Thus, preliminary term sheets or other materials limited to describing the terms of the securities being offered that do not contain the final terms of those securities or the offering may be free writing prospectuses but will not be required to be filed. The filing of a final prospectus supplement under Rule 424 under the Securities Act will not satisfy the filing requirement for a final term sheet (despite the fact that the timing of the filing requirement will in many cases be the same for both documents). [232]

[vi] *Interaction of Communications Rules with Regulation FD*

As discussed in Chapter 4, Regulation FD (Fair Disclosure) requires that whenever an issuer intentionally discloses material nonpublic information, it must do so through a general public disclosure, and that whenever an issuer learns that it has made a non-intentional selective disclosure, it must make public disclosure of that information promptly. [233] Primary registered offerings of securities are generally not subject to Regulation FD, and the following disclosures made by an issuer in communications in connection with a registered securities offering are not subject to Regulation FD:

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- a registration statement filed under the Securities Act for sales of securities by an issuer (but not for registration statements related only to secondary sales), including a prospectus included in such registration statement; [234]
- a free writing prospectus used after filing of a registration statement;
- a communication falling within the exception to the definition of prospectus contained in clause (a) of § 2(a)(10) of the Securities Act (for so-called "free writings");
- any other preliminary prospectus under § 10(b) of the Securities Act;
- a notice permitted by Rule 135 or communication permitted by Rule 134 under the Securities Act; and
- an oral communication made in connection with a registered offering after filing of the registration statement.

At the same time, the Securities Offering Reform Release makes clear that many of the communications that are not deemed to be "offers"— *e.g.*, regularly released factual business information, regularly released forward-looking information or pre-filing communications—are subject to Regulation FD.

Though Regulation FD does not apply to foreign private issuers, compliance is indicative of best practice, and relevant to questions of insider trading. [235]

[d] The Post-Effective Period: After a Registration Statement Becomes Effective

The SEC has a long-standing position that so long as an issuer is "in registration" it should not engage in communication activity outside the prospectus that could be deemed an "offer." An issuer remains "in registration" after the effectiveness of a registration statement through the end of the period that prospectus delivery requirements apply. [236] Rule 174 under the Securities Act eliminates the prospectus delivery period required by §4(a)(3) of the Securities Act for issuers that are reporting companies immediately prior to the effectiveness of a registration statement; however, a prospectus is required to be delivered by dealers in the case of unsold allotment securities and in the case of initial public offerings for 25

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days in the case of securities listed on a national securities exchange and for 90 days in the case of securities not so listed, measured from the later of the *bona fide* offering date and the effective date of the registration statement. [237]

In order to avoid publication of information by a company in registration that could constitute an impermissible offer, issuers should not initiate investor relations or new publicity efforts following an IPO during the prospectus delivery period. [238] Issuers can respond to legitimate inquiries for information about the company's financial condition and business operations, but such communication should be limited to factual information and should not include such things as predictions, projections, forecasts or opinions with respect to value. [239]

Rule 134, discussed above in § 3.02[3][c][i], also permits an issuer to advertise its public offering after the filing of the registration statement in a press release. Typically, such press releases are used to announce a successful offering and are therefore released after pricing following effectiveness of the registration statement. Underwriters also often publish a limited advertisement known as a "tombstone ad" after a successful offering. Tombstone ads are subject to the same, Rule 134-based limitations as to content if issued when communication restrictions continue to apply during the post-effective period.

[e] Research Reports [240]

The issuance of research reports during, or in connection with, an offering, even an IPO, historically has been a customary market practice outside the United States. [241] In the context of U.S.-registered IPOs, however, research reports generally are not distributed in or into the United States because of liability concerns and, except with respect to EGCs, [242] restrictions in § 5 of the Securities Act. [243] In the context of U.S. registered offerings by U.S. reporting

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issuers or certain eligible foreign private issuers (as defined below), the distribution of research reports in or into the United States is permissible under § 5 of the Securities Act, provided the conditions of certain nonexclusive safe harbors are met, but is still subject to prudential restriction because of liability concerns.

To ensure compliance with rules governing the content and dissemination of research reports, the practice in global offerings is to distribute research report guidelines to all offering participants. [244]

[i] *Research Reports in the Context of U.S.-Registered IPOs*

In the context of U.S.-registered IPOs, underwriting syndicates, for the reasons discussed above, generally prohibit the release of research reports in or into the United States during a prescribed blackout period, which typically runs until the later of (i) completion of the distribution of securities that are the subject of the offering and (ii) 25 calendar days [245] after the pricing date of the offering. In the context of global offerings with a U.S. registered component, underwriting syndicates may permit the release of research reports outside the United States (subject to applicable local law requirements). [246]

[ii] *Research Reports in the Context of U.S.-Registered Offerings by U.S. Reporting Companies or Foreign Private Issuers Meeting Certain Conditions*

Underwriters for an offering by a publicly traded company often will have issued research reports about the company and may wish to update those reports in advance of or during an offering. The SEC recognizes that research is essential to an efficient market. Nevertheless, it believes that investors purchasing securities in a registered offering should rely primarily on disclosure in the prospectus and any free writing prospectus.

Accordingly, the SEC has promulgated limited, nonexclusive safe harbors under the Securities Act with respect to the dissemination of certain communications around the time of an offering that protect broker-dealers participating in

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the offering from § 5 liability if they distribute research reports regarding the issuer at these times but only if specified conditions are satisfied. The exceptions that allow the publication of research reports and other information during a U.S. public offering acknowledge that, in the case of seasoned issuers, the policy of ensuring that offers to investors are made only on the basis of the disclosure in the prospectus is outweighed by the importance of keeping such issuers' existing shareholders and the market informed. Such issuers have a wide market following, and most investors already have much information about them. [247]

[A] Research Reports by Broker-Dealers Participating in the Offering

Provided certain conditions are met, Rule 139 under the Securities Act permits broker-dealers that are or will be participating in a U.S. public offering of securities to publish research reports [248] about an issuer [249] or its securities at any time during the offering (*i.e.*, whether before or after filing of the registration statement or before or after effectiveness of such registration statement).

The issuer must be a seasoned reporting company under the Exchange Act (*i.e.*, eligible to use Form S-3 or Form F-3) or a foreign private issuer that satisfies the following criteria: (i) it meets the registrant eligibility requirements for the use of Form F-3 other than certain reporting history requirements, (ii) it meets the Form F-3's public float requirement or is offering nonconvertible securities other than common equity and (iii) it has had securities trading on a "designated offshore securities market" (as defined in Regulation S under the Securities Act) for at least 12 months or has a worldwide market value of its outstanding common equity held by nonaffiliates of $700 million or more (such an issuer, an "Eligible Foreign Private Issuer"). [250] To take advantage of the Rule 139 safe harbor, research reports on the issuer must be published in the regular

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course of the broker-dealer's business and cannot represent the initiation of coverage on the issuer or its securities or the reinitiation of such coverage following a previous discontinuation. [251]

Rule 139 also permits broker-dealers that are or will be participating in a U.S. public offering of securities to publish research reports about the issuer's industry at any time during the offering (*i.e.*, whether before or after filing of the registration statement or before or after effectiveness of such registration statement), provided certain conditions are met. For industry reports, (i) the issuer [252] must be a reporting company under the Exchange Act or an Eligible Foreign Private Issuer, (ii) the research report must include similar information with respect to a substantial number of issuers in the issuer's industry or contain a comprehensive list of securities recommended by the broker-dealer, (iii) the analysis regarding the issuer or its security should be given no greater prominence than that given to other securities or issuers and (iv) the broker-dealer must publish such research reports in the regular course of its business and, at the time of publication, is including similar information about the issuer or its securities in similar reports. [253]

[B] Research Reports by Broker-Dealers About Securities Other Than Those Being Offered

Broker-dealers that are or will be participating in an offering of securities of an issuer [254] may also publish at any time during the offering (*i.e.*, whether

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before or after filing of the registration statement or before or after effectiveness of such registration statement) certain information with respect to certain other securities of the issuer, [255] provided that the issuer is a reporting issuer current in its Exchange Act reports or an Eligible Foreign Private Issuer. [256] In addition, the broker-dealer must have previously published or distributed, in the regular course of its business, research reports on the types of securities that are the subject of the reports (though not necessarily securities of the subject issuer). [257]

[iii] *Research Reports by Broker-Dealers Not Participating in the Offering*

A broker-dealer not participating in an offering of securities (whether in the context of U.S registered IPOs or U.S. registered offerings by U.S. reporting companies or foreign private issuers meeting certain conditions) may publish research with respect to such securities at any time during the offering (*i.e.*, whether before or after filing of the registration statement or before or after effectiveness of the registration statement) if such broker-dealer (i) is not compensated for such publication by persons participating in the offering, (ii) is not acting under any direct or indirect arrangement or understanding with the issuer, any selling securityholder, any participant in the distribution of the securities or any other person interested in the securities and (iii) publishes the research report [258] in the ordinary course of its business. [259]

[iv] *Research Reports in the Context of U.S.-Registered Offerings by EGCs*

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The JOBS Act provides that pre-deal research reports on an EGC do not violate the "gun-jumping" restrictions in the Securities Act. This exemption from the gun-jumping restrictions applies to all public offerings of common stock by EGCs (not just EGC IPOs). The JOBS Act provides that the publication or distribution of a research report by a broker or dealer about an EGC that is the subject of a proposed public offering of common stock pursuant to an SEC registration statement does not constitute an offer for sale or offer to sell a security for purposes of § 2(a)(10) or § 5(c) of the Securities Act, regardless of whether the registration statement has been filed or is effective, and regardless of whether the broker or dealer will participate in the offering. [260]

This lifting of prohibitions on underwriter research is more expansive than the safe harbor provided by Rule 139 under the Securities Act for pre-offering research, which is designed to permit the continuation of ordinary course research on companies that are already publicly traded. The definition of "research report" as used in the JOBS Act is also broader than the definition of "research report" used in Rule 139, in that it includes oral communications. This difference is rooted in the difference in objectives between the JOBS Act (fostering research coverage of EGCs to facilitate their common stock offerings) and Rule 139 (not interfering with ongoing publication of research reports).

By eliminating research reports on EGCs from the definition of "prospectus" in § 2(a)(10) of the Securities Act, the JOBS Act also affects the liability regime of the Securities Act, because research reports on EGCs are no longer subject to liability for material misstatements or omissions under § 12(a)(2). Because § 12(a)(2) refers separately to oral statements, however, materially defective oral communications may still fall within § 12(a)(2)'s liability provisions, whether or not they are research reports. In addition, research reports will still fall within the definition of "offer" covered by the antifraud provisions of § 17 of the Securities Act enforceable by the SEC.

Significantly, the JOBS Act also does not limit the potential for federal securities law antifraud liability for research reports under § 10(b) of the Exchange Act. Accordingly, underwriters generally are unwilling to accept the liability risk associated with publishing research concerning EGCs that is permitted by the JOBS Act.

[v] *Distribution of Research Reports Outside the United States*

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The restrictions resulting from § 5 of the Securities Act do not apply to activities abroad with respect to concurrent offerings outside the United States by non-U.S. issuers, so long as those offerings are being made in reliance on the exemption from the registration requirements of § 5 provided by Regulation S under the Securities Act. Thus, so long as research reports are isolated from the United States, they should not be restricted by § 5 of the Securities Act. [261] Isolation is generally accomplished by limiting mailings to addresses outside the United States, placing a restrictive legend [262] on the face of the reports and

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sending a cover letter or other form of notice together with each report that highlights the prohibitions against distribution to U.S. persons or into the United States. [263]

[vi] *Disclosure Liability Applicable to Research Reports*

One issue that must be considered in connection with the issuance of research reports, including in particular Rule 138 or Rule 139 research reports by broker-dealers participating in a U.S. public offering, is the potential liability associated with the contents of such reports. There is a risk that an investor might sue the distributor of the research report, and possibly the issuer, on the basis of any material misstatements or omissions in the report. Because Rule 138 and Rule 139 provide that covered research reports are not "offers for sale" or "offers to sell" for purposes of §§ 2(a)(10) and 5(c) of the Securities Act, liability for any material misstatement or omission would arise principally under § 10(b) of the Exchange Act and Rule 10b-5 thereunder. [264] Although the preparer of the report might be willing to accept the potential liability risks associated with the contents, because it presumably has satisfied itself as to their accuracy, the issuer also might be held liable for such contents if it has been involved in the preparation of the report (including by holding informational meetings with brokerdealers or otherwise providing comments to the report). [265]

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In the past, the practices of U.S.-based investment banking firms and their non-U.S. affiliates on the one hand, and their European-based counterparts on the other, diverged with respect to the distribution of research relating specifically to an issuer that is the subject of an offering. While many European financial houses routinely distributed such research in the United States if Rule 139 was available (subject to a "blackout period," typically of one to two weeks prior to distribution of the preliminary prospectus), most U.S. firms did not distribute such research in the United States even where Rule 139 was available due to liability concerns (although a number of U.S. underwriters countenanced industry-wide research that merely referred to the issuer). [266] Increasingly, however, U.S. firms have been willing to distribute research during an offering in reliance on Rule 139, in some cases stripping out the recommendation with respect to the issuer's securities to attempt to minimize liability concerns.

These liability concerns, and the resulting restrictions on the distribution of research, have created a regulatory dilemma in the United States and elsewhere. The reluctance of market participants to provide forward-looking information, such as projections and forecasts, in a prospectus filed as part of a registration statement [267] means that forward-looking information is frequently available to investors only orally from members of the syndicate and through research reports. Not only do restrictions on this information impede investor access to forecasts, but brokers' salespeople are frequently pressed to inform clients orally of the view of the in-house analyst even when research reports are not being distributed. Under these circumstances, investors often get an oversimplified view of the analysts' impressions, without the detailed and nuanced analysis that a written report would provide.

[vii] *Publicity Considerations Concerning Internet Communications*

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Under the Securities Act, communications via the Internet are treated as written communications, like those in newspapers or other traditional media. Issuers restrict publicity during an offering and are similarly advised not to establish or expand websites during the period that publicity restrictions may be in effect—typically until the end of the prospectus delivery period. [268] However, consistent with the ability of issuers to disseminate ordinary course corporate communications not relating to an offering under the standard U.S. publicity restrictions, issuers may continue to use an existing website during an offering for ordinary course communications, as long as that information does not conflict with information in the prospectus for the offering. [269] Press releases that can be issued pursuant to Rules 134, 135, 135c, 168 and 169 under the Securities Act, [270] and the preliminary and final prospectuses, can also be posted on an Internet site. [271]

U.S. restrictions on the distribution of research apply equally to the distribution of research over the Internet. Research reports of the type intended for distribution exclusively outside the United States cannot be posted to a website, unless measures are implemented to ensure that the reports cannot be accessed in the United States. However, research reports complying with the provisions of Rules 138 and 139 under the Securities Act may be placed on the Internet sites of broker-dealers without the research being deemed an "offer" for purposes of § 5 of the Securities Act. These rules, however, do not permit an issuer to publish or distribute the same information on its website. [272]

[4] Global Offerings and Interaction with U.S. Public Offering Requirements

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U.S. rules and regulations have imposed a standard pattern on registered public offerings in the United States, and much of the complexity of global offerings involving U.S.-registered offerings is generated by the way in which foreign regulatory regimes impose conflicting patterns. In many cases, the non-U.S. component of a global offering is made in a way that is exempt from the application of the regulations that would apply to an offer to the public in the foreign countries in which the global offering is made. The exemption typically relied on in many countries is the so-called "professionals" exemption, which in certain circumstances permits offers and sales of securities to be made to institutions and other market professionals with few regulatory requirements. If the international offering includes a public offering in one or more national markets, however, various registration and regulatory requirements of that country may apply, and these requirements will have to be integrated with the U.S. rules. In such a situation, complex issues are likely to arise that will have to be identified and resolved at an early stage in the offering process.

[a] The U.S. Registration of Securities Offered and Sold Outside the United States

When a global offering involves a U.S. public offering and the issuer is a foreign issuer, the issuer and the underwriters must decide whether any of the shares to be offered and sold outside the United States should be registered under the Securities Act. So long as the offerings outside the United States are made in accordance with Regulation S under the Securities Act, there is generally no need to register the securities that are offered and sold abroad. [273] However, because regional demand often cannot be anticipated completely accurately at the time of registration, underwriters typically will register more securities than they expect to place in the United States. Moreover, the registration of some of the shares

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offered and sold abroad would permit resales into the U.S. market that are required to be registered, for example, by dealers that purchase the securities in the offering outside the United States and wish to sell them immediately in the United States during the prospectus delivery period mandated by § 4(a)(3) of the Securities Act. For offerings of securities expected to trade primarily in a market outside the United States, the amount of additional securities registered is typically about 10% to 15% of the tranche of securities being offered outside the United States. Foreign issuers whose securities are expected to be traded primarily in the United States should register a significantly higher percentage (and perhaps all) of the offering.

The number of shares that will be offered in the United States generally is estimated at the time the registration statement is initially filed and that number (together with a percentage of the shares offered outside the United States to take account of possible resales of shares into the United States when securities dealers are required to deliver a prospectus by § 4(a)(3) of the Securities Act) is registered under that registration statement. [274] The number of shares to be registered may be increased by an amendment to the registration statement prior to its effectiveness, but, except for automatic shelf registration statements and certain registration statements filed by investment companies, once a registration statement is effective, additional securities (including securities of the same class) can only be registered by filing a new registration statement. [275]

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Regardless of whether any or all of the international shares are to be registered, the registration statement in a global offering need not contain the prospectus to be used abroad because the initial offers and sales outside the United States are not required to be registered, [276] and, accordingly, the obligation to use a prospectus that complies with the requirements of the Securities Act does not apply to them. The registration statement should state clearly in these circumstances that it only covers offers and sales initially made in the United States and, if international shares are being registered, resales into the U.S. market when a registration statement is required to be in effect or a U.S. prospectus delivered. [277]

[b] Offering Documentation in a Global Offering with a U.S.-Registered Component

In the case of a U.S.-registered offering, the offering documentation consists of the relevant registration statement and prospectus and any free writing prospectuses. Preparation of the prospectuses or other offering documentation to be used in the various countries in which a global offering will be conducted can take a great deal of time. A global offering, in particular one with multiple listings, will often involve at least two prospectuses, one for the home market of the issuer, typically prepared in connection with a retail offering or listing pursuant to home market rules and in the local language, and a second, international prospectus, usually prepared in English for institutional investors outside the home market. [278] There are many variations on this theme: multiple prospectuses for public offerings in various countries outside the home market (*e.g.*, Japan and the United States) prepared in accordance with public offering rules in those countries; a separate international version of the prospectus prepared for use in the U.S. public offering component of the offering; a single "global" prospectus used in every jurisdiction, and so on. [279]

While offering participants generally make an effort to make the contents of each prospectus substantively consistent, the judgment in that regard needs to take into account the incremental risks that that will entail as further described below. If home-market rules require particular information that is not required in the United States, should it be included, even if unusual, in a U.S. prospectus? What if the information required abroad seems too risky to include from a liability standpoint in a U.S. prospectus (such as financial projections)? The answers to these questions can vary depending on the circumstances. The typical approach is to include all information required in the home-market prospectus in the U.S. and international prospectuses if it does not raise U.S. liability concerns, and to exclude immaterial or irrelevant information and, in some cases,

information that raises U.S. liability concerns. An example of frequently excluded immaterial or irrelevant information is home-country GAAP financial information required in the home market but not in the United States or elsewhere (*e.g.*, parent company (unconsolidated) financial statements are required in many jurisdictions but not in the United States). [280] Such information is often excluded from the U.S. and international prospectuses on the grounds that it adds little, if anything, to a U.S. or international investor's understanding of the issuer, and it sometimes can be confusing (especially if the local GAAP information is very different from U.S. GAAP or IFRS). In some instances, such additional financial or other information has been included as an annex to the prospectus, headed by a legend that it is being included to comply with home-market statutory or regulatory requirements or home-market practice.

Financial projections required in some markets are a much trickier proposition. Although U.S. rules require discussion of known material trends and uncertainties in respect of financial results and performance, they do not require projections. Accordingly, there is a risk that if projections are published by the company elsewhere and not included in the U.S. prospectus, the U.S. prospectus will then be viewed as having omitted a material fact necessary to make the statements therein not misleading, giving rise to potential liability. [281] If projections are more negative than an investor would otherwise expect from the historical financial information included in the prospectus, then inclusion of those projections would appear necessary to comply with the trend requirement. Where, however, the projections are either consistent with or more favorable than historical information would suggest, including them may subject the issuer to liability under § 11 of the Securities Act and a duty to update. [282] The typical approach in order to avoid this dilemma is to attempt to convince the local regulators that financial projections should not be included given the global nature of the offering and the fact that they would not customarily be included in the prospectuses

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for other parts of the world. This argument is often accepted by regulators, although it may be necessary to include, in lieu of projections, an "outlook" or similar section in which the issuer's prospects are presented in a narrative form, without specific financial projections. Where financial projections cannot be avoided in the home market, consideration should be given to potential liability concerns, on the one hand, and whether omission of the information would cause any required information or any other information in the prospectus to be misleading. [283]

An important logistical question is which prospectus will be the "master" document from which other versions will be copied or translated. The local market prospectus is sometimes chosen as the lead document. If the international and U.S. markets are expected to play a very substantial role in the offering, the international or U.S. offering prospectus may be the primary focus, with translations into other languages prepared when the English draft has matured to an appropriate stage. This approach is especially common where a U.S. public offering prospectus is being prepared.

The timing issues can be quite complex when multiple public offerings are involved and regulators in more than one country each must review a prospectus prepared in accordance with their rules. Much advance planning is needed to ensure that all preliminary filings are done in time, that comments by each regulator can be addressed effectively in each prospectus before it is finalized and that any necessary approvals can be obtained in order to facilitate commencement of the offering on a global basis at the same time. [284]

Special attention also must be paid to the regulatory process in the home market insofar as it relates to whether there will be a final prospectus, or only the original one circulated to investors. In U.S. public offerings, the preliminary prospectus circulated to potential investors in an IPO would contain an indicative price range, the final price would be conveyed to investors either orally or through a free writing prospectus following the effectiveness of a registration statement but prior to the time of sale, and a final prospectus, including all pricing information, would be filed with the SEC in accordance with Rule 424 under the Securities Act. [285] This is not true in many other jurisdictions, where there is

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only one prospectus circulated in connection with the bookbuilding, subscription or other marketing process. If changes need to be made to update information provided in the U.S. preliminary prospectus through a free writing prospectus or otherwise, conflicts can arise between jurisdictions because there is no mechanism for amending or updating the prospectus in certain markets.

The amount of time needed to translate a prospectus into another language should not be underestimated. If an outside translation service is used, for example, a considerable amount of time and effort might be necessary to refine the translation, such as in relation to descriptions of technical aspects of a business. Agreement should be reached early in a transaction as to which party will take responsibility for the accuracy of any translations.

Finally, the due diligence and verification procedures customary in each jurisdiction are likely to be different in certain respects. [286]

[c] Publicity Considerations in the Context of a Global Offering

It may be useful to contrast the U.S. and U.K. rules on publicity in order to highlight some of the difficulties that arise in global offerings. The United Kingdom, like many other jurisdictions, permits much more publicity about an initial public offering outside the offering document than does the United States. Large global equity offerings in the United Kingdom and elsewhere in Europe sometimes have been preceded by full-scale media advertising campaigns and distributions of brochures describing the issuer and the offering process. Such advertising is permitted if certain procedural requirements are followed. English law also permits unlimited communications that are invitations or inducements to subscribe for securities that do not comply with such procedural requirements so long as they are addressed only to persons falling within certain exemptions, the most commonly used of which are for communications made to or directed at investment professionals and high net worth individuals. These sorts of communications could in fact be widely available—on publicly available web pages, for example—but because they are expressly addressed only to investment professionals and high net worth individuals (by way of a legend), and because any

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subsequent offer and actual sales of the securities would only be made to qualified investors under the United Kingdom's Prospectus Rules, widely available communications that would not be permissible under U.S. rules are permissible in the United Kingdom. Conflicts between the U.S. and other systems can arise in global offerings, especially by non-reporting issuers, because, except in limited circumstances, [287] the U.S. securities laws require that publicity efforts by non-reporting issuers be restricted to jurisdictions outside the United States. Difficulties can develop, for example, if advertisements are placed in publications that are also distributed in the United States. For these publications, steps must be taken to prevent the publication in their U.S. editions of advertising materials that could constitute an offer. In some transactions, offering participants have sought to document their efforts to avoid U.S. publicity by getting certain publications to agree in writing not to publish advertisements in specified jurisdictions. [288]

The SEC is particularly sensitive about such matters. In a global equity offering involving a U.K. issuer, where advertisements prepared for publication outside the United States inadvertently appeared in the U.S. edition of *The Financial Times*, the SEC expressed concern and requested an explanation from the offering participants. Despite the liberalization of publicity rules that resulted from the Securities Offering Reforms, the U.S. prohibition against pre-offering publicity for unseasoned issuers and non-reporting issuers will continue to prevent offering participants from placing paid advertisements in U.S. publications or U.S. editions of non-U.S. publications.

As discussed above, SEC rules provide a number of exceptions to the restrictions on publicity related to an offering, especially with respect to activities conducted outside the United States by foreign issuers. Rule 135 under the Securities Act permits an issuer to disclose certain limited information in advance of the filing of a registration statement, while Rule 134 under the Securities Act permits certain limited communications by any party after the filing of a registration statement. [289] In contrast to limitations on information about the offer, routine corporate communications for purposes other than inducing the purchase or sale of the securities being distributed that are consistent with past practice are generally permissible under either Rule 168 or Rule 169 under the Securities Act, subject to certain conditions. [290] Thus, press releases published

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with reasonable regularity regarding financial results or the occurrence of material events with respect to an issuer can generally be issued in the ordinary course of business.

In the case of large, high-profile offerings, restrictions on publicity may become prudent far in advance of the actual offering, especially where there is intense market interest in the offering. In these circumstances, the broad ambit of § 5 of the Securities Act will always create some uncertainty as to whether even "normal" publicity activities could be viewed as offering activities or efforts to condition the market, even following the adoption of certain provisions of the Securities Offering Reforms intended to facilitate greater availability of information to investors and the market. This in turn may lead the issuer to modify its behavior in a way that is detrimental to the flow of information to the market (*i.e.*, by withholding information that in the ordinary course it would otherwise make public), an unintended result of the U.S. restrictions.

As a technical matter, the U.S. restrictions regarding publicity and the other restrictions resulting from § 5 of the Securities Act do not apply to activities abroad with respect to concurrent offerings outside the United States by non-U.S. issuers, so long as those offerings are being made in reliance on the exemption from the registration requirements of § 5 provided by Regulation S under the Securities Act. Regulation S permits advertisements in connection with offerings outside the United States so long as they are not contained in a publication with a "general circulation" in the United States. [291] Moreover, Preliminary Note 9 of Regulation S states expressly that nothing in it "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 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." [292] Customary practices in foreign markets, such as the preparation and distribution of research reports in connection with an offering, full-scale television and press advertising campaigns or the use of offering incentives, as occurred in several of the U.K. privatizations, [293] are not intended to be affected by Regulation S.

Notwithstanding these provisions of Regulation S, prior to 1997, significant uncertainty surrounded the question of whether and when representatives of publications with a general circulation in the United States could participate in offshore press activities, especially one-on-one interviews. Offering participants had been uncertain about what activities might be construed as being "intended to induce purchases … by persons in the United States." [294] Partly in response to this uncertainty, in 1997 the SEC adopted Rule 135e, which contains a safe harbor for foreign private issuers and foreign governments that invite journalists to participate in such activities so long as:

- the relevant activity is conducted offshore; [295]
- at least part of the offering is conducted outside the United States; [296]
- access to the offshore press activities is provided to members of the U.S. and foreign press; and
- any offering-related materials provided to the press that may be of significant interest to U.S. investors contain a prescribed cautionary legend. [297]

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In connection with the general access requirement, the SEC's adopting release clarified that this requirement does *not* prohibit one-on-one meetings with representatives of U.S. publications, or of publications with a general circulation in the United States, so long as prior or subsequent thereto the issuer or its representatives conduct offshore a press conference to which both the U.S. and foreign press are provided access. [298]

Rule 135e has had a beneficial effect on market practice regarding the limitations on publicity imposed on foreign issuers outside the United States, clarifying the scope of permissible press communications and substantially liberalizing the ability of foreign issuers to conduct one-on-one interviews with members of the U.S. and non-U.S. press. Precisely because Rule 135e has had a liberalizing effect, however, foreign issuers and underwriters must continue to pay careful attention to the content of any permitted publicity. Even if statements abroad are exempt from the prohibitions of § 5 of the Securities Act by virtue of Regulation S, Rule 135e or another applicable rule, the SEC may require them to be reflected in a U.S. registration statement if the SEC staff deems them material, they have not yet been reflected in the U.S. disclosure document and the Regulation S offering is in conjunction with a registered offering in the United States; this risk is particularly significant in the case of public statements involving forward-looking information. The SEC staff has been vigilant in this regard and carefully scrutinizes offshore press activities by monitoring the Internet and otherwise in connection with registered offerings to detect the offshore release of information during an offering that is not contained in the registration statement. [299] Also, to the extent that communications by issuers or underwriters

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permitted by Regulation S or Rule 135e are reported in the United States, transaction participants may find themselves liable under U.S. law for material misstatements or omissions in the communication. [300] Because of the SEC's vigilance in this area, U.S. legal advisers generally caution issuers and their underwriters that statements made under Rule 135e should be limited to those they are prepared to have included in the statutory prospectus or a free writing prospectus and warn that strict measures should be adopted to ensure that

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research reports prepared in connection with the offering outside the United States do not find their way into the United States, including by way of the Internet.

The declining importance of U.S.-registered portions of global offerings and the substitution of, for example, Rule 144A offerings to large U.S. institutional investors have reduced the influence of the SEC and the risk to global offerings in respect of these concerns. In addition, the 2012 change to Rule 144A to eliminate the prohibition on offers to non-QIBs allows for publicity in the United States in offerings made in reliance on both Rule 144A and Regulation S. While market participants have not significantly changed offering practices as a result of this liberalization, the concern about non-U.S. communications potentially violating Rule 144A no longer exists. Offering participants that use the flexibility to publicize the 144A portion of the offering in the United States also need not worry about violating Regulation S's prohibition on directed selling efforts so long as the publicity efforts are not directly or exclusively targeted at non-QIB U.S. persons who could not otherwise participate in the offering.

U.S. and non-U.S. underwriters will often coordinate publicity efforts and agree to restrictions on the timing and nature of offering-related publicity efforts across jurisdictions to ensure compliance with U.S. and foreign laws and practices. The global coordinator for the offering is likely to take steps to ensure a unified presentation of the offering to the market. Such steps often include insisting that the underwriters in all syndicates conduct their marketing efforts on the same schedule and that all syndicates follow rules imposed by the global coordinator to preclude any syndicate or group of underwriters from gaining a marketing advantage; however, in a number of cases the syndicates will agree that marketing or premarketing efforts permitted in one jurisdiction can begin prior to the global marketing effort.

Publicity guidelines prepared by U.S. legal advisors in a global offering by a non-U.S. issuer will typically seek to isolate publicity conducted outside the United States. In the case of corporate communications, the isolation is generally accomplished by imposing limitations on contacts by an issuer with members of the press and investment analysts located in the United States, by imposing procedures to ensure that contacts with the press and investment analysts outside the United States do not give rise to publicity in the United States and by limiting the contents of commercial announcements in the United States and communications with U.S. shareholders and employees to certain factual information. [301]

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One issue that sometimes arises in connection with an initial U.S. listing by a foreign issuer is the desire of company management to conduct interviews in New York with members of the media at or near the time of the listing ceremony. Unless any publication of such interview or the information provided therein does not constitute an offer of securities [302] or qualifies under Rule 134, such publication may violate the publicity restrictions of § 5 of the Securities Act unless it can be treated as a media free writing prospectus under Rule 433 under the Securities Act. For a non-reporting issuer, such a free writing prospectus would be permissible if, among other things, (i) the issuer has not paid or given other consideration for the independently prepared media communication and (ii) the issuer's statutory prospectus has previously been filed with the SEC. [303]

In addition, although as a legal matter management of a non-reporting company may, in appropriate circumstances, be able to conduct an interview in connection with the company's listing, practical considerations must also be taken into account. Indeed, a significant concern that can arise in connection with a listing interview is that information not be given to the market that was not contained in the registration statement or otherwise conveyed to investors. Prior to the adoption of the Securities Offering Reforms that permitted the use of media free writing prospectuses, the disclosure of such information was in fact the concern most frequently raised about such interviews by the SEC staff. The disclosure of new or different information in a listing interview that was not previously provided to investors is still a relevant consideration under Rule 159, which focuses for liability purposes on the information conveyed to investors at or prior to the time of sale. [304] Advisors generally seek to ensure that such interviews, if conducted, do not go beyond factual information contained in the registration statement or already otherwise conveyed to investors.

Furthermore, in concurrent U.S. and international offerings, U.S. securities counsel have traditionally permitted foreign issuers to post prospectuses and other offering information relating to the international offering on a website, provided, prior to filing of the registration statement with the SEC, that:

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- such information is not in English;
- the information can be viewed only after confirmation by the person seeking access to such information that he or she resides outside the United States; [305]
- the first page encountered on the website displays a prominent legend in English, stating that the offering information on the website is intended to be available only to residents of countries other than the United States; [306] and
- subsequent pages of the website bear a legend in English indicating that the information contained is not for distribution in the United States.

Securities counsel have also permitted foreign issuers to post English-language prospectuses and other offering information relating to the international offering prior to filing of the registration statement, but only where access can be gained solely by persons holding passwords allocated to non-U.S. residents. Counsel generally advise that offering information not be communicated via electronic mail (unless it cannot be forwarded or copied), unless it is limited to information contained in a press release or notice complying with Rule 134 or Rule 135 under the Securities Act, the communication is being treated as a free writing prospectus or, in the case of a global offering with an unregistered international tranche, procedures are in place to ensure that each of the recipients of the electronic mail is resident outside the United States. Dissemination that is not controlled to specifically identified addressees should be prohibited.

[5] Structure of Underwriting Arrangements

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Public offerings of securities in the United States are generally made through a syndicate of underwriters led by one or more "book runners" or managing (or "lead") underwriters (some or all of whom are sometimes referred to as "representatives"). The underwriting agreement, which defines the relationship between the issuer and the underwriters, is generally prepared in preliminary form by counsel for the underwriters and is required to be filed as an exhibit to the registration statement (in the case of an offering pursuant to a shelf registration statement, through a filing following execution of the underwriting agreement that is incorporated in the registration statement by reference). It is not finalized until the "pricing" of the offering, when the issue price, underwriters' compensation and other final terms are fixed. At that time, the agreement is generally signed by the representative or representatives on behalf of the underwriting group.

In the underwriting agreement, the underwriters agree, subject to specified conditions, to purchase the offered securities on a set future closing date. Each underwriter of a U.S. offering is responsible to the issuer only for its individual underwriting commitment. [307] The underwriting agreement typically includes representations and warranties by the issuer regarding the material accuracy of the registration statement and the prospectus and the issuer's legal status and financial condition. The agreement also describes in detail the conditions to be fulfilled by the issuer prior to the closing, including delivery of legal opinions, officers' certificates and other documents.

Global distributions often are made by a single underwriting syndicate, which may comprise U.S. and non-U.S. underwriters, though on occasion they may be conducted by two or more regional underwriting syndicates. [308] When a

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multiple syndicate structure is used, one syndicate customarily will cover the issuer's home market, while another syndicate will cover the rest of the world. Separate syndicates also may be formed to cover public offerings or significant private placements in particular countries, such as the United States. [309] Syndicate activities generally are overseen by one or more banks acting as global coordinators, whose responsibilities include negotiating the underwriting agreement with the issuer and/or selling shareholders, carrying out due diligence, managing stabilization activities and overseeing offering publicity. [310]

When a multiple syndicate structure is used, the syndicates usually enter into an intersyndicate agreement providing for coordination and allocation of geographic markets among them. [311] Lead managers are generally appointed to oversee each syndicate, while the global coordinators oversee all the syndicates, often maintaining a position through an affiliate in each syndicate in order to be able to monitor more closely their respective levels of demand and bookbuilding activities.

[a] Settlement

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In U.S. underwriting agreements, the closing date is generally the third (in the case of debt offerings) or fourth (in the case of equity offerings) business day after pricing. [312] The SEC has proposed an amendment to the Exchange Act rule governing standard settlement cycles [313] that, if adopted, would shorten the standard settlement cycle in the United States for certain securities transactions, including underwritten offerings of debt securities that price on a customary timetable, from third business day settlement to second business day settlement. [314]

[b] *Force Majeure* Clauses

Termination provisions (sometimes known as "*force majeure* clauses") included in underwriting agreements for domestic offerings in the United States have generally limited underwriters' grounds for termination to a fairly narrow scope. [315] One reason has been the position of the SEC staff that a *force majeure* clause permitting an underwriter to terminate its obligations upon (i) the occurrence of immaterial events affecting the issuer or the securities markets in general or (ii) an inability to market the securities would cause the offering to be characterized as a "best efforts" or contingent offering. [316] As a result, in contrast to firm commitment underwritings, such offering would become subject to the requirement that customer funds be escrowed and to certain other restrictions. [317]

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Underwriters have also been willing to accept limited *force majeure* clauses for U.S. domestic offerings because they are at risk only during the limited period [318] between the signing of the underwriting agreement and the closing. In contrast, the length of time between the signing of the underwriting agreement and the closing of an offering outside the United States varies depending on the jurisdiction and the type of securities offered. [319] The period of underwriting risk in global offerings following the U.S. pattern is now generally limited to a three- to five-business day period between pricing and closing. However, significant differences in the nature of the risk accepted by underwriters continue to exist. In a standard offering by a private issuer, the underwriting agreement typically contains a *force majeure* clause that permits an underwriter to terminate its obligations in the event of significant market upheaval, suspension of trading of the issuer's shares or acts of war and the like. [320] Thus, if there is a sharp downturn in market conditions between the signing of the underwriting agreement and the closing as a result of any of the events specified in the *force majeure* clause, the underwriters have the ability to walk away from the transaction. [321] Underwriters tend to view the unilateral right to declare a *force majeure* event and to terminate the transaction as a fundamental part of the protections provided them by the underwriting agreement. [322]

In some markets where a local retail offering accompanies the international offering, the closing of the retail offering may occur before the closing of the international offering. In such instances, it may not be possible to terminate the offering once the retail offering has closed, and underwriters have, at least in markets where this result is unavoidable, accepted the result that there is no right of termination between the closing of the retail offering and the closing of the international offering. To mitigate this risk, underwriters would seek to shorten this gap.

[c] Indemnity Provisions

Generally speaking, indemnity provisions do not vary markedly between different types of offerings. [323] Where shares are being offered only by one or more of the issuer's shareholders or by both the issuer and one or more of its

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shareholders, there is frequently considerable negotiation as to which party should indemnify the underwriters (or if both parties will do so, the level of their respective obligations). [324] As a general rule, most underwriters will seek a full

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indemnity from both the issuer and the selling shareholders in such circumstances, although they may, depending on the relative bargaining strengths of the relevant parties, ultimately accept indemnities from the selling shareholders up to the gross proceeds to be received by them. A selling shareholder that is not involved in day-to-day management of the company— *e.g.*, a financial investor who does not exercise a significant degree of control over the company—can often limit the indemnity it provides to cover only information about itself that is included in the prospectus. Another possibility is to require the underwriters to pursue an indemnity claim against the issuer first, and then to proceed against the selling shareholder only if the indemnity claim is not satisfied by the issuer after a certain period.

[d] Lock-up Provisions

Lock-up provisions in underwriting agreements restrict the issuer and any selling shareholders from selling or announcing the intention to sell (without the prior written consent of the underwriters and subject to certain limited exceptions) any of the securities being offered or securities convertible into those securities, for a specified period. In equity offerings, directors, officers and major shareholders of the issuer typically enter into similar lock-up arrangements pursuant to individual agreements signed at the time the underwriting agreement is executed. There will often be some negotiation regarding which of the shareholders, directors and officers of the issuer will enter into a lock-up agreement and what carve-outs to the lock-up agreements will be granted in advance. The exceptions that permit the sale of locked-up securities before the termination of the lock-up period are often highly negotiated and tailored to the specific characteristics of the issuer and the type of securities being offered (although certain exceptions, such as the settlement of existing warrants or convertible securities by the issuer, or the transfer of securities as *bona fide* gifts from an officer or director, provided the recipient agrees to be bound by the lock-up terms, are relatively standard).

There are two main reasons for lock-up arrangements. The primary rationale is to prevent overhang and provide for an orderly market by limiting sales into the market while an offering is being absorbed. A second reason for the use of lock-up arrangements relates to the market's perception of the confidence in the issuer of the shareholders, directors and officers that are subject to the lock-up. A key to an offering's success is the market's belief that the share price will rise, and a perception that well-informed investors such as the issuer's management, directors or major shareholders are "cashing out" could significantly harm the price.

The lock-up period in equity offerings is usually 30-180 days (with IPOs tending toward the longer period) after pricing. Because overhang and market

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perception are greater concerns in the context of equity offerings, the lock-up period in debt offerings is usually significantly shorter than in an equity offering and often limited to the time between pricing and closing. Some debt offerings are executed with no lock up at all, and lock-ups in debt offerings do not customarily apply to directors, officers or major securityholders.

Lock-up provisions used in the context of a public offering in the United States must be disclosed in the registration statement. FINRA also imposes certain obligations in respect of lock-up agreements. [325]

[e] Choice of Law

Generally speaking, the underwriting arrangements for a U.S.-registered offering by a foreign private issuer have almost always been governed by the laws of the State of New York (although in relatively rare instances, English law has governed). In global offerings with more than one syndicate, underwriters increasingly accept an underwriting agreement, especially for the home market, governed by the local law of the jurisdiction of the issuer or selling shareholder.

[f] Overallotment Options and Syndicate Short Sales

It is customary for offerings, especially of equity securities, to be accompanied by "overallotment," whereby the managing underwriter is given the authority by the underwriting syndicate to offer and sell more shares than the underwriters have contracted to purchase from the issuer on a "firm" basis. By overallotting shares, the managing underwriter can create a short position that allows the underwriters to purchase shares in the market in the period immediately following the offering as part of their after-market stabilization activities. In order to protect the underwriters in circumstances in which the shares purchased in the aftermarket are not sufficient to cover the short position created through overallotments, particularly where the price of the offered shares increases in aftermarket trading, the issuer typically will grant the underwriters a so-called "overallotment option" (also called a "green shoe option"). [326] The option generally allows the underwriters, for a period beginning with the execution of the underwriting agreement and ending 30 days later, [327] to elect to purchase from the issuer, at the public offering price less the commissions provided

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for in the underwriting agreement, an additional number of shares equal to up to 15% of the number of shares the underwriters have committed to purchase. The option is often limited to use solely for the purpose of covering any overallotments made on behalf of the syndicate by the managing underwriter. [328]

If the offering is a success and the stock performs well in the immediate aftermarket, and there are therefore no post-offering syndicate purchases in the

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market, the managing underwriter will exercise the option on behalf of the syndicate for the number of shares that have been overallotted, and the syndicate will earn the same commissions on the additional shares as it earned on the so-called "firm shares." [329] If, however, the syndicate has purchased shares in the market, the overallotment option will generally be exercised only to cover the syndicate's short position that remains after the shares purchased in the market by the syndicate have first been applied for that purpose. When the number of shares overallotted exceeds the shares underlying the option, the syndicate must cover the amount of the excess—a so-called "naked" short position—solely through purchases in the market. [330] Of course, when shares purchased in the market are used to cover overallotments, the commissions associated with the exercise of the overallotment option are foregone. Any profits or losses arising out of syndicate activities in the market are typically allocated among the underwriters *pro rata* to their underwriting commitments, subject to agreed limits. [331]

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Where the underwriters have not yet decided to exercise the overallotment option at the time of closing, in order to be able to deliver securities to the initial investors in settlement of all allotments, including overallotments (which are indistinguishable from the rest of the allocation), they may need to borrow securities. [332] The borrowing may be arranged with securities lenders if there is an existing market for the class of securities being offered or with preexisting shareholders of the company if there is no such existing market, such as in an IPO. [333] The borrowed securities must be freely tradable and, therefore, cannot be borrowed from an affiliate of the issuer without SEC registration (which, however, should be easy to accommodate in the context of registering the overall offering).

Another issue to consider in relation to short sales is that the restrictions of Regulation M will be deemed to continue through the exercise of the overallotment option unless the overallotment option is only exercised to cover the net syndicate short position at the time of exercise. [334] Accordingly, closing out and then re-establishing a short position prior to exercise of the overallotment option (referred to as "refreshing the shoe") would bar the underwriters from purchasing shares in the market until the option is exercised or terminated, unless the

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ADTV exemption were available [335] (which will not be the case, for example, in a U.S. initial public offering by an issuer that does not have an existing established market for its stock outside the United States). The underwriters' ability to refresh the shoe also must be consistent with the underwriting agreement and the prospectus, as well as with restrictions on underwriting compensation (since the aftermarket sales price when the short position is re-established may exceed the public offering price of the shares in the offering). [336]

[g] Characterization of Underwriters as a Fiduciary

In its 2005 "eToys" decision, the New York Court of Appeals sustained, at the pleading stage, an issuer's claim for breach of fiduciary duty against the lead underwriter in an IPO based on the allegation that the underwriter assumed an additional "advisory relationship that was independent of the underwriting agreement." [337] Specifically, the complaint alleged that the lead underwriter intentionally underpriced the IPO of what was then eToys, Inc., and then allocated shares to customers obligated to return to the underwriter a portion of their profit on reselling the shares. Until this decision, courts rarely had permitted an issuer to pursue fiduciary duty claims against an underwriter, other than with respect to improper use of confidential information. The court accepted that a fiduciary relationship typically involves a higher level of trust than is present in arm's-length business transactions, as well as the well-established proposition that where there is a contract, it determines the parties' relationship. Nonetheless, the court found that the fiduciary relationship claim was based not on the underwriter's role as such, but rather on an allegedly independent advisory relationship it had established with the issuer, particularly with respect to setting the price for the offered shares. [338] A subsequent case in the Appellate Division of the New

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York Supreme Court considering the question of an underwriter's duty to its client in a different context emphasized the narrow scope of the eToys decision. [339] Nevertheless, in light of the holding in the eToys decision, it has become customary to include so-called "eToys" language in underwriting agreements to clarify that the transaction in question is of an arm's-length nature, that the underwriters are not acting as agents or fiduciaries of the issuer and that the issuer has relied on its own legal and financial advisors in making relevant business determinations.

[h] Success Fees

Section 11(e) of the Securities Act limits the liability of an underwriter under § 11 of the Securities Act to the total price at which the securities underwritten by it and distributed to the public were offered to the public unless "such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting." [340] Issuers and sellers outside the United States sometimes provide a "success fee" that may only be for the benefit of the global coordinators or lead managers of the offering in order to give them an additional incentive to ensure a successful transaction. In the context of a U.S.-registered offering, an underwriter's limitation of liability under § 11(e) might be lost if the underwriter receives a benefit from the issuer in which all other underwriters similarly situated did not share on a *pro rata* basis. Because of the serious consequences, practitioners generally advise that the success fee be structured in a way that avoids the risk of losing this limit on liability. For example, if the desire is to reward the global coordinators or lead managers for their special efforts, the syndicate could itself agree on an allocation of commissions that disproportionately rewards the lead managers, such as by increasing the *praecipium* percentage. Such a reallocation of commissions among syndicate members is generally thought to be consistent with § 11(e) because § 11(e) addresses disproportionate benefits from the issuer but does not preclude disproportionate allocations of the commissions by

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and among the underwriters themselves. [341] Another possible approach, if there is more than one syndicate, is to provide the success fee to certain members of the non-U.S. syndicate but not to members of the U.S. syndicate (provided there is no understanding through which a portion of the success fee is to be shared with members of the U.S. syndicate).

[6] Directed Share Programs

Issuers sometimes elect to implement directed share programs, or so-called "friends and family" programs, in connection with IPOs of equity. These programs became particularly popular for IPOs in the technology area in the late 1990s until 2001, but their popularity has waned since then. [342] A directed share program allows an issuer to set aside a portion of the shares to be offered, typically between 2% and 10% of the total offering, for sale by the underwriters to directors, officers and employees of the issuer, their friends and family, and other specified investors.

In general, there are no restrictions under the Securities Act on the types of persons or entities that can participate in directed share programs or on the size of these programs. However, the SEC expressed concern that the implementation of directed share programs might lead to premature and illegal offers of securities that would constitute "gun-jumping" violations of § 5 of the Securities Act. [343] In the registration process, the SEC staff routinely requested that issuers provide supplemental information on the mechanics of offers and sales of shares to investors in directed share programs, including copies of all written communications with prospective investors under these programs. The SEC staff also stated that underwriters should not require purchasers in directed share programs to open and make deposits in brokerage accounts—or otherwise effectively commit to purchase shares—prior to effectiveness of the registration statement. Rule 134 and the Securities Offering Reforms facilitated communications in directed share programs, particularly by liberalizing the contents of communications of offering timing, mechanics and similar matters that are not offers. [344]

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FINRA's rules, however, which apply to the underwriters and other broker-dealers participating in these offerings, [345] do effectively limit the types of persons or entities that can be allocated shares in directed share programs in certain circumstances. For example, FINRA's Rule 5130 prohibits FINRA members from selling "new issues" of equity securities to any account in which certain types of "restricted persons" (including, among others, broker-dealers and most of their employees, owners and affiliates and their immediate family members) have a beneficial interest. [346] Although Rule 5130 contains an exemption from this general prohibition for securities that "are specifically directed by the issuer," this exemption is not applicable to securities directed by the issuer to certain categories of restricted persons (including broker-dealer personnel, finders and fiduciaries) unless these persons or their immediate family members are employees or directors of the issuer, the issuer's parent or a subsidiary of the issuer or the issuer's parent. [347] Because FINRA's rules govern the conduct of its broker-dealer members and not the conduct of the issuer, the question of whether a specific person or entity can participate in a directed share program is ultimately one for underwriters' counsel.

Certain provisions of FINRA Rule 5131 further affect the conduct of directed share programs. Among other things, FINRA Rule 5131 requires officer and director lock-up agreements in IPOs, or other restrictions on the transfer of an issuer's shares in such offerings, to apply equally to securities obtained by officers and directors in directed share programs. [348] FINRA Rule 5131 also requires the managing underwriters to notify the issuer and ensure public

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announcement is made of any impending release or waiver of any lock-up agreement or other restriction on the transfer of the issuer's shares. [349]

[7] Due Diligence Investigation

Underwriters of U.S. public offerings must (with the assistance of their counsel) conduct a due diligence investigation of the company if they are going to assert the benefit of certain defenses to civil liability under the Securities Act in the event of material misstatements in the registration statement or material omissions of statements required to be made therein or that make the statements contained therein misleading. Under § 11 of the Securities Act, issuers have strict liability for any such material misstatements or omissions. Underwriters, as well as directors and certain officers, are also liable unless they "had, after reasonable investigation, reasonable ground to believe and did believe … that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading." [350] If statements in a registration statement are made by experts, then directors, officers and underwriters can rely on those statements without independent investigation as long as they have no reason to believe (and do not in fact believe) that the statements include any material misstatement or omission. Accountants are experts, and therefore their opinions on the audited financials may be so relied upon. [351]

Section 12(a)(2) of the Securities Act applies corresponding liability, with a corresponding diligence-based defense, for material misstatements or omissions in a prospectus. A seller has an affirmative defense to § 12(a)(2) liability if

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he or she can prove that he or she "did not know, and in the exercise of reasonable care could not have known," of the untrue statement or omission. For a discussion comparing "reasonable care" to due diligence, including whether reasonable care requires investigation, *see* § 11.03[2][b].

Given the importance of these defenses, underwriters have developed procedures designed to enable them to show they exercised the requisite level of diligence. As discussed below, the intensity of these procedures usually varies with the type of offering, with initial public offerings at the more intensive end of the spectrum and offerings of investment grade debt by frequent issuers at the less intensive end. They generally include discussion by underwriters and their counsel with various parties, supplemented by a review of key documents. Typically, discussions will include a review of operations with the company's chief operating officer, a review of financial condition, accounting standards and controls with the chief financial officer and the issuer's accountants, [352] and a review of existing and potential litigation or governmental proceedings with the issuer's internal counsel. Additional discussions may be held with important customers, suppliers or lenders, external counsel to the issuer for significant litigation or regulatory matters, controlling shareholders or other third parties with a special relationship with the issuer, particularly in the context of initial public offerings.

Certain documents effective or prepared during the periods for which financial information is furnished (typically three to five years) will be reviewed. These documents may include research reports and significant press releases; SEC and stock exchange filings; the issuer's constituent documents; minutes of relevant shareholders', board of directors' and committee meetings (and in many cases materials prepared for those meetings); material contracts, agreements, licenses and franchises; documents relating to regulatory issues, insurance and intellectual property; the accountants' reports to the company about the adequacy of its accounting procedures and controls; and reports of counsel regarding ongoing litigation. [353]

The accountants will be asked to deliver a "comfort" letter to the underwriters at the time the underwriting agreement is signed and a "bring down" letter reaffirming the accuracy of the comfort letter at closing. The letter gives comfort with respect to certain financial information contained in the prospectus and describes certain procedures the accountants have followed for the period subsequent to the date of the latest financial statements (whether annual or interim) included in the prospectus—the comfort, in effect, is that the accountants have compared certain financial information in the prospectus to the books

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and records of the company and the numbers agree, and that the procedures have not uncovered any undisclosed specified events since the date of the last published financial statements (so-called "negative comfort" or "negative assurance") such as incurrence of material new debt or material losses or other events affecting stockholders' equity. [354] The underwriters also receive opinions from

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their counsel and from the company's counsel on various matters, as well as assurances, in so-called 10b-5 letters, that neither counsel is aware of any material misstatement or omission in the prospectus.

Sections 11 and 12 make no distinction between lead and other participating underwriters. As a result, passively participating underwriters that rely on the lead underwriter's due diligence are potentially liable for the lead's investigative failures. [355] While §§ 11 and 12 are silent on the role of participants in the due diligence process, the SEC staff has noted that to succeed on a separate affirmative defense, nonmanaging underwriters must at least take active steps to assure themselves that the manager made a reasonable investigation. [356]

As referenced above, § 12(a)(2) of the Securities Act imposes civil liability on a seller of securities (such as an underwriter) in the case of material misstatements in a prospectus or material omissions that make the statements contained therein misleading. [357] In connection with the Securities Offering Reforms, the SEC promulgated Rule 159 under the Securities Act, which interprets § 12(a)(2) as requiring an assessment of whether there are material misstatements or omissions in a prospectus at the time of sale (including the time of a contract of sale), [358] without taking into account information conveyed after that time. As a result, underwriters have significantly modified their procedures to ensure that information is conveyed to investors no later than the time of the investors' agreement to purchase in the offering. Such information is being conveyed through filing and access to, or electronic or other delivery of, prospectuses or preliminary prospectuses, free writing prospectuses consisting of term sheets or other updating information and, in some cases, oral communications. Electronic communications, including hyperlinks to documents, have become an important element in the conveyance of information. In connection with this new emphasis on conveyance at time of sale (including contract of sale), underwriters have adopted procedures that extend the comfort they receive regarding the material accuracy and completeness of information to specified information available at the time of sale. Conveyance of that information remains the

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responsibility of the seller (and thus issuers must satisfy themselves that underwriters have properly conveyed any such information).

Appropriate processes for performing the due diligence exercise are generally straightforward to integrate with disclosure preparation when the issuer is engaged in an initial public offering. Because a comprehensive disclosure document corresponding to Securities Act requirements is being prepared for the first time, the underwriters will have access to the information and personnel they require for diligence in connection with the drafting process and time to perform a thorough investigation.

Diligence may be more challenging, however, in an offering by an issuer that files reports under the Exchange Act and that qualifies to use a short-form registration statement (Form F-3). An offering using that form is often accomplished on an expedited basis, particularly if the issuer has a shelf registration statement in effect or is eligible to file an automatic shelf registration statement (which becomes effective immediately upon filing, without delay for review). [359] As a result, the underwriters often may have limited time to complete their due diligence exercise. Moreover, in such offerings, a significant amount of disclosure is incorporated by reference from the issuer's annual report on Form 20-F and other Exchange Act filings. [360] The underwriters are unlikely to have participated in the preparation of those filings, but are nonetheless liable for material misstatements or omissions contained in them that are incorporated into the registration statement and prospectus and not corrected.

To address this issue, some issuers using the shelf registration process appoint a law firm as "designated underwriters' counsel" for all offerings conducted using the shelf facility. That firm will likely be involved in the initial preparation of the registration statement and will have an opportunity to conduct further diligence during the life of the shelf registration. This practice potentially allows much of the diligence for offerings under the shelf to be completed in advance, in order to accommodate the rapid offering execution that shelf registration makes possible, and provides continuity (which is particularly important when the underwriters included in the syndicate change from offering to offering).

Rule 176 under the Securities Act, which was promulgated at the time shelf registration was first introduced, specifies certain circumstances that are relevant in determining whether due diligence has been demonstrated, including the type of issuer and security, and whether there was reasonable reliance on officers, employees and others whose duties should give them knowledge of the facts in

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question and responsibility for documents incorporated by reference at the time such documents were filed.

A 1992 report prepared by a task force of the American Bar Association (the "Due Diligence Report") acknowledged that the methods for conducting securities offerings have changed substantially since the liability provisions of the Securities Act were drafted and suggested that additional factors be considered in determining whether the due diligence standard was satisfied. [361] The report took the position that the factors specified by the SEC in Rule 176 were not sufficient to protect underwriters and suggested that factors including the following be taken into account: the likelihood that an investigation will turn up material changes in the existing disclosure; the extent to which potential investors rely on a credit rating; the extent to which potential investors have access to information comparable to that available to the underwriters; and the time available to conduct due diligence.

No action has been taken by the SEC (or Congress) since the adoption of Rule 176 to adopt the suggestions of the Due Diligence Report or otherwise address due diligence standards. Indeed in the *WorldCom* decision, where the motion of defendant underwriters for summary judgment was denied in a case involving an offering off a shelf registration statement of what was at the time investment grade debt, the court pointed out that governmental inaction in the face of requests for modification such as those contained in the Due Diligence Report suggested that the law had not evolved with changing offering practices. [362]

The passage of the Sarbanes-Oxley Act and related rules and SEC initiatives have sharpened the focus during the diligence process on issuers' internal controls, including heightened scrutiny of auditor communications and audit committee proceedings, and on issuer's disclosure controls, including due diligence relating to certification procedures for public disclosure and disclosure committee actions. [363] Underwriters and their counsel also review management's required report on internal control over financial reporting and related

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independent auditor attestation regarding the effectiveness of the issuer's internal control over financial reporting. [364] Additionally, following the *WorldCom* decision, underwriters and their counsel have developed more formalized due diligence procedures (*e.g.*, preparation of a written summary of due diligence activities) for offerings off shelf registration statements.

[8] State Securities Laws

In addition to complying with the federal securities laws, a foreign issuer offering securities in the United States, including to its U.S. employees, must consider the securities laws of the various states where the securities are offered and sold although federal legislation has greatly reduced the significance of such state laws in the case of companies that file reports under the Exchange Act. [365]

[a] State "Blue Sky" Requirements

Nearly every state of the United States requires that securities be registered under its laws prior to sale to the public in that state or be exempt from state registration. The National Securities Markets Improvement Act of 1996 (the "NSMIA") [366] amended the Securities Act to provide for federal preemption of state laws and regulations requiring registration of securities or securities transactions in many cases. As a result, the need to register securities at the state level has been eliminated in connection with most significant securities offerings in the United States, including those by foreign issuers.

As amended by the NSMIA, § 18 of the Securities Act provides exemptions for certain categories of "covered security" (or any security that will be a "covered security" upon completion of a transaction), including:

- securities that are listed, or approved for listing, on the NYSE, Nasdaq or any national securities exchange that the SEC determines has substantially similar listing standards and securities of the same issuer that rank equally with or senior to such listed securities;
- securities issued by an investment company registered under the Investment Company Act;

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- securities offered or sold to "qualified purchasers" as defined by rule by the SEC; [367] and
- securities offered or sold in certain transactions exempt from registration under the Securities Act, including ordinary secondary market transactions (provided the issuer of the security is a reporting issuer under the Exchange Act), [368] certain transactions exempt from registration under § 3(a) of the Securities Act, private offerings under Rule 506 of Regulation D under the Securities Act, private offerings under § 3(b)(2) of the Securities Act, "crowdfunded securities" under § 4(a)(6) of the Securities Act and certain accredited investor transactions pursuant to § 4(a)(7) of the Securities Act. [369]

Such a "covered security" is exempt from all state requirements with respect to (i) registration and qualification of securities or securities transactions, (ii) prohibitions, limits or conditions on the use of any offering document "prepared by or on behalf of the issuer" of the security [370] and (iii) in the case of an

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exchange-listed security, prohibitions, limits or conditions on offers or sales of the security based on the merits of the offering or the issuer. The NSMIA does, however, preserve the states' authority to maintain and enforce their own antifraud laws and to require certain notice filings for "covered securities" that are not listed on an exchange. [371]

In circumstances where the NSMIA does not apply and there is no applicable state law exemption, U.S. legal counsel for the underwriters is typically responsible for arranging compliance with the necessary state securities registration requirements, and the issuer is responsible for paying the fees of such counsel for blue sky work and any state filing fees and for executing individual state registration forms. Generally, the application for registration in any state includes a uniform state application form, a copy of any related Securities Act registration statement and exhibits thereto, a consent to service of process and a check in payment of a fee based on the aggregate dollar amount of securities registered in the state. [372]

The extent of the state regulators' review of the registration or filing materials submitted varies widely. Many states have adopted a standard of review involving the merits of the offering ("merit review") that differs from the SEC's "full disclosure" requirements. In these states, the securities commissioner may deny registration if the offering is determined to be unfair, unjust or inequitable. Generally, these states have adopted regulations and policies that establish standards that an issuer must meet if its offering is to be considered "fair" and appropriate as an investment for the state's residents. These standards include: (i) a prohibition against offering a class of equity securities with no voting rights or rights unequal to other classes of outstanding shares, (ii) limitations on the maximum underwriting commissions and other selling expenses that may be incurred by the issuer in connection with the offering, (iii) limitations on the amount of securities that may be covered by options issued or to be issued to management and underwriters, and (iv) limitations on the price-earnings ratio of the securities offered.

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There do not appear to be merit or fairness standards of special relevance to foreign issuers, other than the requirement of a number of states, including Texas, that the foreign issuer be able to show that it has substantial assets in the United States. This reflects a concern about the unenforceability in the United States of any judgment against the foreign issuer obtained by a U.S. investor.

[b] State “Legal Investment” Laws

There are also state statutory provisions (often called "legal investment" laws) that govern the various types of investments that are permissible for state-regulated financial institutions. These institutions generally include state commercial and savings banks, savings and loan associations, life and casualty insurance companies and public sector pension and retirement systems.

Typically, these provisions list permissible portfolio investments for these institutions, such as government obligations, corporate bonds, preferred stock and common stock, real estate mortgages and notes and similar types of investments. Most states impose quality standards on such investments, *e.g.*, the security may be required to have an investment grade rating. In addition to specified legal investments, most states also permit regulated institutions to invest, under so-called "basket" provisions, a limited portion of funds in any type of security, including those that do not meet the required standards. The legality of investments in securities issued by corporations and governments varies both from state to state and as among different types of regulated financial institutions. However, those states with the largest base of financial institutions usually permit the purchase of foreign securities, subject to certain quantitative limitations and provided the securities meet the same quality standards as those imposed on similar U.S. investment securities. [373] Some legal investment provisions do not specially list foreign securities among those investments that are legal for institutional investors. In those instances, regulated institutional investors may only purchase foreign securities under the basket provisions referred to above.

[c] Global Blue Sky Developments

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Global offerings, in which offers and sales are made both in the United States and into numerous jurisdictions outside the United States, are occasionally undertaken by issuers offering large amounts of securities. [374] Securities offerings made in jurisdictions outside the United States must also be conducted pursuant to such jurisdiction's securities regulations. The U.S. offering documentation, which will take the form of a prospectus in an SEC-registered offering and an offering memorandum in an exempt offering, will include a section that summarizes the selling restrictions of each foreign jurisdiction into which offers or sales will be made (each referred to as a "selling legend"). [375] Ensuring compliance with a jurisdiction's requirements and notifying investors of those requirements in a selling legend may require consultation with counsel in that jurisdiction. [376]

Both the form [377] and the substance of a selling legend depend on the specific requirements of a given jurisdiction's securities regime, and the legend often includes a statement that the securities will not be offered or sold into such jurisdiction except through transactions that do not constitute a public offering within the meaning of such jurisdiction's securities laws. [378]

[9] Market Manipulation and Stabilization

In U.S. public offerings the activities of the underwriters, including any underwriters engaged in a distribution of securities outside the United States,

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and, in certain respects, the issuer (as well as their respective affiliates), are subject to a number of U.S. rules relating to market manipulation and stabilization. These rules are typically implemented through the agreement among underwriters (and, if there are multiple syndicates, also through the intersyndicate agreement) and, with respect to the issuer, through the underwriting agreement. Since 1997, the U.S. rules relating to market manipulation and stabilization in connection with securities offerings have been contained in Regulation M. [379]

[a] Market Manipulation Under Regulation M

Rule 101 and Rule 102 of Regulation M are designed to prevent interested parties from engaging in activities that could artificially raise the price of a security that is the subject of a "distribution" [380] in the United States. Rule 101 regulates bids and purchases by underwriters, prospective underwriters and other distribution participants, and certain affiliates of such persons. Rule 102 regulates bids and purchases by issuers, selling securityholders and certain of their affiliates.

[i] *Rule 101*

Rule 101 applies to "distribution participants," a category that includes underwriters, prospective underwriters, [381] brokers, dealers and others who are participating or have agreed to participate in a distribution of securities. [382] Rule 101 also applies to affiliated purchasers of distribution participants. [383]

Regulation M exempts from the definition of "affiliated purchaser" a separately identifiable department or division of a distribution participant, issuer or

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selling securityholder that regularly purchases securities, whether for its own account or the account of others, or who recommends or exercises investment discretion with respect to the purchase or sale of securities so long as certain conditions are met. [384]

Rule 101 of Regulation M generally prohibits distribution participants and affiliated purchasers from bidding for, purchasing or attempting to induce any person to bid for or purchase (i) any security that is the subject of a distribution (the "subject security") [385] and (ii) any security into which a subject security may be converted, exchanged or exercised (whether immediately or not), or which, under the terms of the subject security, may in whole or significant part determine the value of the subject security (a "reference security"). Thus, during the distribution of an equity-linked security, the underlying security will be subject to Regulation M even if the terms of the equity-linked security provide for cash

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settlement only (assuming that the value of such equity-linked security is determined in significant part by the price of the underlying security, as would generally be the case). [386]

Unless an exemption is applicable, the restrictions contained in Rule 101 apply to distribution participants and affiliated purchasers during a period that commences either one or five business days [387] prior to pricing [388] (or, if later, the time at which such person becomes a distribution participant) and ends upon the completion of such person's participation in the distribution. [389]

Under Regulation M, when a "distribution" occurs in the United States, the restrictions of Rule 101 apply globally, even to activities conducted entirely outside United States by non-U.S. persons. A "distribution" is any offering of securities in the United States that is distinguished from ordinary trading transactions

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by the magnitude of the offering and the presence of special selling efforts and selling methods. [390]

Rule 101 contains a number of exemptions. Securities with a worldwide reported ADTV [391] value [392] of at least $1 million whose issuer has common equity securities with a public float value [393] of at least $150 million are exempt from Rule 101. [394] Rule 101 also includes an exemption for nonconvertible debt securities, nonconvertible preferred securities and asset-backed securities [395] that are rated investment grade by at least one nationally recognized statistical rating organization. [396] This exemption is based on the premise that such securities are

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traded on the basis of their yields and credit ratings as opposed to the identity of the issuer and, therefore, are less likely to be subject to manipulation. [397]

Rule 144A-eligible securities [398] are exempt from Rule 101 if such securities are sold in the United States only to QIBs or persons reasonably believed to be QIBs in transactions exempt from registration under § 4(a)(2) of, or Rule 144A or Regulation D under, the Securities Act. [399] The exemption also applies if the distribution includes certain persons in the United States not deemed to be "U.S. persons" for the purposes of Regulation S under the Securities Act. [400]

Unsolicited brokerage transactions are exempt from Rule 101, as are unsolicited purchases that are not effected from or through a broker or dealer, on a securities exchange or through an inter-dealer quotation system or electronic communications network. [401]

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Rule 101 contains an exemption for the dissemination of research where such research satisfies the conditions of Rule 138 or 139 under the Securities Act. [402] Rule 101 also contains exemptions for certain basket transactions [403] and inadvertent *de minimis* purchases, [404] among others. [405]

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In addition, Rule 103 of Regulation M provides an exemption from Rule 101 to allow "passive market making" during the Rule 101 restricted period in connection with a distribution of securities listed on Nasdaq. The rule is designed to maintain liquidity in situations where a market maker otherwise may be required to withdraw from the market pursuant to Rule 101. Rule 103 limits a passive market maker's bids to the highest current independent bid (unless necessary to comply with an SEC or FINRA rule relating to the handling of customer orders), limits the amount of net daily purchases each passive market maker can make to the greater of 30% of ADTV or 200 shares and contains requirements relating to identification, notification and disclosure of activity pursuant to the rule. [406]

Over the years, the staff of the SEC recognized the intrusive effects of the extraterritorial application of the market manipulation and stabilization rules in effect prior to the adoption of Regulation M and granted relief, principally on a case-by-case basis, from certain of their restrictions. [407] The Regulation M Release noted that, in response to a request from the London Stock Exchange, this relief would be modified and restated under Regulation M. [408] Other exchanges also had obtained similar relief, which could be modified and restated,

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upon request, under Regulation M. [409] To date, however, no other securities exchange has sought the modification and restatement of such relief.

[ii] *Rule 102*

Under Rule 102, it is unlawful for issuers, selling securityholders and their affiliated purchasers [410] to bid for, purchase, or attempt to induce any person to

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bid for or purchase, any covered security during the applicable restricted period. Rule 102 repeats many of the same provisions set forth in Rule 101 and uses many of the same definitions. Accordingly, many of the subjects discussed above, including, for instance, the duration of the restricted periods, the definitions of distribution and affiliated purchaser and the global applicability of the restrictions, if they apply, will apply to both rules. However, certain of the exemptions included in Rule 101 are omitted from Rule 102. [411]

Rule 102 does not include a general exemption for actively-traded securities similar to that set forth in Rule 101. However, in order to allow an issuer of equity-linked securities to hedge the underlying reference security, Rule 102 contains a limited exemption for actively-traded reference securities that are not issued by the issuer of the security in distribution or by any affiliate of the issuer. The exemption covers reference securities with an ADTV value of at least $1 million that are issued by an issuer whose common equity securities have a public float value of at least $150 million. Rule 102 also does not include the exemptions for *de minimis* or basket transactions included in Rule 101.

Rule 102 includes an exemption that permits an affiliated purchaser of an issuer or a selling securityholder to purchase the securities being distributed. [412] Sales of a significant portion of the securities in distribution to affiliates may require disclosure in the prospectus because of the inability of such purchasers to resell such securities freely.

Rule 102 also includes an exemption for two types of plans in respect of an issuer's securities. First, with respect to plans that are available only to employees and shareholders, Rule 102 exempts any distribution pursuant to a plan by or on behalf of an issuer or a subsidiary of the issuer when the distribution is made solely to employees or shareholders or a trustee acting on behalf of such persons. Second, Rule 102 exempts distributions to persons other than employees or securityholders of the issuer, if bids for and purchases of securities pursuant to such plan are effected solely by an agent independent of the issuer and the securities are obtained from a source other than the issuer (*e.g*, from market purchases by the agent). [413] However, a direct issuance plan (*i.e.*, a plan that

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is open to persons other than employees and securityholders and pursuant to which shares are purchased from the issuer or an affiliated purchaser) is not exempt from the provisions of the rule. [414]

Any affiliate of an issuer or a selling securityholder that is acting as a distribution participant has the option of being subject to the less-restrictive Rule 101 rather than Rule 102. [415] The ADTV exemption in Rule 101 is not available, however, in the case of securities issued by the distribution participant or an affiliate of the distribution participant. [416]

[b] Stabilization Under Regulation M

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Rule 104 of Regulation M establishes a flexible framework for stabilization activities conducted in connection with an offering. [417] Rule 104 provides that no person may effect, either alone or with others, any independent transaction to facilitate an offering other than in conformity with the rule's provisions. [418]

In general, under Rule 104, persons stabilizing the price of a security may initiate a stabilizing bid in any market with reference to the independent prices in the principal market for the security wherever located, and maintain, reduce or increase the stabilizing bid to follow the independent bid in the principal market so long as the stabilizing bid does not exceed either the independent bid in the principal market or the offering price of the security.

Under Rule 104, when the principal market for the security is open, the permissible initial stabilizing bid in any market is limited to a price no higher than the last independent transaction price for the security in its principal market, if (i) the security has traded in its principal market on the day stabilizing is initiated or on the preceding business day and (ii) the current asked price in the principal market is equal to or greater than the last independent transaction price. If either of these conditions is not satisfied, stabilizing may be commenced at a price no higher than the highest current independent bid in the principal market.

Generally, if the principal market is closed, but quotations have opened in the market where stabilizing will be initiated, the initial stabilizing bid may not be made at a price in excess of the lower of (i) the price at which stabilizing could have been effected in the principal market for the security at its close or (ii) the last independent transaction price where stabilizing is being initiated. However, if the last independent transaction did not occur on the day stabilizing

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was initiated or on the preceding business day and the current asked price in such market is equal to or greater than the independent transaction price, the price in clause (ii) will be the highest current independent bid price in the market where stabilizing is being initiated.

If the principal market is closed and quotations have not opened in the market where stabilizing will be initiated, stabilizing may be initiated at the lower of (i) the price at which stabilizing could have been effected in the principal market for the security at its close or (ii) the most recent price at which an independent transaction in the offered security has been effected in any market, if the person knows or has reason to know of such transaction.

If no *bona fide* market exists for the security, stabilizing may be initiated at the offering price. If stabilizing is initiated before the offering price is determined, then stabilizing may be continued after the determination of the offering price at the price at which stabilizing could then be initiated.

The maximum caps on the stabilizing price level under Rule 104 are the offering price and the stabilizing bid in the principal market. Once stabilization has been initiated, Rule 104 permits an increase in the stabilizing bid at any time to the highest independent bid price for the security in its principal market, or if the principal market is closed, the highest independent bid in that market at the previous close, so long as the stabilizing bid does not exceed the maximum caps. Rule 104 also provides for adjustment of the stabilizing bid in an amount equal to the value of a dividend, right or distribution when the security being stabilized goes ex-dividend, ex-right or ex-distribution, respectively. If the price of the security is expressed in a currency other than the currency of the principal market, Rule 104 allows adjustments of the stabilizing bid to reflect current exchange rates. [419]

Rule 104 exempts all distributions of Rule 144A-eligible securities to QIBs made in transactions exempt from registration under § 4(a)(2) of, or Rule 144A or Regulation D under, the Securities Act. The exemption also applies if the distribution includes certain persons in the United States not deemed to be "U.S. persons" for the purposes of Regulation S under the Securities Act. Unlike Rules 101 and 102 that exempt both the subject security and the reference security, the Rule 104 exemption is only applicable to the subject security.

Rule 104 permits stabilizing outside the United States during an offering in the United States without compliance with Rule 104, subject to the following conditions: (i) no stabilization is conducted in the United States, (ii) the stabilizing price is not above the U.S. offering price, and (iii) stabilization is conducted only in jurisdictions with regulation of stabilization comparable to that set

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out in Rule 104. [420] For the purpose of this exemption, the Regulation M Release recognized the pre-Market Abuse Directive [421] stabilization regulations of the United Kingdom as comparable to Rule 104 and invited requests for recognition of additional markets having comparable regulations for purposes of the rule. [422] In a no-action letter granted in connection with the 1998 privatization of shares of Nippon Telegraph and Telephone Corporation ("NTT"), [423] the SEC staff clarified its view that Rule 104 permitted stabilization in the United Kingdom under then-applicable U.K. regulations provided that any stabilization in the United States had been terminated, whether or not stabilization had been effected in the United States previously or the U.S. distribution has been completed. The no-action letter also permitted the Japanese underwriters in the NTT offering to conduct stabilizing activities in Japan in accordance with Japanese regulations, even though this involved stabilizing above the U.S. offer price in contravention of Rule 104(f). This relief was required due to the Japanese practice of setting the offering price at a slight discount to the prevailing market price in a secondary offering, and was conditioned on, among other things, the U.S. distribution being complete before Japanese stabilization could begin. The SEC has since granted a class exemption that provides relief similar to the NTT relief described above in connection with all U.S. and Japanese offerings of equity securities by Japanese issuers provided that certain conditions are satisfied. [424] To date, the SEC has granted relief from the application of Rule 104 only in respect of pre-Market Abuse Directive stabilization activities in the United Kingdom (or otherwise in accordance with the U.K. rules) and on the AEX Stock Exchange in Amsterdam, in addition to stabilization activities in Japan, although it did not

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expressly declare The Netherlands' or Japan's stabilization rules to be equivalent to Rule 104 as it had done in the case of the United Kingdom. [425]

Rule 104 requires any person entering a stabilizing bid to notify the market on which the bid is placed. Furthermore, when a person subject to Rule 104 conducts a transaction in securities and the price of those securities may be or has been stabilized, that person is required to notify the purchaser (in a prospectus or confirmation, for example) of that fact. Rule 17a-2 under the Exchange Act also requires managing underwriters to maintain records of syndicate covering transactions and penalty bids (which permit the initial purchasers to reclaim a selling concession from a dealer when the initial purchasers, in covering syndicate short positions or making stabilizing purchases, repurchase securities sold by that dealer), as well as stabilizing activity, [426] and Rule 104 of Regulation M prohibits the imposition of penalty bids in connection with the offering of any security in contravention of such rule. Rule 104 also imposes disclosure and record keeping requirements for certain syndicate aftermarket activities that occur even after stabilization, as such term is used in Rule 104, has ended. Rule 104 requires any person effecting a syndicate covering transaction or placing or transmitting a penalty bid to disclose [427] that fact to the self-regulatory organization that has direct oversight authority over the principal market in the United States for the security for which the syndicate covering transaction is effected or the penalty bid imposed (although public disclosure of such activity is not required). [428]

For a discussion of two customary underwriting practices related to stabilization activities, "overallotment" (whereby the managing underwriter of an

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offering is given the authority by the underwriting syndicate to offer and sell more shares than the underwriters have contracted to purchase from the issuer on a "firm" basis) and the granting of an "overallotment option," *see* § 3.02[5][f].

[c] Prohibited Solicitations and “Tie-in” Agreements for Aftermarket Purchases

The SEC staff has expressed its view that underwriters, broker-dealers and any other distribution participants are prohibited from soliciting or requiring their customers to make aftermarket purchases until the distribution is completed. [429] The staff also described the practice by some underwriters of requiring their customers to agree to buy additional shares in the aftermarket as a condition to being allocated shares in a distribution (so-called "tie-in" arrangements). The staff views these practices as being prohibited by Rules 101 and 102 of Regulation M and possibly violative of other antifraud and antimanipulation provisions of the U.S. securities laws. [430]

[d] Short Selling by Investors in Connection with a Public Offering

Following revisions implemented partly in response to enforcement actions, [431] Rule 105 of Regulation M makes it unlawful, in connection with an

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offering of equity securities for cash pursuant to a registration statement, for any person to sell short a security that is the subject of an offering and to purchase offered securities [432] from an underwriter, broker or dealer participating in the offering if such short sale occurred during the shorter of: (i) the period beginning five business days before the pricing of the offered securities and ending with such pricing, and (ii) the period beginning with the initial filing of such registration statement and ending with the pricing (such period, the "Pre-Pricing Period"). [433]

Rule 105 contains certain exceptions to its prohibition on purchases of offered securities by persons that sold subject securities short during the Pre-Pricing Period. In particular, subject to the requirements detailed in Rule 105 and as further explained in the August 2007 adopting release, exceptions are available to permit purchases of offered securities by (i) persons that offset short positions in subject securities entered into during the Pre-Pricing Period with *bona fide* purchases of such securities made no later than the business day prior to pricing of the relevant offering, (ii) an independent trading unit of a broker-dealer or other separate account of a person where another separately managed trading unit or account had sold the subject securities short during the Pre-Pricing Period, and (iii) an investment company (including a separate fund or fund series) where an affiliated investment company (or another separate fund or fund series) had sold

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the subject securities short during the Pre-Pricing Period. [434] Rule 105 also does not apply to offerings that are conducted on a best-efforts basis, [435] although the SEC has indicated that it may re-evaluate this exception if it becomes aware of potentially manipulative short selling or other concerns in connection with such offerings. [436]

Footnotes

39 § 15(d)(1) of the Exchange Act.

40 § 12(b) of the Exchange Act.

41 The procedures for listing and registering under the Exchange Act securities issued in a public offering are the same as the procedures applicable to listing and registering outstanding securities, as described in § 3.03 and § 4.02. In the case of a public offering of securities to be listed on an exchange, Exchange Act registration proceeds in tandem with Securities Act registration and is accomplished by using Form 8-A, which incorporates the relevant information from the Securities Act registration statement.

42 While under § 5 of the Securities Act sales cannot be made until a registration statement is declared effective, the SEC has permitted, through no-action relief, certain structures whereby conditional offers to buy shares made before the effective date of a registration statement could be accepted following the effective date, and would not be considered preeffective sales violating § 5 of the Securities Act, without the need for investors to reconfirm their preeffective conditional offers to buy. *See*, *e.g.*, *Morgan Stanley Smith Barney LLC* (avail. Nov. 22, 2016) (granting relief under certain circumstances to permit a broker-dealer to accept after the effective date a customer's preeffective conditional offer to buy shares in an IPO if such customer has not withdrawn its offer to purchase prior to the later of one hour after such broker-dealer provides an email notice of effectiveness to such customer and the time of effectiveness, assuming such shares price within 20% of the price range included in the preliminary prospectus delivered to such customer prior to such offer); *Wit Capital Corp.* (avail. July 14, 1999) (granting relief under certain circumstances if the broker-dealer accepts after effectiveness a customer's pre-effective conditional offer to buy shares without affirmatively seeking such customer's reconfirmation of such offer following post-effective pricing, assuming such customer has been given a final opportunity to withdraw prior to

acceptance and has reconfirmed its offer on a pre-effective or post-effective basis).

43 § 2(a)(3) of the Securities Act.

44 The rules contained in Regulation C under the Securities Act govern the preparation of registration statements under the Securities Act, subject to the provisions of any applicable form or any item of Regulation S-K referred to in such form. Rule 400 under the Securities Act. Registration statement forms used by foreign private issuers generally incorporate by cross-reference specific disclosure requirements set forth in Form 20-F (which itself functions as both an Exchange Act registration statement form and the form for annual reports of foreign private issuers). Alternatively, for domestic issuers, including foreign companies that do not qualify as "foreign private issuers," registration statement forms under the Securities Act generally incorporate by cross-reference specific disclosure requirements set forth in Regulation S-K. *See* Regulation S-K, Item 10.

45 § 23 of the Securities Act.

46 Foreign companies that guaranty securities of or co-issue securities with wholly-owned subsidiaries that are not themselves foreign companies are permitted to use an F-series registration statement if the parent and subsidiary are eligible to present condensed consolidated financial information in the parent company's filings. *See* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Exchange Act Forms, Questions 110.03 and 110.04 (Dec. 8, 2016). *See also* § 3.05[1] regarding special rules for foreign governmental and supranational issuers.

47 The Securities Offering Reforms eliminated Form F-2.

48 Under Regulation S-T, all documents filed with or furnished to the SEC by U.S. and, with certain exceptions, foreign issuers must be submitted electronically, using EDGAR. EDGAR filings are accessible by the public through the SEC's website, www.sec.gov. For a description of the documents that foreign issuers may submit by paper, *see* Rule 101(b) of Regulation S-T and Chapter 4, Note 39.

49 *See* the discussion of Exchange Act registration on Form 20-F in §§ 4.04[1] and 4.11.

50 The public offer and sale in the United States of new shares in the form of ADRs technically involve the registration of two securities: the underlying shares and the ADRs. The underlying shares are registered on Form F-1 or Form F-3 registration statements. The ADRs are concurrently registered, as for any ADR program, by filing a Securities Act registration statement on Form F-6, which, as discussed in § 3.04[3], is a simple registration statement describing the depositary arrangements.

51 *See* Form F-1, General Instruction VI.

52 *See* Form F-3, Item 6.

53 *See* § 3.02[2] for a discussion of shelf registration.

54 An offering of securities by a finance subsidiary of a foreign company may, in certain circumstances, be effected on Form F-3 on the basis of the parent's status and reporting history, even if the subsidiary itself would not qualify. The subsidiary must be purely a financing vehicle with no independent operations and the securities being registered (which will generally be debt securities) must be fully and unconditionally guaranteed by the parent. In such instances, the SEC has authorized the filing of a registration statement containing no financial information regarding the subsidiary and has also exempted the subsidiary from the ongoing reporting requirements of the Exchange Act. *See*, *e.g.*, *The Rank Group plc* (avail. Feb. 2, 1998); *CANTV Finance Ltd. and Compañia Anónima Nacional Teléfonos de Venezuela* (avail. Apr. 4, 1997); *WMC Limited and WMC Finance (USA) Limited* (avail. Dec. 17, 1996); *CSR Limited, CSR America, Inc. and CSR Finance Limited, Inc.* (avail. Oct. 25, 1995); *Quebecor Printing Inc., Quebecor Printing Capital Corporation and Quebecor Printing Capital GP* (avail. Mar. 12, 2000). The Securities Offering Reforms expanded majority-owned subsidiary eligibility in Form F-3 to allow majority-owned subsidiaries to use Form F-3 under the same circumstances in which majority-owned subsidiaries may be WKSIs. *See infra* Note 147. For a discussion of other circumstances in which financial statements of guarantors are required to be included in a registration statement, *see* § 4.05[5][c].

55 Form F-3, General Instruction I; SEC Release No. 33-7053 (Apr. 19, 1994). In determining whether a

company meets the public float requirement, nonvoting common stock held by nonaffiliates may be counted along with voting common stock. SEC Release No. 33-7419 (May 8, 1997). Under certain circumstances, nonvoting preferred stock also may be taken into account to satisfy this public float requirement. *See infra* Note 144.

56 Form F-3, General Instruction I.B.5; SEC Release No. 33-8878 (Dec. 19, 2007).

57 Nonconvertible securities, other than common equity, of a majority-owned subsidiary of a WKSI also may be registered if the parent registrant provides a full and unconditional guarantee of the payment obligations on such nonconvertible securities. Form F-3, General Instruction I.C.1.(c)(ii).

58 Form F-3, General Instruction I.B.2; SEC Release No. 33-7053 (Apr. 19, 1994). The Standards used to determine whether the $1 billion threshold is met would be the same as those used in the similar current test for WKSI status. *See* § 3.02[3][a][ii]

59 *See* SEC Release No. 33-7053 (Apr. 19, 1994).

60 Form F-3, Item 5(a) and Form F-1, Item 4A, as applicable if the issuer is eligible to incorporate by reference under General Instruction IV. Such disclosure also may be made by incorporating by reference any form 6-Ks submitted to the SEC by the issuer after its most recent Form 20-F. *See* § 4.02[3][c].

61 Form F-3, Item 5(b)(1). Form F-1, Item 4A(b)(1).

62 *See* § 4.05[2] for a discussion of the timeliness of financial statements. Form F-3, Item 5(b)(2). Although Form F-3 does not technically require an MD&A to accompany the financial statements required by Item 5(b)(2), market practice is to include or incorporate by reference such an MD&A in registration statements on Form F-3.

63 Effective October 1, 2016, the filing fee for Securities Act registration statements is $115.90 per $1 million of securities. *See* Fee Rate Advisory #1 for Fiscal Year 2017 (Aug. 31, 2016). In the case of ADRs, the fee is payable on the registration statement for the securities underlying the ADRs, together with an additional fee on the registration statement for the ADRs. The minimum registration fee applies separately to the registration of the ADRs and the underlying securities.

64 For a further discussion of the "pay-as-you-go" filing fee approach, *see* § 3.02[2][c].

65 Eligible foreign issuers, for their first year of reporting under IFRS, are permitted to file two years rather than three years of income statements, cash flow statements and statements of changes in equity. *See* SEC Release No. 33-8567 (Apr. 12, 2005); *see also* § 4.05[1]].

Form 20-F generally requires that registration statements include audited financial statements no more than 15 months old (and in some cases 12 months old), and that six-month financial statements (which may be unaudited) and U.S. GAAP information, where necessary, be included if the audited financial statements are more than nine months old. In addition, if the issuer has published interim financial information that covers a more current period than is otherwise required, that more current financial information must be included in the filing. *See* Form 20-F, Item 8.A.5; *see also* § 4.02[3][c][i] .

66 *See* § 4.05[1] and § 4.02[3][b][i], Note 40 for a discussion of U.S. GAAP reconciliation requirements. In 2007, the SEC decided to accept financial statements of foreign companies prepared in accordance with IFRS as issued by the IASB without requiring a reconciliation to U.S. GAAP. SEC Release No. 33-8879 (Dec. 21, 2007).

67 Form 20-F Item 3.A. The income statement and balance sheet items required ("selected financial data") include: net sales or operating revenues, income (loss) from operations, income (loss) from continuing operations, net income (loss), net income (loss) from operations per share, income (loss) from continuing operations per share, total assets, net assets, capital stock (excluding long-term debt and redeemable preferred stock), number of outstanding shares, dividends declared per share and diluted net income per share. *See* § 4.05 for a discussion of other financial statement requirements in registration statements.

68 Similarly, the JOBS Act permits an EGC to cover only two years of financial information in the MD&A section of its IPO registration statement. While the JOBS Act provision modifying § 7(a) of the Securities Act to permit the inclusion of only two years of audited financial statements is limited to registration statements for

the initial public offering of the common equity securities of a company and does not extend to registration statements for other or subsequent securities offerings, the SEC has stated that it will not object if in other registration statements an EGC does not present audited financial statements for any period prior to the earliest audited period presented in connection with its initial public offering of common equity securities. *See* Division of Corporation Finance, Jumpstart Our Business Startups Act Frequently Asked Questions, Question 12 (Dec. 21, 2015 (revised)).

69 The SEC has two offices that may be able to assist foreign companies in resolving conflicting accounting requirements and other procedural matters involved in the registration process. The SEC Office of Chief Accountant, while not concerned exclusively with foreign companies, has considerable experience in assisting foreign companies with the accounting requirements of Forms F-1 and F-3. It provides relevant information concerning submissions in its Protocol for Submissions to the Office of the Chief Accountant, which is available on the SEC's website. *See* SEC, Division of Corporation Finance, International Reporting and Disclosure Issues, Part IV(A) (Nov. 1, 2004).

A special staff section for foreign companies, the SEC Office of International Corporate Finance, also often provides guidance to foreign companies and their counsel and investment bankers during the course of public offerings. It is sometimes desirable for a company contemplating a U.S. public offering (particularly if the company has not previously issued securities in the United States) to schedule a preliminary meeting with the SEC staff in advance of filing the registration statement. The company's counsel ordinarily assists the company in scheduling the meeting and usually accompanies the company to the SEC.

70 Shell companies, blank check companies and issuers with no or substantially no business operations are not permitted to use the nonpublic submission procedure.

71 Because staff members are assigned registration statements based on their industry background, it is advisable for issuers to review carefully recent registration statements and comment letters of companies in the same industry sector in order to anticipate and minimize staff comments. In addition to review by the SEC, offering participants that are FINRA members may not participate in an offering absent prior review by FINRA of certain offering documentation addressing underwriting compensation and arrangements (unless an exemption from review applies), pursuant to FINRA rules. *See* § 3.06[4][b]. Registration statements filed by WKSIs are automatically effective upon filing and not subject to SEC review. *See* § 3.02[3][a][ii] for a discussion of WKSIs.

72 The SEC makes staff comment and issuer response letters publicly available via EDGAR. Both foreign and U.S. companies may continue to use the SEC's confidential review procedure for portions of their written responses to staff comments by submitting to the SEC both (i) a complete response letter containing both confidential and nonconfidential information (filed by hand and requesting confidential treatment pursuant to the SEC's FOIA rules) and (ii) a response letter redacted to eliminate all confidential information (filed by EDGAR). *See* SEC, Division of Corporation Finance, Staff Legal Bulletin No. 1 (with Addendum) (Feb. 28, 1997) (setting out the procedures for the SEC staff's handling of confidential treatment requests). With respect to requests for confidential treatment generally, the SEC cautions issuers that they should not be overly broad in their requests and that there must be an appropriate basis for a request for confidential treatment. *See* Press Release, SEC, Staff to Publicly Release Comment Letters and Responses (June 24, 2004).

73 In addition, the SEC attempts to review all registration statements of foreign private issuers engaging in material business transactions with entities subject to OFAC Sanctions, as discussed in greater detail in § 9.08. The SEC's Office of Global Security Risk will likely be involved in staff review of registration statements of issuers with ties to countries that sponsor terrorism and countries linked to human rights violations. The SEC has stated that the office "will function within the traditional disclosure mission of the Commission" including with the objective of obtaining "appropriate disclosure." *See* § 9.08.

74 The length of the comment period can be affected by the volume of capital markets activity at the time of filing.

75 Section 8(a) of the Securities Act provides that the effective date of a registration statement shall be the

twentieth day after the filing. However, in accordance with Rule 473 under the Securities Act issuers include an express provision on the cover of the registration statement delaying effectiveness until such time as the SEC is prepared to declare the registration statement effective.

After responses to comments have been cleared with the SEC staff, the issuer and the managing or principal underwriters may request acceleration of effectiveness of the registration statement pursuant to Rule 461 under the Securities Act. Rule 461 permits such persons to request a date of effectiveness and, upon two business days' notice to the SEC, an hour of effectiveness. Requests must generally be made in writing, but may be oral if certain conditions are met. *See* Rule 461 under the Securities Act. In generally responding to such requests, Rule 460 under the Securities Act provides that the SEC shall have due regard to whether the registration statement has been distributed to underwriters and dealers reasonably anticipated to be invited to participate in the distribution of the subject security. Accordingly, the managing or principal underwriter typically accompanies its request for acceleration with a letter setting out, or the request itself sets out, prospectus distribution details, including breakdowns of recipients and numbers of copies distributed.

76 *See* § 3.02[1][d] discussing the requirement to include the price range and offering size in an IPO preliminary prospectus before distribution.

77 Rule 433 under the Securities Act. *See* § 3.02(3)(c)(iv) for a discussion of free writing prospectuses and § 3.02[3][c][iii][B] for a discussion of electronic road shows.

78 *See* § 3.02[1][e][i] for a discussion of requirement to deliver a preliminary prospectus prior to confirmation of sales.

79 The ability to make up-to-the-minute demand assessments resulting from the bookbuilding process, and the resultant decrease in underwriting risk, has led to a de-emphasis of underwriting commissions in favor of compensation based significantly on selling efforts. *See* 3.02[5][f]. Bookbuilding also facilitates precise allocation of the securities to particular regions and therefore also to the corresponding banks within the underwriting syndicate or syndicates.

In addition to allocations being determined by indications of market interest, it is also shaped by issuers, as they are increasingly playing a part in the allocation process. *See*, *e.g.*, § 3.06[2][b], which describes the FINRA rule that requires a FINRA member acting as the book-running lead manager of an initial public offering to disclose indications of interest and final allocations to an issuer's pricing committee (or board of directors, if no pricing committee has been appointed).

80 Certain websites use transparent order books or auction systems that permit potential investors to view the bookbuilding process. This mechanism raises questions as to whether the information about the order book or about the nature of the auction process must be disclosed in the prospectus and whether information on the computer screen is itself part of the prospectus, or whether such information constitutes a free writing prospectus. Prior to the Securities Offering Reforms, the SEC granted no-action relief whereby auctions of securities by reporting companies were deemed by the staff not to be in violation of § 5(b)(1) of the Securities Act if either a post-effective amendment or final prospectus supplement describing the auction system was filed. *See In Bear Stearns & Co., Inc.* (avail. July 20, 2000) and *Wit Capital Corp.* (avail. July 20, 2000). *See also W.R. Hambrecht & Co.* (avail. July 12, 2000) (delivery of prospectus for debt securities through Hambrecht's website containing a hyperlink to its auction system would comply with § 5(b)(1) and Rule 424 under the Securities Act where the issuer of the debt securities filed material as in *Wit Capital Corp.*). After the Securities Offering Reforms, free writing prospectuses presumably may be used where permitted to provide investors with the auction-related information. Few companies have gone public through Dutch auctions.

In the initial public offering of Google Inc. in 2004, the SEC permitted an electronic auction offering structure to determine the initial public offering price and share allocations. Participants were required to: (i) obtain bidder IDs electronically by registering on an offering website (and, when registering, consent to electronic delivery of communications related to the offering, including amendments to the preliminary prospectus and the final prospectus and notices concerning the effectiveness of the registration statement and acceptance of bids), (ii) submit a bid by one or more of the Internet, telephone, facsimile or in person, depending upon underwriter requirements, setting forth an amount and bid price for shares, which bid could be withdrawn until underwriter electronic notification of acceptance at the time the initial offering price was set and (iii) reconfirm bids upon electronic notification of the occurrence of certain events (including a prospectus recirculation). As in the case of Wit Capital Corp., offers to buy shares made before the effective date of the registration statement could be accepted, if the bid price were at or above the initial offering price, following the effective date of the registration statement without being considered a pre-effective sale in violation of § 5 of the Securities Act and without the need for investors to reconfirm the bid. *See supra* Note 42. In addition, the offering structure provided that, in the instance where the initial public offering price was less than the bottom of the price range or more than 20% above the top of the price range, Google and the underwriters could provide notice on the offering website of the final offering price, issue a press release announcing the final offering price and send an electronic notice to participants who had received a bidder ID notifying them of the final offering price. Under those circumstances, the underwriters would not require bidders to reconfirm bids unless the prospectus were required to be recirculated. If reconfirmation were not required, the underwriters could accept successful bids by sending electronic notices of acceptance in as little as one hour after the final price was set, with withdrawal rights terminating once a bid was accepted.

81 The amount of securities to be offered may be increased by an amendment to the registration statement prior to its effectiveness, but once a registration statement is effective, additional securities (including securities of the same class) can generally be registered only by filing a new registration statement. Pursuant to Rule 462 under the Securities Act, however, a new registration statement may be declared effective immediately upon filing if it relates to no more than 20% of the amount of securities registered on the initial registration statement. *See infra* Note 83 and accompanying text. Other exceptions include the addition of certain securities offered under automatic shelf registration statements. *See* Rule 413 under the Securities Act; § 3.02[2][c].

82 *See* § 3.02[2].

83 Rule 430A under the Securities Act. The omitted information must be included in a final prospectus, which is required to be filed with the SEC within two business days following the earlier of the date of determination of the offering price and the date the final prospectus is first used in connection with the public offering. If, however, the final prospectus is not filed with the SEC within 15 business days after effectiveness, a post-effective amendment must be filed and declared effective before sales are made, and another 15 business-day period will begin to run from the date of effectiveness of the post-effective amendment. Alternatively, the post-effective amendment could contain the pricing information and be declared effective in the manner of a traditional pricing amendment. Rule 430A is available to any issuer, but is limited to offerings of securities for cash.

Although the preliminary prospectus included in the registration statement when it becomes effective must include an estimate of the amount of securities to be offered and the expected price range, any deviations with respect to volume or price will require the filing of a post-effective amended registration statement only if either (i) the aggregate offering price of the offered securities exceeds the specified maximum or (ii) the aggregate offering price of the offered securities is more than 20% lower than the specified maximum and the reductions in volume and/or price giving rise to such lower aggregate offering price would result in a material change in the disclosure contained in the registration statement previously declared effective. *See* General Instructions of Forms S-1, S-3, S-11, F-1 and F-3; Instruction to Rule 430A(a) and Rule 457(o) under the Securities Act. Moreover, if the aggregate offering price of the securities offered exceeds the specified maximum by less than 20%, the required amendment to increase the size of the offering may be accomplished by means of a short-form registration statement that will be effective immediately upon filing. *See* General Instructions to Forms S-1, S-3, S-11, F-1 and F-3; Rule 462(b) under the Securities Act.

84 Rule 159 under the Securities Act, which focuses for liability purposes under §12(a)(2) of the Securities Act on the information conveyed to investors at or prior to the time of an investment decision. Whereas in the past updated disclosure about the issuer and any corrections to the preliminary prospectus would typically have been included in the final prospectus, such an approach is no longer sufficient as a result of adoption

of Rule 159 as part of the Securities Offering Reforms. The adoption of free writing prospectus procedures pursuant to the Securities Offering Reforms has greatly facilitated the ability of issuers and underwriters to address the disclosure liability structure provided by Rule 159, by simplifying the dissemination of updating information to investors prior to an investment decision to purchase the subject securities. *See* discussion of free writing prospectuses in § 3.02[3][c][iv].

85 *See* Rule 10b-10 under the Exchange Act.

86 For a further discussion of settlement in U.S. public offerings, *see infra* Note 489.

87 At a February 2011 conference, a member of the staff of the SEC Division of Corporation Finance stated that the staff understands that economic conditions have created challenges with pricing, and reviewers are trying to be sensitive and flexible. If a registrant wants extra flexibility in the range, it should provide an analysis of the economic conditions that support extra flexibility. It was stated that the staff has granted these requests when it has seen market trends to support them. SEC Filings Insight (CCH, Feb. 24, 2011).

88 A placeholder offering size, often $50 or $100 million, is typically included on the cover page of the registration statement in initial filings since an offering size is required to be included for the payment of fees. That offering size is typically revised in the amendment filed when a price range is added and any additional fees owed are then paid. Press coverage of initial filings sometimes mistakenly identifies the placeholder amount as the expected IPO offering size, although the market generally disregards such reports. First-time registrants had in the past sometimes been permitted to circulate a form of preliminary prospectus that contained information about the issuer, but did not indicate offering size or an estimated price range. The SEC staff, however, subsequently objected to the circulation of preliminary prospectuses that omit price ranges and they are no longer used in initial public offerings.

89 Rule 15c2-8(b) under the Exchange Act.

90 Section 5(b)(2) of the Securities Act.

91 Rule 424 under the Securities Act sets forth time periods for filing prospectuses that disclose information previously omitted or that constitutes a substantive change from or addition to information set forth in a prospectus. In general, Rule 424 provides that a form of prospectus that discloses information previously omitted from the prospectus filed as part of an effective registration statement in reliance on Rule 430A under the Securities Act shall be filed no later than the second business day following the earlier of the date of determination of the price and the date it is first used after effectiveness. Pursuant to Rule 430A, the form of prospectus filed as part of a registration statement for securities offered for cash that is declared effective may omit information with respect to the public offering price, underwriting (including underwriting terms and syndicate composition), underwriting discounts or commissions, amount of proceeds, conversion rates, call prices and other items dependent upon the offering price, delivery dates, and terms of the securities dependent upon the offering date. Pursuant to Rule 430A information omitted but timely filed under Rule 424 is deemed to be part of the registration statement as of the time it was declared effective.

92 Rule 172 under the Securities Act. The prior actual delivery requirement provided only illusory protection for investors because an investment decision had invariably been made, and settlement might have occurred, before the final prospectus reached the investor. Rule 159 is intended to ensure consideration of disclosure liability based on the disclosure record conveyed to the investor at the time of the investment decision. On the other hand, the need to prepare, print and deliver final prospectuses caused inordinate timing and logistical difficulties for issuers and underwriters. Moreover, the sanction for failing to deliver a final prospectus in accordance with the § 5 requirements is draconian and disproportionate—a strict liability right of rescission under § 12(a)(1) of the Securities Act as a result of the § 5 violation.

Rule 173 under the Securities Act requires that for each transaction involving a sale of securities that requires delivery of a final prospectus, each underwriter, broker or dealer participating in such offering (or if the sale is effected by the issuer and not an underwriter, broker or dealer, then the issuer) send to each purchaser, not later than two business days after the completion of the sale (*i.e.*, the closing of an offering), a copy of the final prospectus or, in lieu of the final prospectus, a notice providing that the sale was made pursuant to a registration statement. This notice typically is included in the confirmation of sale required by

Rule 10b-10 under the Exchange Act to be sent to each investor. Rule 173 also permits purchasers to request a physical copy of the final prospectus. Compliance with Rule 173 is not a condition to the exemption from final prospectus delivery under Rule 172, and thus noncompliance with Rule 173 will not result in a violation of § 5 of the Securities Act.

93 Allotment securities include securities acquired in stabilization activities or in an uninterrupted chain of transactions between dealers (as well as securities acquired directly from the issuer or any selling securityholder).

94 As is the case with underwriters, dealers with a prospectus delivery requirement are required to comply with the notice provisions of Rule 173. *See supra* Note 92.

95 *See* April 2000 Release; SEC Release No. 33-7289 (May 9, 1996); SEC Release No. 33-7233 (Oct. 6, 1995) (the "October 1995 Release"). The SEC continues to express concerns as to whether Internet access is sufficiently universal that delivery should be deemed accomplished solely by an issuer's posting a document on the issuer's or a third party's website.

96 The SEC has adopted an "access-equals-delivery" model for delivery of final prospectuses and adopted a "notice-and-access" model for delivery of proxy material; *see supra* Note 92 and accompanying text and § 4.02[3][c][v]; *see also* SEC Release No. 34-55146 (Jan. 22, 2007).

97 Evidence of actual receipt of documents in electronic form can be shown, for example, by an investor's obtaining a different document through a hyperlink from the required document, by an investor's use of forms or other material available only by viewing the required document or by records generated by a system with the capacity to track which users accessed, printed or downloaded those documents.

98 It should be emphasized that general consent to delivery, discussed below, which may be given in advance, does not obviate the need to meet the notice requirement, which requires specific notice of the availability of the required document.

99 For example, documents may be delivered to investors in portable document format ("PDF"), provided investors are informed of the hardware requirements necessary to download PDF files at the time consent to electronic delivery is obtained and are furnished with the required software and technical assistance at no additional cost. PDF is a graphic representation of text provided in a form that cannot be manipulated with word-processing programs. While the SEC has allowed the use of hypertext markup language ("HTML") for EDGAR filings, issuers are still not permitted to file through EDGAR in PDF format, although they may accompany required filings with unofficial copies in PDF format. April 2000 Release.

100 October 1995 Release.

101 October 1995 Release. In the case of a continuous offering, the prospectus should remain available for as long as the issuer will rely on its delivery through the electronic system.

102 October 1995 Release.

103 *See* April 2000 Release. Issuers and broker-dealers may rely on householding (delivery of one document where multiple investors share an address) for prospectus delivery where investors share an electronic address. *See* Rule 154(d) under the Securities Act. However, issuers cannot rely on householding for electronic delivery of proxy material, because Rule 14a-3(e)(1)(ii)(B)(4) under the Exchange Act requires delivery of the relevant document to a post office box or residential street address.

104 Provision of the consent should not be a condition for opening a brokerage account, except in the case of an online-only brokerage firm.

105 SEC Release No. 33-8027 (Oct. 25, 2001) (order declaring registration statement effective); *see also* SEC Release No. 33-8028 (Oct. 25, 2001) (statements of the SEC Commissioners). The importance of this development is highlighted by the fact that the SEC itself, rather than the staff of the SEC, declared the registration statement effective. The staff would normally take this action.

106 The decision was split two to one with a strong dissent filed by then-Commissioner Hunt. Then-Commissioner Hunt expressed concern that American Life would not be providing separate advance notice to investors in connection with website postings. He argued that this SEC decision was "not consistent with

the protection of investors" and exposed investors to significant losses from fraudulent transactions or material changes in the terms of their annuity contracts.

He concluded his dissent by urging the SEC to seek public comment before expanding its decision with respect to this offering.

107 Issuers of annuities and mutual funds are required to update and deliver prospectuses on a more frequent basis than would be required of issuers of other securities as a result of the frequency of changes to the securities underlying these instruments and the ongoing nature of the sales of these instruments by the issuers thereof. This makes the possibility of electronic delivery of required materials particularly relevant to issuers of annuities and mutual funds.

108 Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229, 114 Stat. 464 (1999) (codified at 15 U.S.C. §§ 7001–31). This act seeks to promote electronic commerce by providing a consistent national framework for the validity and enforceability of electronic signatures and transactions. With respect to information regarding a transaction that, pursuant to applicable laws or regulations, must be provided to a consumer in writing, the act sets forth conditions that must be satisfied in order for electronic delivery of such information to satisfy the delivery requirements of the applicable law or regulation. The act, for example, sets forth requirements regarding consumer consent to electronic delivery, the right of a consumer to withdraw such consent, the right of a consumer to receive paper copies of electronic records and a consumer's ability to access and retain records that have been delivered electronically.

109 *See* § 3.02[3][c][iv].

110 *But see* § 4.05[2] for a discussion of Item 8 of Form 20-F, which requires that financial statements not be older than a specified period prior to the commencement of an offering and thus effectively imposes certain limitations on when offers may be made off the shelves of foreign companies.

111 Rule 415(1)(a)(x) under the Securities Act. For a discussion of the eligibility requirements of Form F-3, *see* § 3.02[1][b]. Shelf registration is also permitted for continuous offerings by issuers not eligible to use Form F-3 and might therefore be used in connection with continuous offerings such as medium-term note programs by such issuers. Rule 415(a)(1)(ix) under the Securities Act. Such offerings must be "continuous" and not merely "delayed." The updating requirements for registration statements and prospectuses of issuers filing on Form F-1, however, make such an approach cumbersome and difficult.

112 *See* Rule 415(a)(i) under the Securities Act.

113 For seasoned issuers that are not WKSIs, the SEC will permit offers and sales of securities from the old registration statement to be made up to six months after the third anniversary of effectiveness, if a replacement registration statement has been filed but not yet become effective. Rule 415(a)(5)(ii) under the Securities Act. For WKSIs, when an existing shelf registration statement is replaced by a new automatic shelf registration statement, there is no extension of the effectiveness of the registration statement that is being replaced because there is no delay in effectiveness of the replacement registration statement.

114 *See* Rule 457(p) under the Securities Act.

115 Excluding offerings by the registrant's parent or subsidiaries. *See* Rule 415(a)(x) under the Securities Act.

116 *See* Rule 415(a)(5) under the Securities Act. Automatic shelf registration is discussed in § 3.02[2][c].

117 Unallocated shelf procedures have been available to foreign issuers since 1994 (SEC Release No. 33-7053 (Apr. 19, 1994)) but were first made available to U.S. issuers in 1992 (SEC Release No. 33-6964 (Oct. 22, 1992)). Prior to the adoption of unallocated shelf procedures, the shelf registration rules required registration of a specified amount of securities of a given class.

118 *See* § 3.02[4] (discussing the portion of a global offering that includes a U.S. public component that must be registered with the SEC).

119 *See* § 3.02[2][c].

120 *See* § 3.05[4].

121 If omitted information that relates to the terms of the offering, the securities, the plan of distribution or any selling securityholders (as opposed to issuer-related information) is included in an Exchange Act filing, a

prospectus supplement must nonetheless be filed disclosing the specific Exchange Act report or reports in which the information is contained.

122 The Securities Offering Reform Release makes clear that the date of first use is not the date the prospectus supplement is given to a purchaser in connection with a sale, but instead the date the prospectus is first available to an underwriter or any prospective purchaser. *See* Securities Offering Reform Release, 70 Fed. Reg. 44,722, 44,773 (Aug. 3, 2005).

123 Supplements as to which this provision applies include those filed in connection with delayed primary offerings and those containing information regarding selling securityholders omitted from the registration statement. Rule 430B(f)(1) under the Securities Act.

124 Establishing a new effective date will not affect the information that was in the registration statement at the time of any prior sale, and the rights of an investor in a prior sale (with a previous effective date) will remain unaffected by subsequently filed prospectus supplements or Exchange Act reports. The new effective date of the registration statement would not be considered the filing of a new registration statement for purposes of form eligibility.

125 Instead, the effective date would be the date of the issuer's most recent annual report (which updates the prospectus for purposes of § 10(a)(3)) of the Securities Act or, if later, the date that the relevant shelf registration statement initially became effective.

126 For an MTN program, incorporation by reference can be particularly useful as a means of avoiding the cost of preparing and printing a new prospectus supplement each time there is a need to disclose recent developments.

127 Rule 424(b)(2) requires that in any shelf takedown under Rule 415(a)(1)(x), any "information previously omitted" from the prospectus filed with the registration statement under Rule 430B—including MTN final pricing information—must be filed no later than two business days after pricing.

128 *See* § 3.05[1].

129 SEC Release No. 33-6240 (Sept. 10, 1980); SEC Release No. 33-6424 (Sept. 2, 1982). Certain aspects of shelf registration applicable to a Schedule B issuer differ from those applicable to a foreign private issuer, but the procedures are generally the same. *See* Edward F. Greene & Ronald Adee, *The Securities of Foreign Governments, Political Subdivisions and Multinational Organizations*, 10 N.C. J. INT'L L. & COM. REG. 1 (1985); Guy P. Lander, U.S. Securities Law for International Financial Transactions and Capital Markets, 114 U.S. Sec. Law for Financial Trans. § 4:18 (2d ed.) (updated Dec. 2015).

130 *See New South Wales* (avail. Sept. 15, 2009).

131 *See* § 3.02[3][a][ii] for a discussion of WKSIs.

132 Automatic shelf registration cannot be used in connection with business combination transactions or exchange offers on Form S-4 or F-4.

133 Issuers may still avail themselves of the SEC's "novel and unique" process providing for review, upon request and prior to offering, of new securities that may raise substantial regulatory issues. *See* Securities Offering Reform, 70 Fed. Reg. 44,722, 44,781 n.538 (Aug. 3, 2005).

The automatic shelf registration procedures do not allow a WKSI to delay the effectiveness of its automatic shelf registration statement. Instead, the WKSI may use any registration statement form for which it is eligible and, if it uses Form S-3 or F-3, can indicate that it is not an automatic shelf registration statement in order not to go effective immediately. If a WKSI does not use an automatic shelf registration, however, it will not be able to avail itself of the liberalized rules applicable to automatic shelf registration.

134 If the SEC later notifies a WKSI that the use of the automatic shelf registration statement was improper, securities sold prior to such notification will not be deemed to have been sold in violation of § 5 of the Securities Act, and ongoing offerings may continue pending effectiveness of a post-effective amendment or a new registration statement, provided that such offering is permitted by the post-effective amendment or new registration statement. *See* Rule 401(g)(2) under Securities Act.

If an issuer that was a WKSI at the time of initial filing of an automatic shelf registration statement is no longer a WKSI eligible to use an automatic shelf registration statement at the time of the filing of its most recent annual report on Form 10-K or 20-F, it will have to either post-effectively amend its registration statement onto the form it is eligible to use or file a new registration statement. An offering that is ongoing at such time can continue until a post-effective amendment is filed, or where appropriate a new registration statement is timely filed and declared effective, provided that such offering is permitted by the post-effective amendment or new registration statement. To be considered timely, the post-effective amendment or new registration statement would have to be filed within 120 days after the issuer's most recent fiscal year-end.

135 As discussed in § 3.02[2][b], if information that relates to the terms of the offering, the securities, the plan of distribution or any selling securityholders (as opposed to issuer-related information) omitted from the base prospectus is included in an Exchange Act filing, a prospectus supplement must be prepared and filed under Rule 424 under the Securities Act identifying the specific Exchange Act report or reports containing such information.

136 An issuer may include in its registration statement securities to be issued by certain of its majority-owned subsidiaries, including securities (i) that are issued by subsidiaries that are themselves WKSIs, (ii) that are nonconvertible securities, other than common equity, that the parent has fully guaranteed, (iii) that are guarantees of nonconvertible securities, other than common equity, of the parent or another majority-owned subsidiary that is guaranteed by the parent, and (iv) that are nonconvertible securities, other than common equity, of a wholly-owned subsidiary. An issuer may also include in its registration statement securities to be sold by selling securityholders. *See* Form F-3, Instruction I.C.

137 This flexibility is unique to automatic shelf registration statements. Requiring post-effective amendments for these additions is intended to ensure that new issuers and their officers and directors become signatories to the registration statement and that all information, opinions and consents are provided in the registration statement, and for purposes of qualification of any debt securities being added to the registration statement for purposes of the Trust Indenture Act. The Securities Offering Reform Release notes that for automatic shelf registration statements the SEC will permit qualification of a trust indenture at the time of filing of a post-effective amendment adding the related debt securities to the registration statement, whereas for other shelf registration statements the SEC staff will continue to take the view that an indenture must be qualified when the related registration statement first becomes effective.

138 *See* clause (1)(B)(2) of the definition of "Well-known seasoned issuer" in Rule 405 under the Securities Act.

139 Fees deposited in the SEC's "lockbox account" to be withdrawn on a pay-as-you-go basis, as opposed to fees paid in advance in connection with the filing of a registration statement, will be applied based on the fee schedule in effect at the time they are used in connection with a takedown.

140 *See* § 3.02[1][a].

141 *See supra* Note 43 and related text for the definition of "offer."

142 For example, the SEC observes in the Securities Offering Reform Release that the current regulatory system has led to the practice of marketing securities through road show presentations that have not been open to retail investors generally. As a result, small investors generally have not had the same access to information as larger investors.

143 Under the Securities Offering Reforms, limitations on communications disseminated at any time during the offering process have been eliminated for WKSIs, although written communications that qualify as a "free writing prospectus" are in some cases required to be filed. *See* the discussion of free writing prospectuses in § 3.02[3][c][iv].

144 The public float test applies to "voting and nonvoting common equity." In the context of Form F-3 eligibility, this language has in the past presented a problem for some foreign private issuers whose most liquid class of equity is preferred stock. For example, for many Brazilian companies the most widely held and traded equity is a nonvoting preferred stock, which has historically been issued because local corporate law does not contemplate nonvoting common stock. The SEC staff has in the past informally taken the view that such securities could not be used in determining public float for purposes of Form F-3 eligibility. *See* SEC Release No. 33-7419 (May 8, 1997), 62 Fed. Reg. 26,386, 26,387 n.11 (May 14, 1997). In discussing how

public float is calculated, the Securities Offering Reform Release states that, for purposes of both WKSI status and Form F-3 eligibility, the SEC interprets "common equity" to include "a class of participating voting or nonvoting preferred stock of a foreign issuer where the issuance of the preferred stock results from requirements of the applicable foreign jurisdiction or market and where the class of preferred stock has liquidation or dividend preferences and other terms that cause it to be the substantial economic equivalent of a class of common stock." This language allows some foreign registrants to include a class of preferred stock in calculating public float, because (i) the original reason for issuing preferred stock rather than common stock was compliance with a limitation under foreign law, and (ii) the company can reasonably conclude that the preferences are immaterial to the market value of the stock.

145 The Securities Offering Reform Release makes clear that issuers may not include for purposes of the $1 billion test the principal amount of securities that were offered in registered exchange offers (principally as so-called "A/B exchange offers") because a "substantial portion of these offerings involve registered exchange offers of substantially identical securities for securities that were sold in private offerings." Securities Offering Reform, 70 Fed. Reg. 44,722, 44,728 (Aug. 3, 2005).

146 In calculating the $1 billion amount, an issuer generally may include the principal amount of any debt and the greater of the liquidation preference and par value of any nonconvertible preferred stock.

147 A parent issuer may include the aggregate principal amount of such securities issued by its majority-owned subsidiaries that the parent has fully guaranteed. A majority-owned subsidiary of a WKSI may also qualify as a WKSI if the subsidiary satisfies the WKSI criteria. Certain securities of a majority-owned subsidiary of a WKSI that is not itself a WKSI may also be included in a WKSI shelf registration statement. *See supra* Note 136.

148 The Securities Offering Reform Release provides that a seasoned issuer is an issuer that is eligible to use Form S-3 or Form F-3 to register primary offerings of securities pursuant to General Instruction I.B.1 of such Forms or is registering securities in reliance on General Instruction I.B.2, I.B.5, or I.C. of Form S-3 or General Instruction I.A.5 or I.B.2 of Form F-3. The Securities Offering Reforms expanded the majority-owned subsidiary eligibility provisions in Forms S-3 and F-3 to allow majority-owned subsidiaries to use these forms under the same circumstances in which majority-owned subsidiaries may be WKSIs. Asset-backed securities issuers offering securities registered on Form S-3 are also considered seasoned issuers but cannot qualify for WKSI status.

149 Foreign governments (or political subdivisions of foreign governments) that register securities on Schedule B are ineligible to use Form S-3 or F-3. As a result, Schedule B issuers cannot satisfy the WKSI criteria and do not benefit from the communications reforms for WKSIs. While the reforms applicable to seasoned issuers do not by their terms apply to foreign governmental issuers filing on Schedule B under the Securities Act, the original shelf registration rules also did not apply to these issuers. A shelf registration process was later extended to such foreign governmental issuers by interpretation by the SEC's Division of Corporation Finance. Steps to extend the benefits of the communication reforms applicable to WKSIs have yet to be taken by the SEC or the Division.

150 *See* Rule 164 under the Securities Act. In addition, Rule 164 excludes investment companies and business development companies, which are subject to a separate framework governing communications, from using free writing prospectuses. *See* Securities Offering Reform Release.

151 Failure to timely file will not by itself result in an issuer being ineligible to use a free writing prospectus, if the issuer is current at the time of determination of ineligible issuer status.

152 *See* Form S-3, General Instruction I.A.3(b)

153 Ineligibility due to bankruptcy proceedings will terminate once the issuer has filed an annual report with audited financial statements subsequent to its emergence from such proceedings.

154 The "was at the time a subsidiary of an issuer" provision is intended to address concerns about a subsidiary that had been convicted of a felony or misdemeanor described in § 15(b)(4)(B) of the Exchange Act prior to its acquisition disqualifying the acquiring issuer from WKSI eligibility.

155 There is a waiver provision that enables the SEC to waive an issuer's ineligibility if the SEC determines,

upon the "showing of good cause," that it is not necessary to categorize such issuer as an ineligible issuer. Rule 405 under the Securities Act. This authority has been delegated to the Division of Corporation Finance. *See*, *e.g.*, *In the Matter of Tenet Healthcare Corporation* (avail. Apr. 19, 2007) (granting relief from being considered an "ineligible issuer" in connection with a consent decree entered for alleged violations of antifraud provisions of the federal securities laws). In July 2011, the Division of Corporation Finance issued guidance regarding the factors it would consider when granting a waiver and, in March 2014, it updated this guidance. SEC, Division of Corporation Finance, Statement on Well-Known Seasoned Issuer Waivers (July 8, 2011), Revised Statement on Well-Known Seasoned Issuer Waivers (Mar. 12, 2014). Waivers will only be granted if a finding is made that such waiver is consistent with the public interest and the protection of investors. The Division of Corporation Finance's inquiry focuses on whether the conduct involved a criminal conviction or scienter-based violation and whether the violation relates to the issuer's own disclosure about itself or calls into question the issuer's current and future disclosure. If the violation does not involve the issuer's own disclosure, a waiver request is more likely to be granted, even if the violation was intentional or reckless. If the antifraud violation involves the issuer's own disclosure but is not intentional or reckless, the following additional factors will be considered: (i) any remedial steps taken by the issuer, (ii) the pervasiveness and timing of the misconduct, and (iii) the impact on the issuer (and the market as a whole) if the waiver request is denied. A waiver may include conditions or undertakings.

In 2009, the SEC released a Compliance & Disclosure Interpretation ("C&DI") in which it explained how an issuer may continue to offer securities off an automatic shelf registration statement if the issuer will no longer be a WKSI at the time of filing its next annual report on Form 10-K. *See* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 198.06 (Jan. 26, 2009). In order to continue to offer and sell securities using its automatic shelf registration statement, the issuer must, prior to filing its next annual report on Form 10-K, amend the automatic shelf registration statement so that it conforms to the requirements that apply to a nonautomatic Form S-3. Specifically, (i) the issuer must file a post-effective amendment to the automatic shelf registration statement prior to filing the Form 10-K to register a specific amount of securities and to pay the associated filing fee, (ii) the prospectus included in the post-effective amendment to the automatic shelf registration statement may not omit information in reliance on provisions of Rule 430B that are available only to automatic shelf registration statements and instead must contain all information required to be included in a Form S-3, and (iii) the issuer must remain eligible to use Form S-3 at the time of the filing of the Form 10-K. Promptly after filing the Form 10-K, the issuer must file either a post-effective amendment or a new Form S-3 registration statement to convert the prior automatic Form S-3 to a nonautomatic shelf registration statement, which must be declared effective by the SEC staff. Pending effectiveness, the issuer may continue to offer and sell securities using the amended automatic shelf registration statement. Similar procedures apply for foreign private issuers with respect to their Form 20-F and F-3 filings.

156 Rule 164(h) under the Securities Act. Rule 164 also provides that an offering participant other than the issuer benefits from the issuer's status if it has a reasonable belief that the issuer is not an ineligible issuer.

157 Information is released or disseminated by or on behalf of an issuer if the issuer or an agent or representative, other than an offering participant who is an underwriter or dealer, authorizes the communication or approves the release or dissemination before it is made. Rule 168(b)(3) under the Securities Act.

158 *See* Securities Offering Reform Release, 70 Fed. Reg. 44,722, 44,735 n.122 (Aug. 3, 2005).

159 In recognition that foreign issuers that are public companies in other markets though not in the United States regularly disclose factual business information in those other markets, the SEC provided that, for this purpose, reporting issuers include foreign private issuers that (i) meet all of the requirements for eligibility to use Form F-3 other than the reporting history provisions, (ii) satisfy the public float threshold of Form F-3, and (iii) either have had their equity securities traded on a designated offshore securities market for at least 12 months or have a worldwide market value of their outstanding common equity held by nonaffiliates of at least $700 million. The public float requirement is not applicable if at least one class of the issuer's common equity is listed on a national securities exchange and it does not sell more than one third of its public float

over the 12-month period to the date the registrant seeks to rely on the Rule 168 safe harbor.

160 Factual business information that reporting issuers release or disseminate is subject to the applicable requirements of Regulation FD, Regulation G, Item 10 of Regulation S-K and Item 2.02 of Form 8-K. *See* § 4.10[6].

161 The Securities Offering Reform Release clarifies that a customer also may be a potential investor and that the information may be received by other people without affecting the availability of the safe harbor so long as the other conditions of the safe harbor are satisfied.

162 The Securities Offering Reform Release states that releasing a new type of financial information shortly before a registered offering might well be outside the safe harbor. Similarly, if an issuer consistently released certain factual business information on a quarterly basis through ordinary course press releases, it could not satisfy the condition if it instituted an accelerated media campaign right before or during an offering to release that type of factual business information on a different basis or with different timing. Nonetheless, the Securities Offering Reform Release makes clear that "regularly released" does not necessarily pertain only to scheduled releases of information but can also pertain to episodic communications, such as a change in earnings guidance, so long as the issuer has previously provided these communications in that manner. In these situations, the nature of the event triggering the communication will be taken into account.

Issuers also look to apply the safe harbor in Rule 168 when speaking or otherwise publicly participating in industry conferences, where similar level executives have participated in the same or similar conferences in prior periods and that the scope of the discussion will be of similar factual business information. Similarly, the safe harbor in Rule 168 is sometimes relied on to permit certain nondeal road shows, meetings by an issuer with an institutional investor outside an offering context. However, in cases where an offering is planned immediately after participation at a conference or a nondeal road show meeting, careful analysis is necessary to determine whether the safe harbor applies or whether the presentation may be an offer (which may itself be a permissible offer).

163 For example, although an issuer would be able to rely on the safe harbor for an earnings release published consistent with past practice, the Rule 168 safe harbor does not apply to the use of an earnings release by an offering participant as part of the marketing materials to potential investors in the registered offering.

164 *See* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 256.25 (Aug. 6, 2015).

165 In order to take advantage of the safe harbor for offshore offerings under Regulation S under the Securities Act, an issuer must avoid "directed selling efforts," including the publication of certain advertisements regarding the offering in a publication with a general circulation in the United States. *See* the discussion of directed selling efforts under Regulation S in § 8.02[1][b]. By analogy, if a foreign company avoids "directed selling efforts" in connection with a registered offering, the SEC should not consider the company's activities in its home market to be acts of gun-jumping.

166 The EU prospectus regime, which aims to bring greater regulatory uniformity in Europe to the levels of publicity in the context of offerings and listings of securities, permits an advertisement of a public offering, or admission to trading on a regulated market, of securities within the EU if the advertisement (i) states that a prospectus has been or will be published (and indicates where investors are or will be able to obtain it) and (ii) is clearly recognizable as such, and not inaccurate, misleading or inconsistent with the prospectus.

167 *See* § 11.03[2]. In certain offerings in the United Kingdom, issuers have also sought to encourage investors to purchase shares by offering them bonus shares or vouchers for free services in connection with purchases of minimum numbers of shares. Although U.S. issuers have not generally offered such premiums, similar incentives could be utilized in public offerings in the United States. In a U.S. offering, the Securities Act registration statement would have to disclose the incentives' terms and effect on the share offering and net proceeds. Under § 10(b) of the Exchange Act and § 17 of the Securities Act, it would be unlawful to use such incentives in a fraudulent or deceptive manner. *See* § 11.04[2] and [3].

168 *See*, *e.g.*, § 27A of the Securities Act (providing a safe harbor for certain forward-looking statements) and

Item 303 of Regulation S-K under the Securities Act (requiring forward-looking disclosure about known material trends and uncertainties).

169 In recognition that foreign issuers that are not public in the United States may be public companies in other markets, this safe harbor also is available for certain non-reporting foreign private issuers as described in *supra* Note 159. It is otherwise not available to non-reporting issuers.

170 Regulation FD, Regulation G, Item 10 of Regulation S-K and Item 2.02 of Form 8-K apply to this dissemination of forward-looking information. *See* § 4.10[6].

171 *See* § 3.02[3][b][iv].

172 In 1995, the SEC proposed a rule under which eligible issuers would have been permitted to "test the waters" for a U.S.-registered IPO—that is, to solicit indications of interest from potential investors prior to the filing of any Securities Act registration statement—without being deemed to have "offered" securities for sale in violation of § 5 of the Securities Act. SEC Release No. 33-7188 (June 27, 1995). This would have allowed companies to gauge investor interest before incurring the significant expense of preparing the disclosure documents required for a registered IPO. This proposal was superseded (and substantially narrowed) by an SEC proposal in the Aircraft Carrier Release, SEC Release No. 33-7606 (Nov. 3, 1998), as amended by SEC Release No. 33-7606A (Nov. 13, 1998), that, after some modification, was adopted in 2001 as Rule 155(b) under the Securities Act and permits an issuer to switch from a private placement to a public offering in certain circumstances and provided that certain requirements are satisfied. *See* § 7.02[6].

173 Rule 163A defines "by or on behalf of" an issuer as any communication authorized or approved by an agent or representative of the issuer (other than an offering participant who is an underwriter or a dealer) before the communication is made.

174 For example, the SEC indicates in the Securities Offering Reform Release that if an issuer or its representative gave an interview to the press prior to the 30-day period, the issuer may not be able to rely on the safe harbor if the interview was published during the 30-day period.

The safe harbor is not available to communications relating to certain business combination transactions; offerings registered on Form S-8 (unless the issuer is a WKSI); offerings by issuers that are or were during the past three years blank check, shell or penny stock companies; or communications by issuers that are investment companies or business development companies. Communications falling within the safe harbor are subject to Regulation FD, other disclosure requirements and the antifraud provisions of the federal securities laws.

Communications made outside the 30-day period would not be an "offer" for purposes of § 5(c) of the Securities Act, but such communications are not excluded from the definition of offer for other purposes under the Securities Act, including the definition of "prospectus" in § 2(a)(10) of the Securities Act. Accordingly, while not "offers," communications made outside the 30-day period are subject to disclosure liability under § 12(a)(2) of the Securities Act, which could give purchasers a right to rescind their purchases. A private action under Rule 10b-5 under the Exchange Act would also entitle the plaintiff to recover damages, but a successful action would require the plaintiff to prove the communication contained a false statement or omission made with scienter (that is, an intent to deceive, manipulate or defraud). *See* §§ 11.03[2] and 11.04[2].

175 Rule 135 under the Securities Act. Only the issuer or a selling securityholder (and any person acting on behalf of either of them) may make such an announcement. Rule 135 permits the disclosure of certain additional information in the context of rights offerings, offerings to employees, exchange offers and offerings made under Rule 145(a) under the Securities Act.

176 In the case of an international offering by a foreign issuer, Rule 135e under the Securities Act permits the names of the underwriters (and other information) to be included in a press release outside the United States, and thus as a practical matter the market is informed of the identity of the underwriters. For a discussion of Rule 135e, *see* § 3.02[3][e][vii].

177 *See* Rule 163(c) under the Securities Act. In December 2009, the SEC proposed amendments to Rule 163(c) that would have broadened this exemption. Under the proposed changes, communications made by

underwriters and dealers, and not just those made by issuers, would be covered by the exemption so long as certain conditions were met. The proposal was not adopted.

178 In light of the "automatic shelf registration" process for WKSIs, it was expected that in most cases WKSIs would take advantage of Securities Offering Reforms by having a registration statement on file and would rarely make such offers prior to filing a registration statement. In fact, however, a substantial percentage of WKSIs do not have automatic shelf registration statements on file or do not register common stock on them. WKSIs are permitted to distribute free writing prospectuses before filing a registration statement relating to the securities as long as the free writing prospectus contains a legend prescribed by the SEC regarding the issuer and information about where documents relating to the offering may be obtained upon filing of a registration statement. Such a free writing prospectus need only be filed when and if a registration statement or amendment covering the offered securities is filed. *See* § 3.02[3][c][iv][A] for a discussion of free writing prospectuses.

179 These pre-filing communications will also continue to be subject to the requirements of Regulation FD, since they will not qualify for Regulation FD's exemption for communications made in connection with a registered securities offering by the issuer. *See* § 4.10[6] for a discussion of Regulation FD.

180 *See* § 3.02[3][c][ii] for a discussion of nonbinding indications of interest in connection with "test the waters" communications.

181 SEC, Division of Corporation Finance, Generally Applicable Questions on Title I of the JOBS Act (Apr. 16, 2012), FAQ 3.

182 For a discussion on EGCs' ability to "test the waters" before and after filing of the registration statement, *see* §§ 3.02[3][b][iv] and [c][ii]. For a discussion on pre-deal research *see* § 3.02[3][e]. Deal road shows are considered part of the marketing, not premarketing stage, *see* § 3.02[3][c][iii][B].

183 Investor education initiatives are often supported by sales force presentations given by research analysts to sales personnel in anticipation of investor education, typically a day before investor education meetings begin.

184 *See* § 7.02[4] for a discussion of pilot fishing in the context of exempt private offerings.

185 *See* § 3.02[3][e][i] for a discussion of the use of pre-deal research outside the United States in the context of U.S. registered IPOs that are part of a global offering.

186 *See* § 7.02[6] for a discussion of concerns related to integration of private and public offerings and of Rule 155 under the Securities Act, which provides a nonexclusive safe harbor for a registered offering following an abandoned private offering and for a private offering following an abandoned registered offering.

187 The filing of a registration statement typically is viewed as a solicitation that would foreclose the availability of the exemption for private offerings under § 4(a)(2) of the Securities Act, except insofar as the issuer or its agent approaches prospective investors with which either has a substantive pre-existing relationship. *See* § 7.02[6].

188 EGCs may commence discussions with QIBs and institutional accredited investors prior to the filing or effectiveness of the registration statement and may deliver freely-tradable shares to them if they do not commit to purchase the securities prior to effectiveness of the registration statement.

189 Although the securities offered to cornerstone investors are generally not part of the registered offering, disclosure of a cornerstone investor should be considered in light of the policy underlying Item 9.B.3. of Form 20-F, which requires an issuer to identify any group of targeted potential investors to whom the securities are offered. *See also* Form F-1, Item 7, which requires disclosure of recent sales of unregistered securities.

190 Offering participants might conclude that an anchor investor should be identified because its ownership position will be material to investors following the offering. Absent such a determination, we do not believe the requirement in Item 9.B.2 of Form 20-F to disclose that a prospective investor intends to purchase more than 5% of the offering should dictate disclosure, since such disclosure is not required of a domestic issuer.

191 The term "oral" is not defined in the Securities Act or the SEC's rules, but the term "written" is defined very

broadly in § 2(a)(9) of the Securities Act to include, among other modes of communication, "graphic communication," which in turn is defined in Rule 405 under the Securities Act. Essentially, any communication other than an in-person or telephonic communication (not in any way preserved for retransmission) will be treated as a written communication. Materials, including slide presentations, that accompany a nonrecorded, in person or telephonic communication are not considered written communications as long as they are not retained by investors or otherwise able to be printed or saved after the time of the communication.

192 A WKSI that communicated information that constituted an offer (*i.e.*, a free writing prospectus) prior to filing a registration statement would rely on Rule 163 under the Securities Act rather than Rule 134 to avoid a gun-jumping violation.

193 Rule 134 is available without regard to whether the statutory prospectus includes a price range, except in the case, such as an IPO, where a price range is required in a statutory prospectus circulated to investors, and where the Rule 134 communication includes pricing or related information. *See* Securities Offering Reform Release.

194 In July 2011, pursuant to § 939A of the Dodd-Frank Act, the SEC amended Rule 134 to remove the safe harbor for credit ratings assigned or expected to be assigned by a nationally recognized statistical rating organization ("NRSRO") to the applicable securities. *See* SEC Release No. 33-9245 (July 27, 2011). The SEC noted that removing credit rating references from the Rule 134 safe harbor "would not necessarily result in a communication that included this information being deemed to be a prospectus or a free writing prospectus." *See* Securities Ratings, 76 Fed. Reg. 46,603, 46,612 (Aug. 3, 2011). However, the result would be that if the credit rating information were included, the entire communication would lose the safe harbor's protection and need to be evaluated under more uncertain facts-and-circumstances criteria. Given the risks of such an exercise, especially in light of the relatively extensive and detailed offering-related information that a Rule 134 communication could otherwise contain, issuers and underwriters typically exclude rating information from deal-related press releases.

195 *See* § 3.02[3][e].

196 SEC, Division of Trading and Markets, Jumpstart Our Business Startup Act—Frequently Asked Questions About Research Analysts and Underwriters (Aug. 22, 2012), FAQ 1.

197 *See* § 3.02[3][b][v][A] for a discussion of premarketing during the quiet period and, more generally, of certain types of activities that constitute premarketing.

198 *See* § 3.02[3][c][iii][B] for a discussion of road shows, the principal type of marketing activity following launch.

199 *See* § 3.02[3][b][v][A] for a discussion of investor education generally and investor education meetings during the quiet period.

200 *See* § 3.02[3][b][v][A] for a discussion of pilot fishing generally and, in particular, to the limited extent permitted during the quiet period.

201 *See* § 3.02[3][e][vi] for a discussion of pre-deal research in respect of EGCs. *See* 3.02[3][e][ii], more generally, for a discussion of research reports in the context of U.S. registered offerings by U.S. reporting companies or seasoned foreign private issuers.

202 *See* § 3.02[3][e][i] for a discussion of the use of pre-deal research outside the United States in the context of U.S. registered IPOs that are part of a global offering.

203 Rule 433(h)(4) under the Securities Act defines a road show as "an offer (other than a statutory prospectus or a portion of a statutory prospectus filed as part of a registration statement) that contains a presentation regarding an offering by one or more members of the issuer's management … and includes discussion of one or more of the issuer, such management, and the securities being offered."

204 Rule 433(d)(8) under the Securities Act and Rule 405 under the Securities Act (excluding certain forms of communication from the definition of "graphic communication" and thus from the definition of "written communication").

205 Rule 433(d)(8)(i) under the Securities Act.

206 Rule 405 under the Securities Act.

207 Rule 405 under the Securities Act.

208 A *bona fide* electronic road show is a road show transmitted by graphic means that is a written communication and contains a presentation by some members of management and includes discussion of the issuer, management or securities being offered, and, if more than one road show that is a written communication is used, covers the same general areas as in the other versions. The *bona fide* electronic road show need not: (i) cover the exact same material as in the other versions; (ii) have the same management present; (iii) include all projections contained in the other versions; or (iv) provide for Q&As. If there is more than one version of the road show that is a written communication, the *bona fide* electronic road show must be made available no later than the other versions. Rule 433(d)(8)(ii) under the Securities Act.

209 *See* § 11.03[2] discussing liability under § 12(a)(2) of the Securities Act and § 11.04[2] discussing liability under Rule 10b-5 under the Exchange Act. Liability under § 11 of the Securities Act does not apply to a road show, unless it is explicitly incorporated by reference into the registration statement, which would be very unusual.

210 However, liability concerns have substantially limited the use of free writing prospectuses that could be construed as having a marketing purpose, and free writing prospectuses have been used most often to describe the terms of offered securities and the offering and occasionally to communicate late-breaking developments.

211 A written communication constituting an offer circulated at the same time as or after delivery of a final prospectus (such as sales confirms)—a so-called "free writing—does not constitute a prospectus under the Securities Act. These communications would not be subject to the rules governing free writing prospectuses. In addition, Rule 134 notices, Rule 135 communications, regularly released factual business information and forward-looking information falling within Rules 168 and 169, and research reports satisfying the requirements of Rule 137, Rule 138 or Rule 139 under the Securities Act, do not constitute free writing prospectuses because they are by rule not offers or prospectuses for purposes of the gun-jumping provisions.

212 Rule 433(h)(3) under the Securities Act defines a written communication or information as prepared or provided "by or on behalf of" a person if the person or agent or representative of the person authorizes the communication or information or approves the communication or information before it is used. Rule 433(h)(3) also makes clear that an offering participant will not be an agent or representative of the issuer solely by virtue of its acting as an offering participant.

213 For a discussion of "ineligible" issuers, *see* § 3.02[3][a][ii]. In addition, Rule 164 excludes investment companies and business development companies, which are subject to a separate framework governing communications, from using free writing prospectuses.

214 WKSIs are permitted to use free writing prospectuses prior to the filing of a registration statement pursuant to Rule 163 under the Securities Act. *See* § 3.02[3][b][iv].

215 Rule 164(e)(ii) under the Securities Act.

216 The required legend indicates how to obtain a prospectus and recommends that potential investors read the prospectus (including Exchange Act documents incorporated by reference). The legend also advises investors that they can obtain the registration statement, including the prospectus and any incorporated Exchange Act documents, through the SEC's website, and that they may request the prospectus from the issuer or any underwriter or dealer by calling a toll-free number. The legend may be a generic one with a toll-free number of the underwriter (or the issuer) for an investor to call to obtain the prospectus.

Disclaimers of responsibility or liability that would be impermissible in a statutory prospectus or registration statement would also be impermissible in free writing prospectuses (*e.g.*, disclaimers regarding accuracy or completeness or that the communication is not a prospectus).

217 Rule 433 requires issuers and offering participants to retain for three years any free writing prospectus used from the date of the initial *bona fide* offering of the securities, but only if the free writing prospectus was not filed with the SEC.

In order to ensure sufficient oversight of the content and usage of a free writing prospectus, Rule 418(a)(8) gives the SEC authority to request production of any free writing prospectus used in connection with an offering.

218 Rule 164 provides, under certain circumstances, a cure provision for failures to file a free writing prospectus, to include the required legend or to comply with the record retention requirements. *See* § 3.02[3][c][iv][C].

219 *See* §§ 11.03[2], 11.04[1] and 11.04[2] for a discussion of the liability standards under § 12(a)(2) of the Securities Act and Rule 10b-5 under the Exchange Act.

220 Rule 433(c)(2)(i) under the Securities Act.

221 As a result, in practice, a free writing prospectus could be used in an offering by a non-reporting or unseasoned issuer without prior or concurrent delivery of a statutory prospectus only in the case of a free writing prospectus published or disseminated by the media as to which neither the issuer nor an offering participant provided consideration for such publication or dissemination. The delivery or availability condition also applies if consideration has been or will be given by the issuer or an offering participant for the dissemination (in any format) of the free writing prospectus or § 17(b) of the Securities Act requires disclosure that consideration has been or will be given by the issuer or any offering participant in connection with the free writing prospectus. Section 17(b) requires disclosure of consideration received or to be received from an issuer, underwriter or dealer for the circulation or publication of a communication describing a security, even if the communication purports not to offer a security for sale.

222 *See* SEC Release No. 33-7856 (Apr. 28, 2000) for the prior guidance.

223 The date of "first use" is the date the free writing prospectus is available to the managing underwriter, syndicate member or any prospective purchaser—not when an underwriter first delivers it to investors.

224 This condition only requires that the issuer information contained in the free writing prospectus be filed and not necessarily the free writing prospectus itself.

225 Most issuers, even if they are ineligible issuers, are permitted to use free writing prospectuses that consist solely of descriptions of the terms of the securities or the offering pursuant to Rule 164. Although a free writing prospectus that contains the final terms of an offering benefits from a later filing deadline, a free writing prospectus that also contains other information that if distributed separately from the final terms would be required to be filed no later than the date of its first use will not benefit from the later filing deadline— *i.e.*, it cannot "piggyback" on the later filing deadline for a free writing prospectus containing only the final terms.

226 The conditions to be met in Rule 433 are (i) the free writing prospectus is filed in accordance with Rule 425 (including the filing timeframe), (ii) the material filed pursuant to Rule 425 indicates on the cover page that it is also being filed pursuant to Rule 433 and (iii) the material filed pursuant to Rule 425 includes the legend required by Rule 433.

227 For example, this filing condition would be triggered where an underwriter included a free writing prospectus on an unrestricted website or sent out a press release regarding the issuer or the offering that would constitute a free writing prospectus. On the other hand, the Securities Offering Reform Release states that a free writing prospectus on a website with access restricted to an underwriter's investors or an e-mail by an underwriter to its customers that are potential investors, regardless of the number of such customers, will not require filing. If an issuer distributes a free writing prospectus prepared by an offering participant, however, the free writing prospectus would become an issuer free writing prospectus as a result of this distribution and require filing by the issuer.

228 Rule 164 does not provide a cure mechanism for failure to include a hyperlink to the statutory prospectus in an electronic free writing prospectus of an unseasoned or nonreporting issuer. Similarly, a free writing

prospectus that includes a hyperlink to a prospectus that does not contain a price range when required would constitute a § 5 violation.

229 There may be situations where it will not be clear how to communicate the proper legend to the same prospective purchasers because information as to recipients of the original unlegended communication is not available, in which case it will be necessary to err on the side of overinclusiveness.

230 Pursuant to Rule 433(f) under the Securities Act, an independently prepared media publication would be considered a free writing prospectus prepared on behalf of an issuer or any other offering participant if the issuer or any other offering participant (or any person acting on its behalf) provided, authorized or approved the information that is prepared and published or disseminated by a person that is in the business of publishing, radio or television broadcasting and is unaffiliated with the issuer or any other offering participant.

231 Rule 433(f) also provides that such a free writing prospectus (i) does not need to be filed if the substance of the free writing prospectus has previously been filed, and (ii) may include information that the issuer or offering participant reasonably believes is necessary or appropriate to correct information in the communication, and that the issuer or offering participant may file a copy of the materials provided to the media (so long as it contains all the information provided to the media) in lieu of filing the actual written communication as published or disseminated.

In cases where an issuer or other offering participant prepared, paid for or gave consideration for the preparation, publication or dissemination of or uses or refers to a published article, television or radio broadcast or advertisement, the issuer or other offering participant would have to satisfy the general conditions for use of the free writing prospectus at the time of publication. In other words, for non-reporting issuers and unseasoned issuers, a statutory prospectus would have to accompany or precede the communication, which would have the practical effect of prohibiting such issuers from publishing or broadcasting written advertisements, "infomercials" or broadcast spots that included information beyond that permitted by other safe harbors (*e.g.*, Rule 134). For seasoned issuers, the most recent statutory prospectus would have to be on file with the SEC and the issuer or offering participant would have to file the free writing prospectus no later than the date of first use.

Rule 433 also allows an issuer that is in the media business to be able to rely on the media condition if the issuer (i) is the publisher of a *bona fide* newspaper, magazine or business or financial publication of general and regular circulation, or a *bona fide* broadcaster of news, including business and financial news, (ii) has established policies and procedures for the independence of the content of the publications or broadcasts from the offering activities of the issuer, and (iii) publishes or broadcasts the communication in the ordinary course.

232 As a result, issuers and underwriters that use a free writing prospectus to convey the final terms of an offering to investors for Securities Act § 12(a)(2) purposes typically file both the free writing prospectus and a prospectus supplement that includes the same description of the final terms as the free writing prospectus (as well as any terms omitted from the free writing prospectus).

233 *See* § 4.10[6] for a discussion of Regulation FD.

234 Regulation FD provides that secondary offerings will be excluded from the regulation's requirements if the offering also includes a registered capital formation transaction for the account of the issuer. Regulation FD makes clear, however, that inclusion of a capital formation transaction for the account of the issuer as part of the offering for the purpose of evading the requirements of Regulation FD will not exclude the secondary portion from its requirements. The exclusion for registered business combination transactions remains available.

235 *See* § 4.10[6] for a discussion of Regulation FD.

236 *See* SEC Release No. 33-5180 (Aug. 16, 1971).

237 *See* § 3.02[1][e] for a discussion of the prospectus delivery requirement.

238 While arguably "publicity," so-called "bell ringing" ceremonies at the NYSE or Nasdaq are generally thought

to be permitted.

239 *See* discussion of Rules 168 and 169 under the Securities Act, which provide a nonexclusive safe harbor for certain factual and forward-looking information in § 3.02[3]a][iii].

240 For a discussion of a reporting issuer's ongoing communications with financial analysts and related disclosure issues, including the duty to correct or update previous communications, Regulation FD, selective disclosure to analysts and management participation in the preparation of analysts' reports, *see* § 4.10.

241 *See* § 14.07[5][b], which discusses limitations that both European and U.S. underwriters may impose on the distribution of pre-deal research in certain circumstances in light of the Global Research Settlement, as well as certain FINRA rules.

242 *See* § 3.01.

243 *See* § 3.02[3][b] and [c] for discussions of impermissible offers during the quiet period and waiting period, respectively. *See* § 3.02[3][e][vi] for a discussion of liability concerns in connection with the preparation and distribution of research reports.

244 If the lead managers of an offering determine that research should not be distributed in the United States, even in accordance with Rule 139 (as discussed below), this prohibition generally is imposed on all members of the syndicate to level the playing field and avoid any concern about imputed liability among the members. If an underwriter nonetheless distributes research in violation of the prohibition, the underwriter could well be expelled from the syndicate.

245 The 25-day period generally coincides with the 25-day period following an IPO registration statement effective date set forth in Rule 174(d) under the Securities Act during which broker-dealers must deliver a prospectus in connection with transactions in the IPO security. *See* § 3.02[1][e][i]

246 *See* § 3.02[3][e][vii] for a discussion on the distribution of research reports outside the United States in the context of global offerings. *See also infra* Note 266 for discussion of blackout periods with respect to research distributed other than in the context of IPOs.

247 Special difficulties may arise in connection with spin-offs and similar transactions involving the disposition by a parent company of some or all of the shares in a subsidiary or investee company. There will likely be some flexibility for the publishers of research reports about the parent (but not initiators of such coverage) to continue to reflect information about the subsidiary or investee in such research reports to the same degree as in the past, although special care will need to be taken with respect to potentially sensitive or material information about the subsidiary or investee or information about the spin-off or similar transaction.

248 Rule 139 under the Securities Act defines a research report as "a written communication, as defined in Rule 405 under the Securities Act, that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision." Rule 139(d) under the Securities Act.

249 The issuer (or any of its its predecessors) must not be or have been during the preceding three years a shell company (other than a business combination related shell company), blank check company or penny stock issuer. Rule 139(a)(1)(ii).

250 *See* Rule 139(a)(1)(i)(B) under the Securities Act.

251 *See* Rule 139(a)(1)(iii) under the Securities Act. Rule 139 permits a broker or dealer participating in a distribution of securities to initiate coverage on a new class of an issuer's securities as long as research reports about the issuer or its securities, including a different class of securities, have been published or distributed previously or at least one such report has been distributed or published following the discontinuation of coverage.

252 The issuer (or any of its predecessors) must not be or have been during the preceding three years a shell company (other than a business combination related shell company), blank check company or penny stock issuer. Rule 139(a)(1)(iii) under the Securities Act.

253 Rule 139(a)(2) under the Securities Act. Rule 139(a)(2) also requires that any projections must:

- have been published previously on a regular basis;
- be included with respect to either a substantial number of companies in the issuer's industry or subindustry or substantially all companies covered in the report; and
- cover the same periods with respect to such other companies.

The industry research report may include a more favorable recommendation than the one included in the last report, provided the report contains "similar types of information about the issuer or its securities as contained in prior reports."

254 The issuer (or any of its predecessors) must not be or have been during the preceding three years a shell company (other than a business combination related shell company), blank check company or penny stock issuer. Rule 138(a)(4) under the Securities Act.

255 As with Rule 139 under the Securities Act, Rule 138 under the Securities Act defines a research report as "a written communication, as defined in Rule 405 under the Securities Act, that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision." Rule 138(d) under the Securities Act.

256 Rule 138 under the Securities Act. Rule 138 is applied on an offer-by-offer basis for issuers that use the SEC's shelf registration procedures. Thus, having an effective shelf registration statement in place that covers both debt and equity (either allocated or unallocated) will not, in itself, preclude the availability of the rule. *See* SEC Release No. 33-7132 (Feb. 1, 1995).

257 Rule 138(a)(3) under the Securities Act. *See* § 3.02[3][e][iii].

258 Rule 137 under the Securities Act. As with Rules 138 and 139, Rule 137 defines a research report as "a written communication, as defined in Rule 405 under the Securities Act, that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision." Rule 137(e) under the Securities Act.

259 In addition, the issuer (or any of its predecessors) of the securities being offered must not be (or have been during the preceding three years) a blank check company, a shell company (other than a business combination related shell company) or a penny stock issuer. Rule 137 under the Securities Act.

260 JOBS Act § 105.

261 Although distribution of research outside the United States in connection with an offering by a non-U.S. issuer should not raise issues under § 5 of the Securities Act, it does raise certain issues under Regulation M under the Exchange Act, which, as described in § 3.02[9][a], generally prohibits, both inside and outside the United States, the solicitation, commencing with a one- or five-business day restricted period before the offering price is determined, of offers to buy securities of the same class as the securities that will be distributed in the offering, in order to avoid manipulation of the price of such securities. Rule 101 of Regulation M provides certain exemptions for research distribution, principally where the research satisfies the conditions of Rules 138 or 139 under the Securities Act or where it relates to certain actively traded securities. The exemption for certain actively traded securities, the relatively brief period during which distribution of research would be affected and the current practice of many issuers to adhere to a blackout period that would, in any event, exceed the Regulation M restricted period have resulted in Regulation M having minimal impact on most global offerings by non-U.S. issuers.

An additional concern is that information, particularly forward-looking information, not required to be included in a registration statement under Securities Act requirements but included in research reports, may be required by the SEC to be included in the registration statement if that information is published in the United States, including in media reports based on research reports obtained outside the United States, notwithstanding that neither the issuer nor any underwriter had any involvement in those media reports. *See infra* Note 299. In an offering by a Chinese company in 2000, for example, information derived from a research report, including financial projections, was published in various U.S. newspapers. The research report was distributed only outside the United States, and the information was published without the consent of the company or of the underwriter that had prepared the report. The issuer nevertheless was required to include a risk factor in its prospectus that stated the assumptions on which the projections were based and urged investors not to rely on the projections. *See* PetroChina Company Limited, Prospectus (Mar. 30, 2000); *see also* LG. Philips LCD Co., Ltd., Prospectus (July 15, 2004). As a result of the SEC's focus on this area, some underwriters consider avoiding the inclusion of projections or forecasts in pre-deal research in SEC-registered offerings, even though published exclusively outside the United States.

262 The legend could read as follows: "Neither this document nor any copy of it may be taken or transmitted into the United States or distributed in the United States or to any U.S. person (within the meaning of *Regulation S* under the Securities Act)." While it is not strictly necessary for the legend to refer to U.S. persons in the case of most offerings that fall into Category 1 of Regulation S, a restriction on distribution to U.S. persons is often included regardless of the Regulation S category of the issuer in order to decrease the likelihood that research reports will make their way inappropriately into the United States (*e.g.*, through distribution by a U.S. person resident abroad to an affiliate in the United States). For a discussion of the different Regulation S categories, *see* § 8.02[1][c].

263 If a research report satisfies the requirements of Rule 138 or Rule 139 under the Securities Act, its distribution, even in the United States, will not constitute directed selling efforts under Regulation S and will not be inconsistent with the offshore transaction requirement for the Regulation S offering. As a result, such research report need not be isolated from the United States. Rules 138(c) and 139(c) under the Securities Act.

264 *See* § 11.04.

265 Concern that issuers may be held liable for the contents of research reports that they participate in preparing was heightened by a 1997 SEC enforcement action, *In the Matter of Presstek, Inc.*, SEC Release No. 34-39472 (Dec. 22, 1997). *See* § 4.10[1], which discusses concerns arising from issuer involvement in the preparation of research reports, including a discussion of *Presstek*.

In addition to these liability concerns, issuer involvement in reviewing research reports may be further constrained by FINRA rules. Pursuant to these rules, U.S. broker-dealers may not submit a research report to an issuer prior to publication, except to review certain sections of the draft report (not including those sections that contain the research summary, research rating or price target) for factual accuracy. *See* FINRA Rule 2241(b)(2)(N) and Supplementary Material .05. We understand that many firms have extended this prohibition globally so that it applies also to non-U.S. broker-dealer affiliates within the same holding company structure. However, NASD Rule 1050(f) allows a foreign research analyst employed by a foreign affiliate of the FINRA member to contribute to a "globally branded" research report without having to be registered with FINRA. The research report must prominently disclose (i) each affiliate that contributed to the report, (ii) the names of any foreign research analysts employed by any contributing affiliate, (iii) that such research analysts are not registered or qualified as research analysts with FINRA, and (iv) that such research analyst may not be an associated person of the FINRA member and therefore may not be subject to FINRA restrictions on communications with a subject company, public appearances and trading securities held by a research analyst's account.

266 Blackout periods, during which the dissemination of research by syndicate members is prohibited, were developed by European banks as a way of reducing these liability concerns. Their imposition subsequently became routine in global offerings. In the past, blackout periods typically ran four weeks or longer. However, in recent years, many offerings have imposed a blackout period shorter than this, or in some cases even eliminated it altogether, on the theory that it may not in fact be very useful in protecting against liability for research reports.

Lead managers typically interpret the blackout periods they impose on the syndicate to apply even to research reports previously published by underwriters and included on electronic systems operated by third parties. Agreements with third parties sometimes do not permit authors to have such reports deleted upon request. A syndicate member may therefore need to seek permission from the global coordinator to allow a corresponding departure from the blackout restrictions for the offering in question.

In addition to self-imposed blackout periods, FINRA rules may impose research quiet periods following U.S. public offerings for non-EGCs. *See* § 14.07[5].

267 Changes to the U.S. securities laws, intended to encourage issuers to include such forward-looking information in offering documents, have not met with great success. *See* § 4.06[1][a].

268 *See* § 3.02[1][e] for a discussion of aftermarket prospectus delivery requirements.

269 Information on an issuer's website should be regularly and frequently updated, not only during a public offering and in the immediate run-up and aftermath, but outside the offering context as well. Generally, material should be checked to ensure its accuracy and currency. The SEC has cautioned that "[i]n effect, a statement may be considered to be 'republished' each time that it is accessed by an investor or … each day that it appears on the website." April 2000 Release, Use of Electronic Media, 65 Fed. Reg. 25,843, 25,855 (May 4, 2000). During an offering, material other than the prospectus also should be vetted to ensure conformity with the prospectus.

270 *See* § 3.02[3] for a discussion of press releases issued pursuant to Rules 134, 135, 168 and 169.

271 The prospectus should be in the form most recently filed with the SEC and should be removed or properly archived at the end of the prospectus delivery period.

272 SEC Release No. 33-7856 (Apr. 28, 2000) (the "April 2000 Release"); *see* § 3.02[3].

273 In the past, the securities of both U.S. and non-U.S. issuers sold outside the United States were registered only to cover the possible flowback of such securities into the United States, not the initial sales themselves. However, following amendments in 1998 to Regulation S, it is generally necessary as a practical matter to register both U.S. and non-U.S. sales of equity securities of a U.S. issuer in the initial distribution, rather than attempt to rely on Regulation S with respect to the non-U.S. sales of such securities. Such registration is generally required because Rule 905 of Regulation S under the Securities Act provides that equity securities of U.S. issuers acquired from the issuer, a distributor or any of their respective affiliates in a transaction in compliance with Regulation S are deemed to be "restricted securities" as defined in Rule 144 under the Securities Act, meaning that such securities may not be freely traded in the United States unless they are registered under the Securities Act, satisfy the requirements of Rule 144 or are sold under another exemption from the registration requirements of the Securities Act. *See* § 8.02[2].

274 The number of shares to be registered must also include those subject to the underwriters' "overallotment option," which is discussed in § 3.02[5][f].

275 WKSIs may file a post-effective amendment to an effective automatic shelf registration statement to increase the number or add a class of securities not previously included in the relevant registration statement or to add securities of a majority-owned subsidiary otherwise permitted to be included in an automatic shelf registration statement. *See* Rule 413 under the Securities Act. WKSIs may also register an indeterminate number of securities of any class on an automatic shelf registration statement without specifying whether the securities are being sold in primary offerings or secondary offerings on behalf of selling securityholders. Classes of securities registered also do not need to be allocated between the issuer, its eligible subsidiaries or selling securityholders. Registration fees may be paid on a pay-as-you-go basis and additional information with respect to any particular offering may generally be provided by a prospectus supplement. An issuer that is a WKSI based only on its registered nonconvertible securities may only register nonconvertible securities (other than common equity) on an automatic shelf registration statement unless it is eligible to use either Form S-3 or F-3 for a primary offering because it has a public float of $75 million or more. *See* § 3.02[2][c] (discussing automatic shelf registration statements).

For issuers not eligible to use automatic shelf registration statements, a new registration statement must be filed to increase the number or add a new class of securities being offered. Under Rule 462 under the Securities Act, a new registration statement may be declared effective immediately upon filing if it relates to no more than 20% of the amount of securities registered on the initial registration statement, provided that certain conditions are satisfied. *See* Rule 462 under the Securities Act. In addition, Rule 416 under the

Securities Act permits certain additional securities arising from stock splits, stock dividends and related occurrences to be offered under effective registration statements under certain circumstances. *See* Rule 416 under the Securities Act.

276 *But see supra* Note 273, noting the possible need to register non-U.S. sales of equity securities of a U.S. issuer. U.S. issuers offering equity securities outside the United States using a prospectus that is different from that used in the United States will need to consider whether that prospectus will be required to be filed with the SEC as a free writing prospectus (and whether the prospectus used in the United States will need to be delivered to the recipients of any such free writing prospectus prior to or with the delivery of the free writing prospectus), or whether the same prospectus should be used in all jurisdictions, with any different or alternative pages used outside the United States filed as part of the U.S. registration statement with the SEC. *See* also Rule 433(d) under the Securities Act; § 3.02[3][b]iv].

277 The reason for making this clear is to reduce the risk that the issuer and the underwriters of the international offering will be exposed to liability, mainly under § 11 or § 12(a)(2) of the Securities Act, in respect of the international offering (a risk that may also be mitigated by the limitations on the extraterritorial application of the U.S. securities laws as a result of the Supreme Court's decision in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010), as discussed in § 11.10[3]). The statement, which should be added to the cover page of the registration statement, could read as follows: "The shares being registered include [insert number] shares that are to be offered outside the United States but that may be resold from time to time in the United States while a registration statement is required to be in effect or a prospectus is required to be delivered." It would also be advisable to add the following sentence to the underwriting section of the U.S. prospectus (or to the single prospectus when only one is being used in and outside the United States): "This Prospectus may be used in connection with [securities] initially offered outside the United States in the [international offering] insofar as such [securities] are resold from time to time in the United States in transactions that require registration under the Securities Act."

In order to buttress the argument that these liability provisions do not apply to purchases outside the United States, additional text along the following lines should also be included in the prospectus used outside the United States (or in the single prospectus when only one is being used in and outside the United States):

> The [securities] being offered outside the United States pursuant to the [international offering] have not been registered under the Securities Act for offer or sale as part of their initial distribution. Each [international underwriter] has represented and agreed that it has not offered or sold and will not offer or sell such [securities] as part of its initial distribution within the United States. The [securities] being offered outside the United States have been registered under the Securities Act for resale from time to time in the United States in transactions that require registration under the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

If a separate prospectus is being used for the offering outside the United States, it would also be advisable not to include in the international prospectus any paragraph in the U.S. prospectus relating to the enforceability of judgments by U.S. persons and the section of the U.S. prospectus that typically refers to the SEC registration statement and the exhibits thereto.

278 In global offerings where the only public offering is in the United States, typically one prospectus can cover the whole global offering.

279 U.S. issuers in U.S. public offerings will need to consider whether a prospectus used outside the United States will be required to be filed with the SEC as a free writing prospectus (and whether the prospectus used in the United States will need to be delivered to the recipients of any such free writing prospectus prior

to or with the delivery of the free writing prospectus). *See* Rule 433(d) under the Securities Act; § 3.02[3][c][iv]. Alternatively, offering participants may seek to use a single prospectus that meets the requirements of all relevant regulators and file as part of the U.S. registration statement any different or alternative pages that may be necessitated by the requirements of the non-U.S. regulators.

280 In certain cases, a company may prepare both home-country GAAP financial statements and U.S. GAAP or IFRS financial statements, such as where it is required by outstanding bond covenants to do so or because home-country GAAP is not familiar to the international community. In such instances, the issuer may choose to use the U.S. GAAP or IFRS financial information in its international offering documents and its local GAAP financial information only in its home-market retail offering.

281 The SEC staff has insisted, in certain circumstances, that projections and other information released offshore be included in the prospectus. *See infra* Note 299.

282 Information included in a prospectus in a U.S. registered offering could give rise to liability under, among other provisions, § 11 of the Securities Act. *See* § 11.03[1]. Regarding the duty to update, *see* § 4.10[4]. Domestic issuers similarly seek to avoid liability under § 11 through incorporation by reference of earnings releases that include earnings guidance by electing to submit the earnings guidance information pursuant to Item 7.01 of Form 8-K. Unlike information filed pursuant to Item 8.01, information in a report furnished pursuant to Item 7.01 is not automatically incorporated by reference into a filing under the Securities Act. *See* § 4.10[8] Note 621.

283 If included, steps can be taken in the United States to attempt to minimize the potential liability associated with the forward-looking information in prospectuses. *See* § 11.03[5]. Offering participants may be more willing to include this type of information in offering memoranda in Rule 144A offerings, where liability under § 11 of the Securities Act is not an issue, but even in Rule 144A offerings, consideration should be given to the impact of including the projections on a potential claim under Rule 10b-5 under the Exchange Act.

284 If sales are made in one market before they can be made in another, premature secondary market trading in that market, and uncontrolled resales into other markets, could adversely affect the distribution as a whole.

285 *See* Rule 159 under the Securities Act.

A written confirmation of sale may be delivered to investors as long as the final prospectus is filed with the SEC by the required filing date or the issuer has made a good faith and reasonable effort to file such a prospectus within the required time under Rule 424 and, if the issuer has not timely filed the prospectus, the issuer files the prospectus as soon as practicable thereafter. Rule 172 under the Securities Act; *see also supra*, Note 92 and accompanying text.

286 For example, U.S.-style diligence typically includes interviews with key officers of the issuer and access to the issuer's significant documents, including minutes of the meetings of the board of directors and all material contracts. In the United Kingdom, a similar "verification" process is conducted in connection with disclosure in the relevant offering documents; moreover, extensive "verification notes," identifying the basis for each disclosure in the prospectus, are often produced particularly in the context of a premium listing in the United Kingdom.

287 *See* Rule 433 under the Securities Act for the limited circumstances under which a non-reporting issuer may use a free writing prospectus. For a discussion of free writing prospectuses, *see* § 3.02[3][c][iv].

288 Although it may be possible to get such publications to agree not to publish advertisements in specified jurisdictions, they generally will not agree to restrict ordinary articles to certain editions, and these too can raise questions under the U.S. rules against publicity.

289 *See* §§ 3.02[3][b][ii] and 3.02[3][c][i].

290 *See* § 3.02[3][a][iii].

291 *See* the definitions of "directed selling efforts" and publication "with a general circulation in the United States" in Regulation S, both of which are discussed in § 8.02[1][b].

292 SEC Release No. 33-7356 (Oct. 10, 1996), 61 Fed. Reg. 54,518, 54,518 n.9 (Oct. 18, 1996).

293 In the privatization of the electricity distribution companies of England and Wales, for example, rebates on electricity bills were offered to individuals who purchased shares.

294 Preliminary Note 9 to Regulation S under the Securities Act.

295 We understand that some issuers have taken the view, which we believe is reasonable, that the Rule 135e safe harbor should be available even though some of the issuer's officers participating in the press conference are physically located in the United States, provided certain conditions, such as the following, are met: (i) the members of the press all are physically present outside the United States, (ii) the officers participate through a video- or audio-conference facility set up at a closed location in the United States, (iii) the conference facility is linked for transmission only to the press conference offshore and not to any other location or person, and (iv) U.S. journalists are invited to participate offshore, but no journalist is allowed to participate while physically located in the United States.

296 In proposing the safe harbor, the SEC indicated that the safe harbor would not be available in connection with offerings conducted solely in the United States because there would be no "apparent reason for conducting offshore press activities." *See* SEC Release No. 33-7356 (Oct. 10, 1996), 61 Fed. Reg. 54,518, 54,522 (Oct. 18, 1996). This limitation may create difficulties for offerings by non-U.S. issuers wishing to conduct offers exclusively in the United States while also conducting press activities in their home jurisdictions or elsewhere outside the United States. Such circumstances may arise where the issuer's home market is not large enough to accommodate a sizeable offering or does not have a sufficiently liquid

securities market for trading purposes. The adoption of Rules 168 and 169 under the Securities Act as part of the Securities Offering Reforms, however, has eased this tension for ordinary course business communications consistent with past practice. *See* § 3.02[3][a][iii][A].

297 In general, the legend must include statements to the effect that (i) the materials are not an offer for sale of the securities in the United States and (ii) the securities may not be sold in the United States absent registration or an exemption from registration and that any public offering will be made by means of a prospectus containing detailed information regarding the company and its management, as well as financial statements. The materials also must not include any purchase order or coupon that could be returned indicating interest in the offering. In addition, if the issuer or selling securityholder intends to register any part of the offering in the United States, the legend must include a statement to that effect.

Under Rule 135e under the Securities Act, research reports can form part of a press package distributed to members of the U.S. press in reliance on the safe harbor. SEC Release No. 33-7470 (Oct. 10, 1997). Generally, however, offering participants have elected not to take advantage of this option.

In circumstances in which Rule 135e is not available (*e.g* ., with respect to press contacts in the United States), the relief granted by the SEC staff in the 1996 Deutsche Telekom offering (which predated Rule 135e) may be helpful in understanding the publicity activities that the SEC has deemed permissible in exceptional circumstances. The 1996 Deutsche Telekom offering, which ultimately yielded proceeds of over $12 billion, attracted intense public interest in both the general and financial press. To ensure that the company was able to maintain an appropriate flow of information to the marketplace during the months leading up to the offering, the company sought and was granted no-action relief that allowed certain press activities in the United States in the period up until one month before the first filing of the U.S. registration statement with the SEC, and set forth certain guidelines for publicity activities during the remainder of the offering process. *See Deutsche Telekom AG* (avail. June 13, 1995 *)*. Following the implementation of the Securities Offering Reforms, entities that qualify as WKSIs may release communications that reference a securities offering at any time, although those communications would likely be classified as free writing prospectuses that would need to be filed with the SEC. *See* Rule 163 under the Securities Act; § 3.02[3][b][iii].

298 *See* SEC Release No. 33-7470 (Oct. 10, 1997). In 2000, the SEC staff tightened its standards with respect to the availability of press-related materials on the Internet (*see* SEC Release No. 34-42728 (Apr. 28, 2000), though it has indicated some flexibility in the context of Regulation S-only offerings. *See* § 8.02[1][d].

299 In a number of U.S.-registered transactions, members of the SEC staff questioned the availability of Rule 135e, even when all its conditions appear to have been met. In these transactions, press articles found their way into the United States, including by way of the Internet. The staff seriously considered delaying at least one of these offerings, but stepped back from this draconian measure. The staff has, however, required the inclusion in the prospectus of statements made at press conferences or in other communications protected by Rule 135e. For example, in a public offering of an Italian issuer involving a registered offering in the United States, the issuer's chairman conducted an interview during the offering on CNN International in which the offering was discussed, and the issuer disclosed certain projections to the Italian press that were not included in the issuer's preliminary U.S. prospectus. Although the SEC staff ultimately accepted that the interview was permissible under Rule 135e, the issuer was required to amend its final U.S. prospectus to include the projections released to the Italian press, expressly subjecting the issuer to Securities Act liability for them. In a subsequent U.S. public offering by a Korean bank, the SEC staff required the inclusion in the U.S. prospectus of statements, including projections made during the offering, by the bank's senior officers abroad and reported by various news services.

Although the SEC rules for registration statements do not require the inclusion of all "material" information unless the registration form in question otherwise requires it or the omission of material information would make the information contained therein misleading, the staff has nonetheless insisted on inclusion of information it deems material based on the policy that all investors should have equivalent information when making investment decisions, a concern that goes beyond SEC rules and appears to run counter to the safe harbor from the registration requirements that Rule 135e expressly affords. By requiring the prospectus to contain Rule 135e communications, the staff has sought to put U.S. investors on the same footing as those outside the United States. The staff has even pressed these views where third parties, including members of the media, have improperly or without authorization from the issuer published in the United States information derived from research reports or other information regarding the issuer distributed outside the United States. *See supra* Note 261. It seems less defensible in such circumstances to force the issuer to include in its prospectus information prepared and circulated improperly by third parties. Following implementation of the Securities Offering Reforms, such research reports could potentially be made to fit into the free writing prospectus rules in order to resolve potential publicity questions arising under § 5 of the Securities Act, although offering participants may not be willing to accept prospectus liability on such reports. *See* § 3.02[3][c][v].

Because the staff has the power to accelerate the effectiveness of a registration statement, it essentially has the ability as a practical matter to force the inclusion in a prospectus of any information released abroad, whether or not the staff has a legitimate basis in the SEC's rules for its demands. Where, however, the registrant is prepared to include the Rule 135e statements in its statutory prospectus or as a separate free writing prospectus if the staff insists, threats to delay the offering, in order to allow for a "cooling-off" period, are particularly unwarranted and inconsistent with the safe harbor Rule 135e purports to grant.

300 If the information is included in the prospectus after being reported in the United States, or is released as a free writing prospectus, ordinary prospectus liability would attach to such information. Otherwise, only the general U.S. antifraud rules would apply.

301 *See* § 7.02[4] for a discussion of publicity in private offerings in the United States. Following the 2012 change to Rule 144A under the Securities Act to eliminate the prohibition on offers to nonQIBs, there has been some limited relaxation related to publicity in the United States in the context of private offerings in the United States. While issuers and underwriters remain cautious because of Rule 10b-5 liability concerns, they have been willing to include underwriters' names and other limited factual information that is outside the scope of the Rule 135c under the Securities Act nonexclusive safe harbor.

302 The issuer could argue that there is no offer of securities being distributed if the offering is "all sold."

303 For purposes of an independently prepared media free writing prospectus for which no payment or other consideration has been made by the issuer or another offering participant, the statutory prospectus included in the registration statement would not be required to include a price range otherwise required by rule. *See* Rule 433(b)(2)(ii) under the Securities Act. *See* § 3.02[3][c][v][A].

304 *See* § 3.02[1][a]; *see also supra* Note 84 (discussing Rule 159).

305 Access is generally limited through electronic "gateposts." Gateposts vary in the degree of restriction they impose. At the most restrictive end are password-protected mechanisms, through which only those established to be non-U.S. persons are granted passwords in advance permitting access to the site. The party dispensing passwords typically uses the same means of self-certification and independent verification as to residence as have historically been used in the nonelectronic context. Somewhat less restrictive are gateposts requiring the entry of a post code or other address indicator, which is electronically compared to an existing database of post codes or addresses outside the United States (typically in one or a handful of countries in which the offering is concentrated), and restricts access where the information does not provide assurance that the user resides outside the United States. The least restrictive gateposts ask the user to certify that he or she is not a U.S. person by clicking "yes" or "no" in response to a question to this effect, and only permits access to those users who certify that they are not U.S. persons. Such gateposts involve no independent verification by the party posting the materials on the website.

306 The legend should be similar to the one required by Rule 135e under the Securities Act, although the relief from publicity restrictions provided by Rule 135e is not available for information posted on a website (even if posted on a server located outside the United States), except for press-related materials of foreign issuers where access to the website is limited as described above.

307 The several liability of underwriters in a U.S. offering contrasts with the joint and several liability of underwriters that sometimes applies in offerings outside the United States. The U.S. practice is that if one

or more underwriters default with respect to less than a specified portion (typically either 1/10th or 1/11th) of the underwritten securities, the remaining underwriters will assume the obligations of the defaulters *pro rata*. If, however, the amount exceeds the specified percentage, the agreement may be terminated by the other underwriters.

308 In the multiple syndicate context, allowing the foreign syndicate to proceed on a joint and several liability basis (as is sometimes done outside the United States) while the U.S. syndicate proceeds in the customary manner (*i.e.*, several liability only) is generally not desirable because it is invariably the case that the closing of each offering is conditioned on the closing of the other: if the obligations of the U.S. underwriters are several, and the obligations of the underwriters in the other syndicate are joint and several, a default by a single U.S. underwriter that releases the other U.S. underwriters from their obligations to carry out the U.S. offering could, in effect, vitiate the joint and several character of the obligations of the underwriters in the other syndicate. One solution to this problem is to allow the U.S. underwriters to agree severally, and the other underwriters to agree jointly and severally, and to condition the closing of each offering on the closing of the other, but not to allow the underwriters outside the United States to escape from their obligations if the U.S. offering fails to close solely by reason of a default by one or more U.S. underwriters. Another approach is to require the U.S. offering to go forward on a reduced basis (*i.e.*, without the shares that had been allocated to the defaulting U.S. underwriter) in cases in which the default relates to an agreed percentage of the offering, typically between 10% and 15%.

On the related question of contribution, U.S. and non-U.S. underwriters, particularly in the context of multiple syndicates, sometimes negotiate regarding the contribution to be made by foreign underwriters to losses suffered by U.S. underwriters in connection with claims by U.S. investors, as the U.S. market is the most prone to litigation and the most likely to result in claims against underwriters. Non-U.S. underwriters not offering securities in the United States may therefore seek to obtain a limitation on their contribution liability to losses arising out of claims made by investors who purchased securities from their syndicate (or in the case of single syndicate offerings, their selling region).

309 Regardless of whether a single international syndicate or multiple syndicates are used, any sales in the United States by a non-U.S. syndicate member generally must be effected through an SEC-registered broker-dealer (which often is an affiliate of the non-U.S. syndicate member). *See* § 15 of the Exchange Act and Rule 15a-6 thereunder. Although the SEC proposed amendments to Rule 15a-6 that would have permitted foreign broker-dealers not registered with the SEC to effect transactions with qualified investors in the United States, subject to the terms and conditions specified in Rule 15a-6, as proposed to be amended, those amendments have not been adopted. SEC Release No. 34-58047 (June 27, 2008). All other applicable local rules would also have to be observed by the relevant syndicate. For example, a single syndicate in a distribution that includes U.S. sales must comply with FINRA requirements. *See* § 3.06.

310 An agreement among underwriters governing these and other matters is also typically entered into by the underwriters in each syndicate.

311 In some cases, the underwriters in the non-U.S. tranche may agree to allocate among themselves the responsibility for making offers and sales in particular countries.

312 In offerings by foreign issuers conducted wholly or primarily outside the United States, the period between signing and closing is more variable.

313 SEC Release No. 34-78962 (Sept. 28, 2016), proposing an amendment to Rule 15c6-1(a).

314 The SEC has not proposed any change to the standard settlement cycle for underwritten offerings of equity securities that price on a customary timetable, but has requested comment as to whether a change should be made. SEC Release No. 34-78962 (Sept. 28, 2016).

315 A typical provision reads as follows:

> This Agreement shall be subject to termination in the absolute discretion of the

> Representatives … if prior to such time (i) trading in the Company's Common Stock shall have been suspended … or trading in securities generally on the New York Stock Exchange shall have been suspended or limited or minimum prices shall have been established on such Exchange, (ii) a material disruption in securities settlement, payment or clearance services in the United States shall have occurred, (iii) a banking moratorium shall have been declared either by Federal or New York State authorities or (iv) there shall have occurred any outbreak or escalation of hostilities, declaration by the United States of a national emergency or war or other calamity or crisis the effect of which on financial markets is such as to make it, in the judgment of the Representatives, impracticable to market the Securities.

316 *First Boston Corp.* (avail. Sept. 3, 1985).

317 Rules 15c2-4 and 10b-9 under the Exchange Act.

318 *Force majeure* clauses have increasingly less significance as settlement periods continue to shorten. *See* SEC Release No. 34-78962 (Sept. 28, 2016) (proposing a shortened standard settlement cycle as described above).

319 In certain privatizations, the right to terminate by reason of *force majeure* was eliminated, or could only have been invoked by the sellers and the underwriters jointly, marking a major departure from U.S. practice.

320 Following the terrorist attacks in the United States on September 11, 2001, many investment banks expanded their *force majeure* provisions to include references to (i) material disruptions in commercial banking, securities settlement and clearance services and (ii) the occurrence of any other calamity or crisis.

321 The International Capital Markets Association recommends the following *force majeure* provision, which is widely used and representative of such provisions in Euromarket underwriting agreements generally:

> Notwithstanding anything contained in this Agreement, … the [Joint] Lead Manager[s]… on behalf of the Managers may by notice to the Issuer … terminate this Agreement at any time before the time on the Closing Date when payment would otherwise be due under this Agreement to the Issuer in respect of the Securities if, in the opinion of the Lead Manager, there shall have been such a change in national or international financial, political or economic conditions or currency exchange rates or exchange controls as would in their view be likely to prejudice materially the success of the offering and distribution of the Securities or dealings in the Securities in the secondary market …
>
> ICMA PRIMARY MARKET HANDBOOK at A9-3, International Capital Market Association (2016).

This provision grants much more discretion than its counterpart in a typical underwriting agreement for a U.S. transaction. If there is a U.S. syndicate as part of a dual-or multi-syndicate global offering, and if it is a condition that each tranche must close for any to close, and if the *force majeure* clause in the underwriting agreement follows the IPMA recommendation, then, in practice, the scope of the U.S. *force majeure* clause is much less important, even if narrower, because if the international tranche fails to close, so will the U.S. tranche.

322 Certain private issuers have been able to moderate, although not eliminate, *force majeure* clauses in the context of offerings of their securities. Changes to *force majeure* clauses in this context have generally taken three forms, though all of them are unusual. First, some private issuers have been successful in requiring underwriters to consult them before terminating the offering. Second, some private issuers have

been able to eliminate one or more of the conditions that may constitute *force majeure .* Finally, some private issuers have required underwriters to exercise reasonable judgment before terminating the offering, as opposed to leaving the termination decision to the underwriters' sole discretion. (If reference is made simply to the underwriters' judgment or discretion, without qualification as to whether it must be reasonable, a reasonableness qualification would be implied in any event if the underwriting agreement is governed by New York law.)

In addition, in the context of privatizations, sovereigns have been successful in resisting *force majeure* provisions in underwriting agreements. This result has been due both to the large size of most privatizations and to their high profile in the public eye; underwriters have apparently been willing to accept this additional risk in light of the potential rewards.

While practice in the United States varies, some agreements provide that the issuer must pay the underwriters' out-of-pocket expenses if the *force majeure* clause is invoked. In Europe, it is typical for the issuer to agree to pay all the underwriters' expenses (sometimes subject to a cap), whether the offering proceeds to completion or not.

323 Because underwriters of an offering in the United States may be subject to civil liabilities under federal or state law, they will customarily require indemnification by the issuer with respect to all liabilities arising out of material misstatements or omissions in the registration statement (including the prospectus, any preliminary prospectus, any road show and certain free writing prospectuses), excluding certain minor portions for which the underwriters assume responsibility.

For decades, however, the SEC has stated that it believes indemnification for liabilities arising under the Securities Act is against public policy and thus may be unenforceable. If such indemnification is sought for officers, directors or controlling persons of an issuer, the SEC has long required issuers (as a condition to acceleration of the effectiveness of a Securities Act registration statement) to agree to submit to a court the issue of enforceability of such indemnities and to be governed by such court's decision. Item 512(h) of Regulation S-K under the Securities Act.

While this undertaking does not apply to undertakings to indemnify underwriters, the policy considerations are the same (*see*, *e.g.*, *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970)), and underwriting agreements for offerings in the United States usually provide that if indemnification is held by a court to be unavailable, the issuer and the underwriters will share aggregate losses (through a procedure known as "contribution") in such proportions that the issuer will pay a much greater share of such losses than the underwriters as a group.

It is also customary for an issuer to agree in the underwriting agreement for a U.S.-registered offering to make generally available to its securityholders an earnings statement covering a period of at least 12 months beginning after the effective date of the registration statement. Section 11(a) of the Securities Act provides that a person who purchases securities after such an earnings statement has been made available must prove that he or she acquired the securities in reliance on a materially false or misleading statement in the registration statement in order to have a right to recovery under § 11. Before that time, he or she need only show that the security was included in a registration statement that contained an untrue statement of a material fact or made a material omission. The filing of an annual report on Form 20-F is one method of satisfying the requirements of § 11(a) of the Securities Act. *See* Rule 158 under the Securities Act; *see also* § 11.03[1][a].

324 This issue frequently arises where local corporate law limits the ability of the issuer to give financial benefits or assistance to shareholders. In Germany, for example, stock corporations are prohibited from granting any benefit to a shareholder other than on the basis of arm's-length commercial dealings, the distribution of a validly declared dividend or distributions in a liquidation proceeding. Outside these circumstances, payments or other transfers of benefits to shareholders constitute an unlawful repayment of capital by the issuer. In its so-called "DT 3" decision of May 31, 2011, the highest German court in civil matters (Bundesgerichtshof, the "BGH"), held that the assumption of prospectus liability by an already public issuer in connection with a pure secondary offering constitutes an unlawful repayment of capital to the selling

shareholder(s), unless the issuer receives compensation for the assumption of prospectus liability in the form of a specific, measurable benefit reflected in the issuer's balance sheet. BGH, II ZR 141/09, *available at* http://openjur.de/u/168086.html. According to the BGH, absent such compensation, an issuer may only assume prospectus liability in such an offering if the selling shareholders fully indemnify the issuer for any losses it may incur as a result of the assumption of prospectus liability. The BGH did not address the question of whether the indemnification of the underwriters by the issuer in a pure secondary offering raises similar issues. Neither did it deal with the question of whether the analysis is different if an issuer assumes prospectus liability in connection with an initial public offering and first-time listing of its shares where no new shares are offered, although there are strong arguments that the principles of the "DT3" decision apply *mutatis mutandis* in such a scenario. If the selling shareholders indemnify the issuer for any losses it may incur in connection with the assumption of prospectus liability in the context of a pure secondary offering, including losses arising from the indemnification of the underwriters by the issuer, the issuer should be permitted to indemnify the underwriters for prospectus liability. If the selling shareholders do not so indemnify the issuer, the underwriters should make sure that they get full indemnification from the selling shareholders. Where there are no such local law constraints, the indemnity is typically provided by the issuer, as well as by the selling shareholders.

325 *See* § 3.06[1] (discussing the obligation of FINRA members to include certain mandatory provisions in lock-up arrangements) and § 3.06[4][b] (discussing the lock-up of securities received by members of the underwriting group as underwriting compensation or otherwise).

326 The term "green shoe option" arises from an offering in 1963 by the Green Shoe Manufacturing Company, the first offering to include an overallotment option.

327 In March 2005, Ernst & Young (since renamed "EY") circulated an accounting alert taking the position that, among other things, an overallotment option exercisable after the closing date of an offering should be treated as a call option that "will likely meet the definition of a derivative under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities." EY's On Call Advisory Services Accounting Alert: Overallotment (Greenshoe) Provisions Evolve into FAS 133 Derivatives (Mar. 23, 2005). Although the alert speaks generally about overallotment options, we understand that EY's interpretation is not intended to relate to overallotment options on the issuer's own stock, but does include options over its debt securities, including convertible debt securities. The alert was not predicated on any recent change in the interpretation of the accounting statement by the SEC or otherwise, and we understand that certain firms may not share EY's views. Moreover, subsequent to the alert, EY clarified that its position regarding FAS 133 treatment is limited to so-called "free" options—namely, those options that may be used for any purpose, and not solely to cover overallotments.

328 Historically, the option granted to underwriters in U.S.-registered offerings to acquire additional securities at the offering price could be exercised solely to cover overallotments, if any. As a result of the 1997 implementation of Regulation M, however, the option granted to the underwriters need not be restricted to covering overallotments in transactions to which Regulation M does not apply (*e.g.*, U.S.-registered offerings benefiting from the ADTV exemption or Rule 144A offerings). Thus, technically, underwriters may now receive "free" options in connection with offerings in which the underwriters are not subject to Regulation M, allowing them to exercise the option at any time, whether or not to cover a short position. However, to the extent underwriters continue to sell securities throughout the period during which such an option could be exercised, the issuer, any selling shareholders and their affiliated purchasers would be subject to the longer Regulation M restricted period because they cannot benefit from the ADTV exemption.

Free options also raise other regulatory considerations. To the extent the distribution of securities is ongoing in the United States, the underwriters will continue to have prospectus delivery obligations with respect to those sales. The underwriters also, as a practical matter, may be deterred from selling the shares acquired on exercise of a free option at more than the issue price, as doing so would require amendment of the underwriting compensation disclosure in the prospectus. *See* Items 501 and 508 of Regulation S-K. The additional underwriting compensation resulting from sales of such shares at prices above the original issue price also could implicate FINRA review requirements and rules relating to underwriting compensation. *See* § 3.06[4] (describing FINRA's Corporate Financing Rule).

FINRA rules also affect the structure of the overallotment option in a U.S.-registered offering. *See* § 3.06[4][a] (discussing FINRA constraints on the size of such an option in a U.S.-registered offering). In addition, overallotment options in offerings subject to EU regulations are subject to certain limitations pursuant to the EU Market Abuse Regulation and its implementing measures. These limitations constrain the green shoe option in a number of ways, including by restricting it to 15% of the number of shares initially offered, capping a naked short position resulting from overallotment not covered by a green shoe option at 5% of the original offering size and providing that the exercise of the option be used solely to cover overallotments. *See* Commission Delegated Regulation (EU) 2016/1052 with regard to regulatory technical standards for the conditions applicable to buy-back programs and stabilization measures.

329 One issue that issuers occasionally raise is whether the commissions payable on shares obtained through exercise of the overallotment option should be the same as the commissions paid on underwritten securities. Because shares obtained on exercise of the overallotment option are not underwritten, a few issuers have successfully argued that only the selling, and not the underwriting, component of the commissions should be paid. It is very unusual, however, for underwriters to accept this.

330 A syndicate's short position is created at the time the securities are priced and allocated (following effectiveness of the registration statement in an offering registered with the SEC). The short position is typically at least as large as the number of securities available to the underwriters through the overallotment option. The lead manager's decision as to the size of the short position at any given time during the typical period during which the overallotment option can be exercised (30 days) primarily depends upon its perception of the aftermarket trading of the securities in question. In the case of an offering that trades at a significant premium in the immediate aftermarket, the overallotment option may be exercised immediately and the short position closed out at the same time. A lead manager might not establish a naked short position unless it is concerned about the potential for supply to exceed demand in the aftermarket, with the consequent negative pressure on price. It will assess the situation based on, among other factors, market conditions and the level of interest expressed in the securities being offered during the marketing process. *See* SEC, Division of Corporation Finance, Current Issues and Rulemaking Projects (Nov. 14, 2000) (setting out the views of the SEC staff on certain issues relating to syndicate short sales).

The SEC staff takes the view that securities sold in any naked short sales must be registered with the SEC together with the securities registered for sale on a firm-commitment basis or pursuant to the exercise of the overallotment option. A specific number of shares to cover naked short sales does not, however, need to be included on the cover of the registration statement in order to register such sales. The registration statement is deemed by the SEC staff to include an indeterminate number of naked short securities. *See* SEC, Division of Corporation Finance, Current Issues and Rulemaking Projects (Nov. 14, 2000). The effect of this staff position is to impose §§ 11 and 12(a)(2) liability with respect to naked short sales, but no additional registration fee is required.

331 The SEC staff takes the view that the underwriters must disclose in the prospectus the possibility that they will make short sales and engage in short covering transactions. It has stated that the disclosure should also describe what short sales are, distinguishing between covered and naked short sales, explain how short positions may be covered and how underwriters determine the method for closing out such sales, explain when a naked short position may be created and outline the potential effects (*e.g.*, raising or maintaining the market price of the securities in question or preventing or retarding a decline in their market price) of such transactions). The staff provided model language that may be used verbatim, or adapted, to address the required points. *See* SEC, Division of Corporation Finance, Current Issues and Rulemaking Projects (Nov. 14, 2000). Private offerings under Rule 144A typically include similar disclosure. The SEC has also promulgated Rule 10b-21 under the Exchange Act, an antifraud rule aimed at abusive naked short selling by sellers that deceive broker-dealers or other specified persons regarding the ability of the sellers to deliver securities in time for settlement and that in fact fail to deliver securities by settlement. *See* SEC Release No. 34-58774 (Oct. 18, 2008).

332 If the overallotment option is to be exercised and settled after the closing of the offering of the underwritten

securities, the issuer is generally expected to "bring down" its representations, warranties and officers' certificates to the time of the overallotment closing, and bring-down 10b-5 letters regarding the absence of material misstatements or omissions in the offering materials, as well as bring-down accountants' comfort letters on the financial information contained in such materials, are generally required. Where the overallotment option is limited to covering short positions generated in connection with the initial placement of securities in an offering, the overallotment securities were actually sold to investors at the time of the closing for the firm securities. Notwithstanding the view of practitioners that a bring-down of diligence documentation is not necessary from a legal standpoint under such circumstances, underwriters generally insist on the receipt of bring-down 10b-5 letters and comfort letters at the option closing for commercial reasons.

333 As an alternative to formally borrowing securities, the underwriters may arrange with a portion of the initial investors to delay delivery of the securities. In connection with making these arrangements, the underwriters should consider the restrictions on the regulation of credit in connection with distributions in § 11(d) of the Exchange Act, as well as Regulation T (discussed in § 9.05[11]).

334 *See infra* Note 389.

335 As noted in *infra* Note 417, Regulation M should not be deemed to restrict non-U.S. purchases or inducements to purchase the subject securities after the U.S. distribution is completed (even if the ADTV exemption is not applicable). This view is consistent with the views expressed in a no-action letter under Rule 10b-6 under the Exchange Act, one of the predecessor rules to Regulation M. *See Williams, William J., Jr.* (avail. Nov. 27, 1996). That letter was granted in the context of a request by the syndicate to increase the number of shares for which the overallotment option could be exercised to cover syndicate short sales in excess of the syndicate short position at the time of completion of the initial distribution. The staff confirmed that so long as the further sales by the syndicate occurred outside the United States, the U.S. distribution would not be deemed to continue for purposes of Rule 10b-6.

336 *See supra* Note 327.

337 *EBC I, Inc. v. Goldman Sachs & Co.*, 832 N.E.2d 26 (N.Y. 2005).

338 *See EBC I, Inc. v. Goldman Sachs & Co.*, 832 N.E.2d 26 (N.Y. 2005).

339 *See HF Mgmt. Services LLC v. Pistone*, 818 N.Y.S.2d 40, 42, 43 (N.Y. App. Div. 2006) (noting that the decision in EBC I was "the exception that proves the rule" and that "a fiduciary aspect [is] absent from the majority of underwriting relationships").

340 Notwithstanding the apparently clear limitation on liability in § 11(e), the U.S. District Court for the Southern District of New York has suggested in *dictum* that, in light of the broad definition of "underwriter" under the Securities Act, the amount of securities "underwritten" by a lead underwriter in an offering may be greater than the amount formally allocated to it. *In re WorldCom, Inc. Securities Litigation*, Fed. Sec. Rep. (CCH) ¶93,139 (S.D.N.Y. Mar. 14, 2005); *see* § 11.03[1][b], Note 39.

341 This solution may not work if the issuer wishes to reserve to itself the discretion to direct the underwriters how to allocate the commissions among themselves, rather than having fixed arrangements set out in the agreement among underwriters.

342 *See* Telis Demos, Alibaba IPO Will Have 'Friends and Family' Share Program, WALL ST. J. Sept. 5, 2014, noting that while use of directed share programs has declined, several large IPOs in recent years, including that of Alibaba Group Holding Ltd., have implemented such programs. Separately, in recent years the idea of selling to "friends and family" has expanded some as issuers that want to include marketing to specific investor groups have sold a small portion of shares in an IPO to groups of fans, customers and other constituencies of investors through electronic platforms, like Loyal3.

343 *See* § 3.02[1] for a discussion of "gun-jumping."

344 *See* Rule 134 under the Securities Act. *See* § 3.02[3][c][i] for a discussion of Rule 134.

345 Although FINRA's rules are applicable only to its members, which generally will include all the U.S. broker-dealer participants in the offering, the rules require those participants in certain circumstances to obtain the

agreement of foreign members of the underwriting syndicate and selling group to comply with the rules as well. *See* § 3.06[2].

346 FINRA Rule 5130 defines a "new issue," in general, as any IPO of an equity security as defined in § 3(a)(11) of the Exchange Act made pursuant to a registration statement or offering circular (regardless of whether the securities are so-called "hot issues" that immediately trade at a premium in the secondary market). FINRA Rules, Rule 5130(i)(9), FINRA MANUAL.

347 In order to establish a parent-subsidiary relationship, the parent must have either (i) the right to vote 50% or more of a class of voting security of the subsidiary or (ii) the power to sell or direct 50% or more of a class of voting security of the subsidiary. FINRA Rules, Rule 5130(d)(1)(B), FINRA MANUAL.

348 FINRA Rules, Rule 5131(d)(2)(A) FINRA MANUAL. The NASD and NYSE initially proposed these rules in response to concerns raised by a special advisory committee convened in 2002 by the NYSE and NASD at the request of the SEC in the wake of concerns regarding IPO allocation abuses by certain investment firms. Notably, the special advisory committee recommended that the SEC and self-regulatory organizations adopt restrictions regarding directed share programs beyond those set forth in the NASD's and NYSE's proposed rules on the topic. Specifically, the committee recommended that directed share programs be limited to 5% of an IPO. In addition, the committee recommended that issuers include more detailed disclosure on directed share programs in prospectuses by including, for example, disclosure on total size of programs, number and nature of participating individuals or institutions, amounts purchased, minimum percentages of shares allocated to employees and allocations to participants exceeding a specified threshold. The committee further recommended that each listed company be required to include, in its code of business conduct and ethics, a policy regarding receipt of shares in a company's IPO by directors and executive officers. *See NYSE/NASD IPO Advisory Committee Report and Recommendations* (May 2003); *see also* SEC Release No. 33-8565 (Apr. 7, 2005) (providing guidance on activities that are prohibited in connection with IPO allocations); *cf*. Press Release, SEC, Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings to Corporate Executives and Directors (Apr. 28, 2003) (stating that directed share programs would be exempt from the voluntary initiative regarding IPO allocations agreed to by several large investment banking firms in connection with the global research settlement entered into among such firms and the SEC, NYSE, NASD and other regulators); *see also* § 14.07[5][b].

349 FINRA Rules, Rule 5131(d)(2)(B), FINRA MANUAL.

350 § 11(b)(3) of the Securities Act.

351 *But see* Note 53 in § 11.03[1][c] for a discussion of litigation concerning, among other matters, underwriter reliance on WorldCom, Inc.'s audited (and therefore expertized) financial statements, where the court held that the existence of "red flags" regarding the accuracy of expertized information, including audited financial statements, can create a duty to investigate.

352 While historically meetings with accountants were sometimes conducted without management present, accountants have generally instituted policies requiring the attendance of company management at diligence sessions with accountants.

353 Privilege issues sometimes play a role in determining which counsel communications are made available in connection with due diligence.

354 The guidelines for accountants' comfort letters are set forth in Auditing Standard ("AS") 6101 (Letters for Underwriters and Certain Other Requesting Parties) ("AS 6101"). AS 6101 became effective December 31, 2016, succeeding AU 634 (Letters for Underwriters and Certain Other Requesting Parties), which in turn had succeeded Statement on Auditing Standards ("SAS") No. 72 (Letters for Underwriters and Certain Other Requesting Parties) (1998), and comfort letters are still sometimes referred to as SAS 72 letters. AS 6101 states that accountants may provide negative assurance in a comfort letter with respect to changes during a period subsequent to the date of the latest financial statements included in the prospectus, but may only provide such assurance as of a date that is less than 135 days from the end of the last period for which the accountants have performed an audit or an interim review in accordance with AS 4105 ("AS

4105") (Reviews of Interim Financial Information). AS 4105 succeeded AU 722 (Interim Financial Information, which in turn had succeeded SAS No. 100 (Interim Financial Information) and a review of interim financial information for comfort letter purposes is still sometimes referred to as a SAS 100 review. As a result of this 135-day rule, and depending on the timing of preparation and review of its interim financial statements, an issuer effectively may be precluded from making an offering during certain periods of the year. "Negative assurance" in this context generally refers to the language in a comfort letter to the effect that nothing came to the attention of the auditor that would cause it to believe that (i) any material modifications should be made to the relevant financial statements for them to be in conformity with GAAP, (ii) unaudited interim financial statements contained in the prospectus were not prepared on a basis substantially consistent with the audited financial statements contained in the prospectus, or (iii) there were certain changes in specified financial statement line items after the date of the financial statements included in the prospectus as compared to the comparable prior-year period (in the case of line items in the income or cash flow statement) or to the most recent balance sheet contained in the prospectus (in the case of balance sheet line items) from what is stated in the prospectus except for changes that the prospectus discloses have occurred or may occur (so-called "stub period comfort"). In addition, in U.S. registered transactions, negative assurance would typically also include language to the effect that nothing came to the attention of the auditor that would cause it to believe the financial statements contained in the registration statement do not comply as to form in all material respects with the applicable accounting requirements of the Securities Act and the rules and regulations thereunder.

Initially, review under AS 4105's predecessor provision was only applicable to the interim financial statements of SEC registrants and companies making regulatory filings with certain other U.S. government agencies. Effective for reviews of financial information for interim periods beginning after December 15, 2009, such review has also been permitted for interim financial statements of an entity (i) that meets certain conditions related to the auditor and financial reporting framework applicable to the interim financial information as compared to the audited annual financial statements, and (ii) when the interim financial information is condensed information, such condensed interim financial information purports to comport with an appropriate reporting framework and other content and financial information availability conditions are met. Appropriate reporting frameworks may include FASB ASC 720 and Article 10 of Regulation S-X with respect to U.S. GAAP or IAS 34 with respect to IFRS issued by the IASB. Comfort letters delivered in Rule 144A/Regulation S offerings regularly include customary negative assurance in respect of interim periods where the financial statements for such interim periods are included in the offering memorandum.

355 *See*, *e.g.*, *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 697 (S.D.N.Y. 1968) (Participating underwriters "who did nothing and relied solely on [lead underwriter]" were bound by their failure to conduct a reasonable investigation).

356 *See* "New High Risk Ventures," Exchange Act Release No. 34, 9671 (July 26, 1972), 1972 WL 125474, at *6 (July 27, 1972) ("[The participant] must satisfy himself that the managing underwriter makes the kind of investigation the participant would have performed if he were the manager.").

357 Section 12(a)(2) also applies to oral statements. *See* § 11.03[2] for a general discussion of § 12(a)(2).

358 Oral contracts of sale of securities are generally valid and binding under state law. Therefore, a contract of sale is commonly entered into in a phone call with a customer immediately following pricing of an offering.

359 With shelf registration, certain qualifying issuers can register securities that may then be offered in a single transaction or a series of transactions. *See* the discussion of shelf registration, including automatic shelf registration, in § 3.02[2][c].

360 *See* § 3.02[2][c].

361 Report of Task Force on Sellers' Due Diligence and Similar Defenses Under the Federal Securities Laws, as submitted to the A.B.A., Section of Business Law, Committee on Federal Regulation of Securities (July 10, 1992).

362 *See In re WorldCom, Inc. Securities Litigation*, 346 F. Supp. 2d 628, 671 (S.D.N.Y. 2004). In the Aircraft Carrier Release, SEC Release No. 33-7606 (Nov. 3, 1998), as amended by SEC Release No. 33-7606A

(Nov. 13, 1998), the SEC proposed amendments to Rule 176 under the Securities Act to clarify further factors to be considered by underwriters in the determination of whether a reasonable investigation had been conducted. The proposed rules, which were seen as largely codifying current practice by major underwriters, were never adopted. For a discussion of the impact of the WorldCom on diligence standards, *see* § 11.03[1][c].

363 *See generally* Chapters 4 and 5 for a discussion of the Sarbanes-Oxley Act.

364 *See* § 5.04.

365 *See* § 7.09.

366 National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996).

367 While the SEC proposed a definition of "qualified purchaser" that is the same as the definition of "large accredited investor" included in its 2007 proposal to revise Regulation D, the proposal has not been adopted. However, all states have laws or regulations in place under which offers and sales of securities to certain classes of institutional investors are exempt from state registration requirements. Although the breadth of the exemption varies from state to state, in most cases it covers financial institutions generally, including broker-dealers and other institutional purchasers of securities. *See* § 7.09. In connection with amendments to Regulation A adopted in 2015, the SEC adopted a limited definition of "qualified purchaser" that includes purchasers and offerees of securities in Tier 2 Regulation A offerings. *See* Rule 256 of the Securities Act.

368 The practical result of this provision of the NSMIA is to preempt blue sky laws with respect to secondary trading in securities issued by an SEC-reporting issuer (in addition to all transactions in NYSE or similarly listed securities). This preemption would not extend to secondary trades in all types of securities; for example, state registration requirements with respect to unlisted securities of a foreign issuer that furnishes information pursuant to Rule 12g3-2(b) under the Exchange Act are not preempted under this provision of the NSMIA.

369 The NSMIA provides preemption for all transactions exempt from registration pursuant to regulations promulgated by the SEC under § 4(a)(2) of the Securities Act (but not for transactions exempt under Rule 144A). Transactions meeting the requirements of Rule 506 of Regulation D accordingly qualify for preemption; transactions under Rules 504 and 505 of Regulation D do not. *See* § 7.02, Note 31. The preemptive treatment accorded to Rule 506 transactions pursuant to the NSMIA is of no practical significance with respect to large underwritten private placements to institutional investors in the United States, both because such placements are generally not made in technical reliance on Rule 506, *see* § 7.02[2], Note 40 and accompanying text, and because Rule 506 provides a registration exemption only to the issuer of the security (and not the underwriters of the placement), *see* § 7.02[2], Note 32 and accompanying text. These private placements are often conducted under state law self-executing exemptions for offers and sales to specified types of institutional investors. *See* § 7.09, Note 309.

370 An offering document is deemed "prepared by or on behalf of the issuer" if "the issuer or its agent or representative" (i) authorizes the document's production and (ii) approves the document before its use. SEC Release No. 33-7418 (Apr. 30, 1997), Definition of "Prepared By or On Behalf of the Issuer" for Purposes of Determining if an Offering Document is Subject to State Regulation, 62 Fed. Reg. 24,572, 24,573 (May 6, 1997).

371 In addition, the NSMIA would not preempt state legislation adopted in response to accounting scandals and corporate governance abuses. The California Corporate Disclosure Act, for example, requires a publicly traded corporation incorporated or qualified to do business in California to include additional information in its annual information statement including disclosure of, among other things, the company's independent auditor, annual compensation of each member of the board of directors and executive officers, and any loans made to a member of the board of directors or any executive officer at preferential rates. CAL. CORP. CODE §§ 1502.1, 2117.1 (West 1990 & Supp. 2008). Although additional states may be considering adopting similar provisions, none to date has passed equivalent legislation.

372 Certain state disclosure and other requirements may also need to be satisfied.

373 For example, California insurers may to a limited extent make investments in foreign securities that are substantially of the same type and investment grade as eligible domestic investments, subject to concentration limits both on total foreign investments and total investments from a single foreign jurisdiction. CAL. INS. CODE § 1241 (West 2011). Similarly, New York life insurers are permitted to invest up to 10% of their "admitted assets" in Canadian investments and up to 20% of their "admitted assets" in foreign investments that are of the same types as eligible domestic investments including, among others, government obligations, corporate bonds, real estate mortgages and corporate stock. N.Y. INS. LAW § 1405(a)(7)(A) and (C) (McKinney's 2015). Certain other restrictions generally apply and vary with the type of investment, including concentration limits on total investments from a single foreign jurisdiction and ratings and exchange listing requirements. Similar provisions also govern foreign investments of New York property and casualty insurers. N.Y. INS. LAW § 1404 (McKinney's 2015).

374 The first equity offerings made by General Motors and AIG following their receipt of funds under the Troubled Asset Relief Program ("TARP") were examples of such global offerings.

375 It is common for offerings to include selling legends relating to "professional" exemptions in the countries that are most commonly marketed in (including Canada, EEA countries, Switzerland, the UK, Japan, Hong Kong, Singapore, the Dubai International Financial Centre, and Australia). These more regularly used selling restrictions are commonly provided by counsel to the underwriters based on forms kept by the underwriters internal legal departments. Global Blue Sky typically refers to inclusion of additional jurisdictions; for example, in the AIG offering mentioned in the note above, selling legends were included for 40 jurisdictions.

376 In most cases, foreign counsel will provide the selling legend that will be included in a U.S. issuer's offering document. Generally, counsel to the underwriters reviews such information because it is the underwriters that are responsible for offers and sales of securities to investors. Underwriters' U.S. counsel should be sure to review such disclosure with foreign counsel to ensure, among other things, not only the restrictions, but also the exemption under which the offers and sales will be made, is included in such disclosure.

377 Counsel in some jurisdictions advise that portions of a legend be in bold text or capitalized due to the requirement that such information be prominently placed.

378 Such statements generally also include a reference to the fact that the offer and sale of securities will be made pursuant to an exemption from such jurisdiction's filing and registration requirements.

379 SEC Release No. 34-38067 (Dec. 20, 1996) (the "Regulation M Release"); *see* § 7.10 for further discussion of Regulation M (in the context of private placements).

380 In the case of securities registered on a shelf, Rules 101 and 102 require each takedown off the shelf to be analyzed independently to determine whether it constitutes a distribution and, if it does, as of when the relevant rule applies to that takedown. *See* SEC, Division of Market Regulation, Staff Legal Bulletin No. 9, Frequently Asked Questions About Regulation M (Oct. 27, 1999) (revised Sept. 10, 2010), Fed. Sec. L. Rep. (CCH) ¶60,009 ("Staff Bulletin No. 9").

381 The term "prospective underwriter" includes any person who (i) submits a bid to participate in a distribution and knows or is "reasonably certain" that such bid will be accepted or (ii) has reached, or is "reasonably certain" to reach, an understanding with an issuer, selling securityholder or managing underwriter that such person will become an underwriter. In either case, such person will be considered a prospective underwriter regardless of whether the terms of the underwriting have been agreed upon. Rule 100 of Regulation M.

382 A broker-dealer that performs only ministerial duties and receives a fixed fee consistent with its limited role (*i.e.*, its compensation is not based on the success of the offering and is a customary amount) will not be deemed a distribution participant. *See* Staff Bulletin No. 9.

383 For purposes of Regulation M, "affiliated purchaser" includes an affiliate of a distribution participant, issuer or selling securityholder that, directly or indirectly, controls "the purchases of any covered security by a distribution participant, issuer or selling securityholder, whose purchases are controlled by any such person, or whose purchases are under common control with any such person." Rule 100 of Regulation M.

384 Such persons will not be considered "affiliated purchasers" if: (i) the distribution participant, issuer or selling

securityholder maintains and enforces written policies and procedures reasonably designed to prevent the flow of information to or from the affiliate that might result in a violation of Rule 101, 102 or 104 of Regulation M, (ii) the distribution participant, issuer or selling securityholder obtains an annual independent assessment of the operation of such policies and procedures, (iii) the affiliate has no officers (or persons performing similar functions) or employees (other than clerical, ministerial or support personnel) in common with the distribution participant, issuer or selling securityholder that direct, effect or recommend transactions in securities, and (iv) the affiliate does not, during the applicable restricted period, act as a market maker (other than as a specialist in compliance with the rules of a national securities exchange) or engage, as a broker or dealer, in solicited transactions or proprietary trading, in covered securities. *See* Rule 100 of Regulation M.

Certain aspects of the "affiliated purchaser" definition are derived from and intended to codify various exemptive and no-action positions taken by the staff of the SEC under the market manipulation and stabilization rules in effect prior to the adoption of Regulation M.

385 The Regulation M Release clarifies that, in the case of debt securities, an issuer's outstanding securities will not be deemed to be the same as the security in distribution unless they are identical (*i.e.*, feature the same coupon rate, maturity date and other terms). By contrast, outstanding shares that differ only in voting rights from the shares being distributed are deemed to be the same security as the shares in distribution.

The SEC staff has also clarified that where a company is concurrently making a distribution of the same securities in two different offerings, an inducement to purchase securities in one offering should not constitute an impermissible inducement with respect to the second offering. For example, where a company offers its shares to the public for cash while concurrently offering its shares to shareholders of an acquisition target in connection with a merger, *bona fide* offers to sell or the solicitation of offers to buy shares distributed in one distribution would not be impermissible inducements with respect to the concurrent distribution of the same securities. However, sales efforts that go beyond *bona fide* offers to sell or the solicitation of offers to buy securities may result in a finding of impermissible inducements to purchase. *See* Staff Bulletin No. 9.

386 Conversely, activities in respect of a derivative security (*e.g.*, a convertible bond, warrant or option (including a short position in a put option)) related to a security in distribution (*e.g.*, the underlying common stock) will not be subject to the rule, so long as the price of the derivative security is not used to determine the price of the security in distribution under the terms thereof.

387 The restricted period commences one business day prior to pricing if the subject security has an average daily trading volume ("ADTV") value of at least $100,000, and the issuer has a public float value of at least $25 million. *See infra* Note 391 (explaining the calculation of ADTV value). In all other cases, the restricted period commences five business days prior to pricing. As used in Regulation M, the term "business day" is defined as a 24-hour period that includes an entire trading session for the security in the principal market for the security being distributed. Thus, for example, if pricing occurs at the close of trading in the principal market on Tuesday and a one-business day restricted period applies, the restricted period will begin at the close of trading in the principal market on Monday. If, however, pricing occurs prior to the close of trading on Tuesday, the restricted period would begin prior to the opening of trading in the principal market on Monday. *See* Staff Bulletin No. 9; *see also* Rule 100 of Regulation M.

388 Pricing occurs when the parties agree on the price, regardless of whether the agreement has yet been (or will ever be) memorialized in writing. *See* Staff Bulletin No. 9.

389 An underwriter will be deemed to have completed its participation in a distribution when its participation has been distributed and after any stabilization arrangements and trading restrictions in connection with the distribution have been terminated. *See* Rule 100 of Regulation M. For a selling group member that is not part of the underwriting syndicate, its participation in a distribution is completed when the selling group member has sold its entire allotment. *See* Staff Bulletin No. 9. A distribution participant's participation in a distribution will not be deemed completed if a syndicate overallotment option is exercised in an amount that exceeds the net syndicate short position at the time of exercise. *See* Staff Bulletin No. 9. In this case, any

purchases made prior to the exercise of the option would constitute a violation of Regulation M. *See* § 3.02[5][f] for a discussion of overallotment options and syndicate short sales. Securities acquired by a distribution participant for investment purposes, that is, securities placed in an underwriter's investment account, will be considered distributed for purposes of Regulation M. *See* Regulation M Release. It is prudent for securities placed in such an investment account to be retained for a reasonable period of time. In addition, pursuant to FINRA requirements, any FINRA member acting as a manager (or in a similar capacity) of a distribution of a subject security, reference security or actively-traded security under Rule 101 must send a notice to FINRA, generally required no later than the close of business the next business day following the pricing of the distribution, providing the date and time of the pricing of the offering and the offering price. *See* FINRA Rules, Rule 5190(d), FINRA MANUAL.

390 Rule 100 of Regulation M. Neither the existence of exercisable warrants (or convertible securities) nor the approaching expiration date of such securities would itself cause the issuer of the warrants or convertible securities to be deemed to be in distribution. *See* Staff Bulletin No. 9. Special selling efforts, such as the solicitation of warrant exercises or conversions, a temporary reduction of the warrant exercise or conversion price or the payment of a soliciting dealer's fee, might cause a distribution to be deemed to be present. *See* Staff Bulletin No. 9.

391 ADTV may be calculated based on the two calendar months preceding the offering or on a 60-day rolling period ending within ten days of the filing of the related registration statement or, if there is no registration statement or the offering is being made pursuant to a shelf registration statement, ending within ten days of the pricing.

In the context of a security convertible into an actively-traded security, the SEC staff has clarified that the ADTV of the reference security does not affect the restricted period of the subject security; rather, the ADTV of the subject security (*i.e.*, the convertible security) determines the restricted period. *See* Staff Bulletin No. 9.

ADTV is calculated based on "worldwide" trading volume of common equity securities (per the definition found in Rule 100) and the SEC staff has clarified (in Staff Bulletin No. 9) that “[t]he phrase ‘common equity securities' includes the equivalent type of stock of a foreign issuer. As a result, a foreign issuer with an existing exchange listing outside the United States may already have ADTV for purposes of Regulation M at the time of its U.S. initial public offering.

392 According to the Regulation M Release (text at note 42), "a distribution participant should have flexibility in determining a security's ADTV value from information that is publicly available, if such participant has a reasonable basis for believing that the information is reliable. [Footnote omitted.] Furthermore, in calculating the dollar value of ADTV, any reasonable and verifiable method may be used. For example, it may be derived from multiplying the number of shares by the price in each trade, or from multiplying each day's total volume of shares by the closing price on that day."

393 Public float value is defined as the aggregate amount of common equity securities held by nonaffiliates and is disclosed, in the case of U.S. issuers, in annual reports on Form 10-K filed with the SEC under the Exchange Act. *See* Rule 100 of Regulation M.

394 The SEC staff has granted exemptions to underwriters to engage in market making where the actively traded security exemption was not met, particularly in the context of noninvestment-grade sovereign debt issuances.

395 Regulation M's definition of "asset-backed security" comes from Item 1101 of Regulation AB, and is used to describe a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the securityholders.

396 Pursuant to § 939A of the Dodd-Frank Act, the SEC was charged with removing from SEC regulations all references to or requirements of reliance on credit ratings. Accordingly, the SEC has attempted to identify the characteristics of securities that make the markets for investment grade securities difficult to manipulate

and has indicated that its goal is to implement the requirements of the Dodd-Frank Act without necessarily changing the substantive results under the various rules and forms or imposing undue additional burdens on market participants. SEC Release No. 34-64352 (Apr. 27, 2011). The proposed approach would remove the references to credit ratings in Rules 101(c)(2) and 102(d)(2) and would instead exempt nonconvertible debt and preferred stock and asset-backed securities from Regulation M if they (i) are liquid relative to the market for that asset class (as indicated by the daily trading volume and number of market makers, among other things), (ii) trade in relation to general market interest rates and yield spreads (rather than in relation to issuer-specific factors), and (iii) are relatively fungible with securities of similar characteristics and interest rate yield spreads (for trading purposes). The determination of whether these factors are met would be required to be made using reasonable factors of evaluation and then verified by an independent third party, which could not be counsel to the underwriter or issuer or an affiliate of theirs. The SEC requested comment on what the qualifications of such a third party should be, and whether for example an entity eligible to be a "qualified independent underwriter" in the distribution should be required. Although the SEC, in the context of eliminating credit rating references in other rules in 2013, indicated it would address the proposed removal of such references from Rules 101 and 102 separately at a later time, it has not yet done so. *See* SEC Release No. 34-71194 (Dec. 27, 2013).

397 Rule 101 also includes exemptions for "exempted securities," as defined in § 3(a)(12) of the Exchange Act (including certain government and municipal securities), face-amount certificates issued by a face-amount certificate company and redeemable securities issued by an open-end management investment company or a unit investment trust.

398 For a discussion of the requirements of Rule 144A, *see* § 7.02[3].

399 This exemption does not cover private placements of Rule 144A-eligible securities to accredited investors that are not QIBs.

400 For a discussion of the requirements of Regulation S, *see* Chapter 8.

401 The staff of the SEC has clarified that market transactions would be deemed solicited where an indication of interest has been solicited by a syndicate member from a client to purchase in the distribution, but the client instead wishes to buy immediately in the market. *See* Staff Bulletin No. 9.

In connection with Rule 10b-6 under the Exchange Act, one of the predecessor rules to Regulation M, the SEC indicated that the dissemination of research to particular customers by sales personnel (in contrast to the dissemination of research continuously through the use of routine distribution systems such as mailing lists) would render a transaction solicited, and thus outside the scope of permissible transactions under Rule 10b-6. The SEC also noted that research transmitted orally must be evaluated in the context of the entire oral presentation, including whether the broker-dealer or the customer initiated the contact, the sophistication of the customer and the normal course of dealings with the customer, and further noted that, in most cases, the oral transmission of positive research by sales personnel on their own initiative would constitute a solicitation and an inducement to purchase. *See* SEC Release No. 33-6550 (Sept. 19, 1984); *see also supra* Note 261 (discussing certain exceptions to Regulation M for the distribution of research that is in compliance with Rule 138 or 139 under the Securities Act). Although Rule 10b-6 is no longer in force, the SEC has indicated that interpretations under the rules in effect prior to the adoption of Regulation M remain relevant to interpretations of similar terms and concepts used in Regulation M. *See* the Regulation M Release.

402 For a discussion of Rules 138 and 139 under the Securities Act and the dissemination of research in connection with a global offering, *see* §§ 3.02[3][e][iii] and [iv].

In the case of research reports not meeting the conditions of Rule 138 or 139, the SEC declined to codify an exemption based on existing market practice, which often involved the distribution of such noncomplying research reports outside the United States in a manner consistent with local market practice when the securities being offered were those of a non-U.S. issuer. *See* SEC Release No. 33-7375 (Dec. 20, 1996). The SEC noted, however, that there might be circumstances in which the distribution outside the United States of such noncomplying research reports might be appropriate during a global offering.

The issue has become less important since the adoption of Regulation M because of the frequent availability of exemptions under Regulation M (in particular, the actively-traded securities exemption) and the relatively brief restricted periods under Regulation M (which are shorter than the typical research blackout periods imposed by lead managers). Many practitioners are of the view that prohibiting the distribution outside the United States of noncomplying research reports in the context of global offerings by non-U.S. issuers would be an inappropriate extra-territorial exercise of U.S. authority.

403 This exemption codifies certain no-action relief granted by the staff of the SEC under Rule 10b-6 under the Exchange Act (which was, as mentioned above, one of the predecessor rules to Regulation M). *See Basket Trading During Distributions* (avail. Aug. 6, 1991). Rule 101 exempts *bona fide* basket transactions in covered securities in the ordinary course of business if (i) the security being distributed constitutes 5% or less of the value of the basket being purchased and (ii) the basket contains at least 20 securities. The exemption also permits the adjustment of an existing basket position related to a standardized index if such adjustment is made in the ordinary course of business as a result of a change in the composition of the relevant index.

404 The de minimis exemption exempts purchases that in the aggregate total less than 2% of the security's reported ADTV and unaccepted bids. The de minimis exemption is limited to persons who maintain and enforce written policies and procedures reasonably designed to achieve compliance with Rule 101. Once inadvertent transactions are discovered, subsequent transactions are not covered by the exemption. In addition, even if a trade subsequently is broken, it must be considered a purchase for the purpose of the exemption.

405 Rule 101 exempts from its coverage transactions among distribution participants in connection with a distribution, and purchases of securities from an issuer or selling securityholder in connection with a distribution, in either case that are not effected through an exchange, as well as transactions complying with the passive market making and stabilization provisions contained elsewhere in Regulation M and bids and purchases of odd-lots. In addition, Rule 101 exempts the exercise of any option, warrant, right or conversion privilege set forth in the instrument governing a security, as well as offers to sell or the solicitation of offers to buy the securities being distributed (including securities acquired in stabilizing) or securities offered as principal by the person making such offer or solicitation. *See* Regulation M Release, Anti-Manipulation Rules Concerning Securities Offerings, 62 Fed. Reg 520, 532 n. 95 (Jan. 3, 1997); *see also* Staff Bulletin No. 9.

406 A Nasdaq market maker that is affiliated with the issuer or selling securityholder but is not acting as a distribution participant may not rely on Rule 103. *See* Staff Bulletin No. 9.

407 *See Distributions of Certain United Kingdom Securities and of Certain Securities Traded on SEAQ International* (avail. Jan. 10, 1995). This letter restated and expanded similar relief first granted in the late 1980s and permitted passive market making in connection with offerings by certain issuers listed on the London Stock Exchange's Stock Exchange Automated Quotation System ("SEAQ") or quoted on the London Stock Exchange's Stock Exchange Automated Quotation International system ("SEAQI").

The SEC staff recognized that Rule 10b-6, one of the predecessor rules to Regulation M, would have interfered with the London Stock Exchange rules intended to preserve the integrity of London's trading market. These rules were designed to prohibit "fair-weather" market making by effectively preventing a member firm from resuming market making activities in a security for three months after the firm ceased to make a market in that security. Market makers in London thus do not withdraw from the market when they or their affiliates participate in an offering, as they would be required to do, absent an exemption, by Rule 10b-6 (as well as by Rule 101 of Regulation M). *See* L. E. Bergmann, *Selected Trading Practices Developments*—1987, ALI-ABA Course of Study—Broker Dealer Regulation (Jan. 21–22, 1988).

408 *See London Stock Exchange* (avail. Aug. 5, 1997). The London Stock Exchange's revised relief under Regulation M permits broker-dealers that are members of the London Stock Exchange to engage in "passive" market making activities in connection with offerings by certain issuers when such broker-dealers would otherwise be prevented from making a market by Regulation M. "Passive" market making refers to

the ability of the U.K. firms to provide depth and liquidity in the U.K. securities market by continuing to act as market makers without leading the market in price or size of quotations. Without the relief granted by the SEC, the London Stock Exchange was concerned that, in the case of securities that did not qualify for the actively-traded securities exemption of Rule 101, Regulation M would impede the normal functioning of the U.K. securities market when members of the London Stock Exchange (or their affiliates) participated in a distribution of covered securities while making a market in such securities on the London Stock Exchange.

In substance, the SEC relief permits members of the London Stock Exchange and certain affiliates to bid for, purchase, or solicit the purchase of securities that are the subject of a U.S. distribution (or a reference security), notwithstanding the application of Rule 101, when such securities are listed on SEAQ or, in certain cases, SEAQI. This relief is applicable during the period commencing (i) one business day before the determination of the offering price and ending upon completion of participation in the distribution in the United States in the case of securities with an ADTV value of $100,000 or more that are issued by an issuer whose common equity securities have a public float value of $25 million or more or (ii) five business days before the determination of the offering price and ending upon completion of participation in the distribution in the United States in the case of all other securities. The relief is subject to a number of conditions, including that members of the London Stock Exchange not enter any bids for or make any purchases of covered securities at a price higher than the highest bid, and that no bids be made for a quantity of covered securities greater than the largest quoted bid size currently displayed on SEAQ or SEAQI by an independent member of the London Stock Exchange not participating in the distribution. These restrictions do not apply to purchases following unsolicited inquiries or unsolicited brokerage transactions.

Under the relief, London Stock Exchange members are also required to reduce their bids if such bids subsequently become higher in price or larger in size than any independent bid. Disclosure of the passive market making activities must also be included in the prospectus filed under the Securities Act in connection with the U.S. distribution.

409 *See*, *e.g.*, *Rhone-Poulenc S.A.* (avail. Jan. 25, 1993) (SEAQI and Marché des Options Négociables de Paris ("MONEP"), which also included exemptions for concurrent exchange offers by the French government (the selling shareholder) and the company); *TOTAL* (avail. June 23, 1992) (SEAQI and MONEP, which also covered a concurrent exchange offer); *TOTAL* (avail. Oct. 18, 1991) (SEAQI and MONEP); *Novo Nordisk A/S* (avail. June 18, 1991) (Copenhagen Stock Exchange); *Société Nationale Elf Aquitaine* (avail. June 10, 1991) (SEAQI and MONEP); *Trans Canada Pipelines Limited Equity Offering* (avail. June 10, 1991) (Montreal Stock Exchange); *Norsk Hydro a.s.* (avail. May 6, 1988) (Oslo Bors).

410 An affiliated purchaser of an issuer or selling securityholder that is acting as a distribution participant may, however, comply with the provisions of Rule 101 rather than Rule 102 if the affiliated purchaser is not itself the issuer or selling securityholder (although the ADTV exemption in Rule 101 will not be available to an affiliated purchaser, as that exemption is unavailable for securities issued by an affiliate of a distribution participant). *See also infra* Note 414 (examining certain no-action relief that has been granted under Regulation M to affiliated purchasers of issuers and certain other parties that are not acting as distribution participants).

411 According to the Regulation M Release, these exemptions are omitted because issuers and selling securityholders have a direct stake in the proceeds of the offering and thus may have a greater incentive to manipulate the price of covered securities. The release also notes that transactions by issuers and selling securityholders generally are not monitored by self-regulatory organizations and that issuers and selling securityholders generally do not engage in the same type of market activities as part of their business as those persons subject to Rule 101. *See* Regulation M Release.

412 *See* the Regulation M Release, Anti-Manipulation Rules Concerning Securities Offerings, 62 Fed. Reg. 520, 522 n.95 (Jan. 3, 1997); *see also* Staff Bulletin No. 9.

413 An agent will not be considered independent of the issuer in cases where the issuer exercises any direct or indirect control or influence over the timing, manner, price or amounts of purchases or selects the broker or dealer through which purchases may be exercised. Such control or influence will be deemed not to exist if

the issuer, not more than once in any three-month period, revises the basis for determining its contributions to a plan or the frequency of its allocations to a plan, or revises the formula that determines the amount or timing of purchases by the agent.

414 The SEC staff has granted no-action relief from Rule 102 to an open-end investment fund that, by its nature, engaged in continuous offers to sell and repurchase securities. *See Popular High Grade Fixed-Income Fund* (avail. Sept. 10, 2002); *see also ING Senior Income Fund* (avail. Oct. 17, 2002) (granting relief from Rule 102 to an investment fund for purposes of a rescission offer to purchase its securities while engaged in a distribution of shares subject to Rule 102); *accord Oppenheimer Senior Floating Rate Fund* (avail. Aug. 31, 2005).

415 An affiliated purchaser of an issuer or selling securityholder that is not acting as a distribution participant would be subject to the more restrictive Rule 102. However, the SEC staff has granted no-action relief to affiliated purchasers of the issuer of the securities being distributed that were not, themselves, acting as distribution participants to allow the affiliated purchasers to conduct certain market making and other transactions in the subject securities. *See*, *e.g.*, *UBS AG* (avail. Sept. 22, 2000). Relief has been granted subject to compliance with certain conditions, and has been premised on certain factors, including that the subject securities would have qualified as actively-traded securities under Rule 101(c)(1) of Regulation M, that the relevant activities were being undertaken in the ordinary course of business and that the withdrawal of the affiliated purchasers from the market could have had possible "serious harmful effects" both in the home market and in the United States or create disruptions for customers or conflict with fiduciary duties of the affiliated purchasers. *See Deutsche Bank Aktiengesellschaft* (avail. Sept. 16, 2010); *see also Bank of Montreal* (avail. Apr. 8, 2011); *Shinhan Financial Group Co., Ltd.* (avail. Mar. 5, 2009); *ABN AMRO Holding N.V.* (avail. Aug. 7, 2007); *Allianz SE* (avail. Mar. 23, 2007); *Banca Intesa S.p.A.* (avail. Nov. 1, 2006); *Sanpaolo IMI S.p.A.* (avail. Nov. 1, 2006); *Allianz AG* (avail. Apr. 10, 2003); *UBS AG* (avail. Sept. 22, 2000). The SEC staff has also granted no-action relief under Rule 102 to permit an issuer to engage in a share repurchase program while engaged in a distribution of its securities, subject to numerous conditions. *See Barclays Bank PLC* (avail. Aug. 2, 2007).

416 The issuer's ADTV will still be significant under such circumstances because it is used to determine whether the restricted period relating to the issuer's or its affiliate's market activities will begin one business day or five business days prior to pricing. For example, a distribution participant that is an investment banking subsidiary of a global investment bank that is the issuer of securities in an offering will be subject to the restrictions of Regulation M and therefore must be out of the market one business day before the pricing date in that offering.

417 It is worth noting that the term "stabilization" has different meanings within and outside the United States. Rule 104(a) of Regulation M refers to stabilization "in connection with an offering" and applies to market interventions that precede the completion of a distribution (but generally do not extend beyond such completion). *See infra* Note 420. Outside the United States, stabilization is a more general term, often referring to market activities of underwriters occurring during a specified period following the closing of an offering. Non-U.S. jurisdictions may require that a global offering of securities also comply with the stabilization rules of that jurisdiction. Interesting issues therefore arise in trying to apply Regulation M in the context of aftermarket activities called "stabilization" abroad. For example, stabilization in accordance with European Union rules is permitted for a limited period after an offering. Regulation M should not be deemed to restrict non-U.S. purchases or inducements to purchase the subject securities after the U.S. distribution is completed. The Rule 104 restrictions also would not need to be followed because the offering in the United States has been completed. This view is consistent with the views expressed in a no-action letter under Rule 10b-6, one of the predecessor rules to Regulation M. *See Williams, William J., Jr.* (avail. Nov. 27, 1996), which is discussed in *supra* Note 335.

418 Rule 104, unlike Rules 101, 102 and 103, applies to all "offerings" and not merely to "distributions" within the meaning of Rule 100. *See* Staff Bulletin No. 9.

419 The term "current exchange rate" is defined as the current rate of exchange between two currencies, which is obtained from at least one independent entity that provides or disseminates foreign exchange quotations

in the ordinary course of its business. Rule 100 of Regulation M.

420 Rule 104 regulates stabilization activities only so long as the U.S. component of a global offering is continuing or if the stabilization activities "facilitate the offerings in the United States" even though the U.S. distribution is completed. *See Nippon Telegraph and Telephone Corp.* (avail. Nov. 8, 1999). It should thus be the case that in general, once the U.S. distribution is completed, and assuming no U.S. purchases or sales are being made in connection with syndicate stabilization activities, Rule 104 is no longer applicable and only local regulations apply. *See supra* Note 417.

421 The Market Abuse Directive was the predecessor to the current Market Abuse Regulation.

422 The staff of the SEC has approved reliance on the pre-Market Abuse Directive U.K. stabilization regulations even outside the United Kingdom provided that: (i) the stabilization activities are conducted subject to and in compliance with the U.K. stabilization regulations, (ii) at least a portion of the international offering is or will be conducted in the United Kingdom, (iii) the stabilization activities will be conducted by or under the management of an "authorized person" (any underwriter or other financial services firm that is an authorized person under the U.K. Financial Services Act 1986 (or any successor law) as in effect from time to time, whether the firm is acting for its own account or for the accounts of others (*e.g.*, as an agent of an underwriting or other selling group)), and (iv) the stabilization activities will occur at a time when no stabilization is being conducted in the United States. *See Nippon Telegraph and Telephone Corp.* (avail. July 28, 2000).

423 *Nippon Telegraph and Telephone Corp.* (avail. Dec. 11, 1998).

424 *See Nippon Telegraph and Telephone Corp.* (avail. Nov. 8, 1999).

425 *See supra* Note 422 and accompanying text; *ING Group N.V.* (avail. June 10, 1997). The SEC has not determined that the post-Market Abuse Directive (or post-Market Abuse Regulation) stabilization rules of the United Kingdom, The Netherlands or any other member of the European Economic Area are equivalent to Rule 104. Such a determination may in any case be of limited utility, because Rule 104 relates to stabilization activities during a distribution, whereas stabilization safe harbors and related activities in jurisdictions outside the United States often apply only during a specified period following the closing of an offering. *See supra* Notes 417 and 420.

426 *See also* Items 508 of Regulation S-K under the Securities Act (requiring that the "plan of distribution" section describe any prospective stabilizing and aftermarket activity, including syndicate covering transactions and penalty bids).

427 The SEC has granted an exemption from this notification requirement for nonconvertible debt securities, nonconvertible preferred securities and asset-backed securities that in each case are rated investment grade. *See The Bond Market Association* (avail. Dec. 10, 1997). *But see infra* Note 546 for a discussion of the removal from SEC regulations of all references to or requirements of reliance on credit ratings.

428 Notice of a penalty bid should be submitted to FINRA when the penalty bid will be assessed. If notice of a penalty bid is given at the time of pricing because the agreement among underwriters contains a penalty bid provision but no penalty bid is in fact imposed, the staff of the SEC has stated that an amended notice should be filed to reflect that no such assessments were made. *See* Staff Bulletin No. 9. As a practical matter, penalty bids are rarely used.

429 SEC, Division of Market Regulation, Staff Legal Bulletin No. 10, Prohibited Solicitations and "Tie-in" Agreements for Aftermarket Purchases (Aug. 25, 2000), Fed. Sec. L. Rep. (CCH) ¶60,010.

430 In January 2005, the SEC announced the filing of settled civil injunctive actions in federal court against Morgan Stanley & Co. Incorporated and Goldman, Sachs & Co. The actions related to the firms' allocations of stock in initial public offerings they underwrote in 1999 and 2000, where it is alleged, among other things, that they attempted to induce certain customers who received allocations to place purchase orders for additional shares in the aftermarket. In settlement of this matter, both banks consented, without admitting or denying the allegations of the complaint, to final judgments that permanently enjoined them from violating Rule 101 of Regulation M, and ordered each of them to pay a $40 million civil penalty. *See SEC v. Morgan Stanley & Co. Incorporated*, SEC Litigation Release No. 19050 (Jan. 25, 2005); *SEC v. Goldman, Sachs &*

Co., SEC Litigation Release No. 19051 (Jan. 25, 2005). Similar cases were also brought against other investment banks, including J.P. Morgan Securities, Inc. and Credit Suisse First Boston Corporation, alleging allocation abuses in initial public offerings carried out during the same period. *See SEC v. J.P. Morgan Securities, Inc.*, SEC Litigation Release No. 18385 (Oct. 1, 2003); *SEC v. Credit Suisse First Boston Corporation*, SEC Litigation Release No. 17327 (Jan. 22, 2002).

FINRA has adopted rules that, among other things, prohibit its members from engaging in certain "*quid pro quo*" allocation arrangements in connection with initial public offerings. *See* § 3.06[2][b] for a discussion of FINRA Rule 5131.

431 Prior to revisions adopted in August 2007, Rule 105 had only prohibited covering short sales of securities made during the Pre-Pricing Period (as defined below) with offered securities purchased from an underwriter, broker or dealer participating in the offering. Under the prior rule, however, the SEC had brought a number of enforcement actions for violations of Rule 105. *See*, *e.g.*, *In re GLG Partners, LP*, SEC Release No. 34-55956 (June 26, 2007); *Amaranth Advisors L.L.C.*, SEC Release No. IA-2601 (May 9, 2007); *In re Goldman Sachs Execution & Clearing L.P.*, SEC Release No. 34-55465 (Mar. 14, 2007); *SEC v. Solar Group S.A.* (S.D.N.Y. Nov. 6, 2006), SEC Litigation Release No. 19899 (Nov. 6, 2006); *SEC v. Compania Internacional Financiera S.A.* (S.D.N.Y. Dec. 20, 2005), SEC Litigation Release No. 19501 (Dec. 20, 2005). Certain of these enforcement actions involved trading activities intended to conceal the fact that shares acquired in offerings were being allocated to cover short sales entered into during the Rule 105 Pre-Pricing Period. *See* SEC Release No. 34-54888 (Dec. 6, 2006). As a result, the SEC has amended Rule 105 of Regulation M to prohibit, subject to certain exceptions, all purchases of offered securities by persons making short sales of the securities that are the subject of the offering during the Rule 105 Pre-Pricing Period, irrespective of whether the acquired securities were used to cover the short position.

432 In connection with offerings of convertible or exchangeable securities, the underlying security is not deemed to be an offered security for purposes of Rule 105. As a result, Rule 105 does not prohibit a person that shorted common stock in the Pre-Pricing Period from purchasing securities that are convertible into or exchangeable for such common stock. The SEC has noted, however, that it would continue to monitor the convertible offering market and may re-evaluate the treatment of these offerings under Rule 105. *See* SEC Release No. 34-56206 (Aug. 6, 2007).

433 The prohibition is based on the price distortion that can result when pre-pricing short sales are covered with shares sold in the offering, thereby undermining the market's ability to work as an independent pricing mechanism and thus the integrity of the offering price. Short sales by traders aware of their ability to cover short sales with offering shares do not involve the same market risk as short sales that are intended to be covered with open market shares, and this can upset price discovery and the efficiency of the pricing process. *See* SEC Release No. 34-56206 (Aug. 6, 2007).

434 Rule 105(b) of Regulation M. The SEC has indicated that it will also consider on a case-by-case basis specific requests for exemptive relief from entities that may not otherwise qualify for the separate account exception of Rule 105. *See* SEC Release No. 34-56206 (Aug. 6, 2007).

435 The prohibition originally did not apply to offerings filed under Rule 415 under the Securities Act on the grounds that shelf offerings of equity securities were not common when Regulation M was adopted, and it was the SEC's understanding at that time that potential investors generally were not aware of shelf takedowns until just before they took place, meaning that pre-pricing short sales were arguably not focused on any prospective offering. However, in light of the evolution of shelf offering techniques to include many of the features of nonshelf offerings, *e.g.*, road shows and other special selling efforts, thereby giving investors advance notice of the offering before it occurs, and because shelf offerings of equity securities have become commonplace, in 2004 the SEC amended Rule 105 of Regulation M to extend the prohibition to shelf takedowns. *See* SEC Release No. 34-50103 (July 28, 2004); *see also supra* Note 433, which describes the pricing disruption concerns pre-pricing short sales can raise.

436 The SEC has also indicated that it will continue to monitor whether trading patterns in debt securities raise manipulative concerns in connection with debt offerings. In addition, the SEC has stated that it will continue

to monitor the use of derivative strategies that may replicate the economic effect of the activity that Rule 105 is designed to prevent. *See* SEC Release No. 34-56206 (Aug. 6, 2007).

U.S. Regulation of the International Securities and Derivatives Markets, § 3.03, LISTING EQUITY SECURITIES IN THE UNITED STATES

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 3.03 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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A foreign company that lists securities on a U.S. exchange must register under the Exchange Act the class of securities to be listed. As a consequence, the issuer will become subject to the periodic reporting and other requirements of the Exchange Act, including the corporate governance, accountability, auditor independence and other requirements of the Sarbanes-Oxley Act and the Dodd-Frank Act. [437] In addition, listing on the NYSE or Nasdaq will subject the issuer to the ongoing rules of the exchange including various corporate governance, notice and other requirements. [438]

[1] Registration Under § 12 of the Exchange Act

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[a] Section 12(b)

As discussed in § 4.02, a class of securities, whether newly issued or already outstanding, that is listed on a national securities exchange (such as the NYSE or the Nasdaq [439]) must be registered under § 12(b) of the Exchange Act. [440] The SEC must declare the registration statement effective before such securities may be listed. [441]

[b] Core Disclosure Document—Form 20-F

The statutory disclosure requirements set out in the Securities Act and the Exchange Act are substantially identical. Over time, beginning in the early 1980s, the SEC developed the view that the information necessary for investors purchasing in a distribution should be the same as the information necessary for investors to make informed secondary market trading decisions (which was the primary rationale for imposing periodic reporting in the Exchange Act).

This recognition led to two important developments. First, the accounting and disclosure requirements for a registered public offering were made substantially identical to the accounting and disclosure requirements for registration of

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a class of securities under the Exchange Act or for periodic reporting thereunder. [442] Second, an integrated disclosure system was developed, important consequences of which were shelf registration and later automatic shelf registration. [443] Under that system, for many issuers, information filed under the Exchange Act need not be repeated in prospectuses prepared subsequent to the Exchange Act filing, but may simply be incorporated by reference, thus reducing the size of the prospectus and the time necessary for its preparation.

Under the integrated disclosure system, the accounting and disclosure requirements for foreign issuers under the Securities Act and the Exchange Act now derive from the same form: Form 20-F. Form 20-F is used both for original registration and for annual reports subsequently filed under the Exchange Act, and is the source of requirements for company disclosure to be included in registration statements under the Securities Act. [444]

In 1999, the SEC adopted a complete revision of Form 20-F that replaced most of its issuer-related disclosure requirements, other than financial statement requirements, with international disclosure standards adopted by the International Organization of Securities Commissions ("IOSCO"). [445] The adoption of Form 20-F based on the IOSCO standards did not change the requirement that financial statements be prepared in accordance with, or reconciled to, U.S. GAAP, which can be a significant obstacle for foreign issuers seeking access to U.S. markets. In 2007, however, the SEC adopted amendments to Form 20-F that now allow foreign private issuers to file financial statements prepared in accordance with IFRS, as issued by the IASB, without reconciliation to U.S. GAAP. [446]

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The changes to Form 20-F based on IOSCO standards also did not affect the supplementary disclosure requirements provided for in the SEC's industry guides, which can be another significant obstacle for foreign banks, insurance companies and mining companies in particular. [447] In addition, although much in the IOSCO standards was clearly inspired by the previous Form 20-F and by U.S. disclosure practices, there are extensive differences in wording between the IOSCO standards and previous Form 20-F. The SEC staff is likely to interpret the IOSCO standards, where the wording differs but is ambiguous, in light of analogous provisions of Regulation S-K.

Substantial revisions were also made to Form 20-F pursuant to the Sarbanes-Oxley Act and the rules adopted by the SEC thereunder. In particular, new disclosure requirements were established with respect to off-balance sheet transactions, contractual obligations, non-GAAP financial measures, conclusions on the effectiveness of an issuer's disclosure controls and procedures and internal control over financial reporting, management's responsibility for establishing and maintaining internal control over financial reporting and the related accountants' attestation report, audit committee financial experts, codes of ethics and auditor fees and services. [448] Certain of the rules implementing the Sarbanes-Oxley Act mandate disclosures in periodic reports filed under the Exchange Act, but do not impose those requirements in Securities Act registration statements. [449]

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Substantial changes have also been made to Form 20-F since the passage of the Sarbanes-Oxley Act, including additional disclosure requirements relating to corporate governance practices; [450] ADR fees; [451] changes in auditors; [452] and a shortening of the reporting deadline, with annual reports on Form 20-F required within four months of the issuer's fiscal year end. [453]

Most recently, changes have been made to the Form 20-F disclosure requirements as a result of implementation of the disclosure mandates of the Dodd-Frank Act, including the following:

- the requirement that every reporting company that is an operator or has a subsidiary that is an operator of coal or other mines in the United States make certain health- and safety-related disclosures. These provisions apply to foreign issuers that operate or have subsidiaries that operate mines in the United States. [454]
- the requirement that any reporting company, including a foreign issuer, that manufactures or contracts to manufacture products for which conflict minerals are necessary to those products' functionality or production disclose whether or not its conflict minerals originate in the Democratic Republic of the Congo and adjoining countries (collectively, the "DRC Countries"). If a

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  company is unable to conclude that its conflict minerals did not originate in any DRC country (or the minerals came from recycled or scrap sources), it is required to file a "Conflict Minerals Report" as an exhibit to the annual report that provides, among other things, detailed disclosure regarding measures taken by the company to exercise due diligence with respect to its supply chain, including an independent private sector audit. [455]
- the requirement that any reporting company, including a foreign issuer, that engages in the commercial

development of oil, natural gas, or minerals disclose payments made to governments for such development.

- the commercial development of oil, natural gas or minerals. [456]

[2] Obtaining a Listing in the United States

[a] Application for Listing

In selecting a market on which to list their securities, issuers should consider not only fees and applicable rules for listed companies, but also the different market structures and types of trading in each market. For example, the NYSE is a hybrid market combining features of auction markets and automated trading. Historically, the NYSE operated principally as an auction market— *i.e.*, a market in which the prices at which securities are bought and sold are generally established and trades executed in electronic or face-to-face contacts at a single electronic or physical location between floorbrokers of buyers and sellers. In addition, a member of the exchange (a "designated market maker," formerly called "specialists") is selected for each listed security and is responsible for maintaining a fair and orderly market in that security, even if it must to a limited extent trade for its own account in order to meet public demand. The NYSE has expanded its automated trading platform in response to technological advances and regulatory demand. [457] Nasdaq markets are "dealer markets"— *i.e.*, markets in which market-makers agree to quote bid and offered prices for standard small transactions in particular securities and to execute trades at those prices. Executions can be placed at a multiplicity of market-makers and electronic market centers.

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In each of these exchanges, immediate reporting of transactions provides real-time price information. Proponents of each of these markets claim particular advantages of their trading and market-making procedures (*e.g.*, cost of trading, price improvement, liquidity, *etc.*), as well as the prestige of a listing on that market. [458]

Once a decision to list on the NYSE or Nasdaq has been made, an application must be submitted to the exchange. In connection with an IPO, the exchanges typically request two months to complete work on the application, whereas secondary listings of equity or debt securities typically can be accomplished more quickly. Trading will commence on a date chosen by the issuer in consultation with the exchange and after the related registration statement has been declared effective. The listing application contains various certifications and undertakings from the issuer and upon listing the issuer will become subject to numerous continued listing requirements. Key NYSE and Nasdaq listing standards are set out in the next two sections.

[b] New York Stock Exchange Listing Standards

In order to make the U.S. equity markets more accessible to foreign companies, the NYSE has special standards and procedures for listing shares [459] or ADRs [460] of foreign companies where there is a broad, liquid market for a company's shares in its home country. [461] The principal criteria include distribution and size standards that require the foreign issuer to have, worldwide, a minimum of 5,000 holders of 100 or more shares (determined on the basis of beneficial ownership, if known, in addition to holders of record), and a minimum of 2.5 million publicly held shares [462] having a market value of at least $100 million. [463]

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The alternate listing standards for foreign companies also require the issuer to meet one of the following three alternative financial standards (determined under U.S. GAAP or IFRS) based on earnings, operating cash flow or global market capitalization: [464]

- to have pre-tax earnings from continuing operations, after minority interest, amortization and equity in the earnings or losses of investees and as adjusted for certain specified items, of at least $100 million in the aggregate for the last three years (with a minimum of $25 million in each of the most recent two years); [465] , [466]

- for companies with a total worldwide market capitalization of not less than $500 million and revenues (in the most recent 12-month period) of $100 million to have aggregate operating cash flow (calculated in accordance with NYSE specifications) for the last three years of at least $100 million in the aggregate (with a minimum of $25 million, as adjusted for certain specified items, in each of the two most recent years); [467]
- to have not less than $750 million in total worldwide market capitalization (with not less than $75 million in revenues in the most recent fiscal year). [468]

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Foreign companies may also rely on the "affiliated company" standard, the principal criteria for which are (i) global market capitalization of at least $500 million, (ii) minimum of 12 months of operations (although there is no requirement to have been a separate corporate entity for such period), (iii) a parent or affiliated company being a listed company on the NYSE in good standing and (iv) such parent or affiliated company retaining control over the foreign company or being under common control with the foreign company (with control presumed to exist when the parent or affiliate holds directly or indirectly 20% or more of the foreign company's voting stock). The affiliated company must have a market value of publicly held shares worldwide of at least $60 million. [469]

NYSE MKT, formerly NYSE Amex Equities, has a focus on small-cap companies and less stringent listing standards. A foreign issuer can qualify for listing under the NYSE MKT domestic listing standards [470] or the more relaxed

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foreign company standards: distribution and size standards that require the foreign company to have, worldwide, a minimum (i) 800 round-lot holders, (ii) 1,000,000 publicly held shares [471] and (iii) market value of publicly held shares of $3,000,000. [472] The NYSE also operates NYSE Arca, an all-electronic exchange that primarily lists exchange-traded notes, funds and other products.

Prior to submitting an application for listing, a company must undergo a confidential eligibility review in which the NYSE will consider whether the company satisfies the listing standards. [473] The NYSE charges companies listing fees at the time their shares are listed and on an ongoing basis annually. The initial listing fee and the annual listing fee are charged on a per-share basis. [474] The issuer may list any additional shares issued after the initial listing by filing with the NYSE a subsequent listing application and required opinions of counsel and paying all necessary listing fees. [475] Upon listing, the issuer is required to enter into a listing agreement with the NYSE, which sets out the continuing obligations of the issuer to implement certain NYSE policies. [476] The NYSE permits foreign private issuers to follow home country practice in lieu of certain corporate governance provisions and may, on a case-by-case basis, waive or modify obligations that relate to financial reporting or certain other corporate governance matters, other than corporate governance obligations imposed by the Sarbanes-Oxley Act and related NYSE rules. [477]

[c] Nasdaq Listing Standards

Effective July 2006, Nasdaq [478] created a new listing tier—the Nasdaq Global Select Market ("Nasdaq/GSM"), with financial and liquidity requirements higher than those of the NYSE or other Nasdaq markets (the Nasdaq Global

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Market and the Nasdaq Capital Market). [479] The current listing requirements for the inclusion of securities in all three markets are based on the distribution of the issuer's stock and the size of the issuer. [480] The requirements to list on the Nasdaq Global Market and Nasdaq Capital Market are considerably less difficult to meet than current NYSE requirements, especially with respect to the requirements for inclusion of shares of common stock (or ADRs representing such shares) of foreign issuers in the Nasdaq Capital Market.

For shares of common stock (or ADRs representing such shares) of an issuer to be eligible for initial inclusion in Nasdaq Capital Market, the issuer must satisfy one of three alternative sets of criteria ("entry standards"). Under each of these, the issuer must meet the following criteria: (i) at least one million publicly held shares or ADRs worldwide, [481] (ii) 300 round lot holders of record of the shares or ADRs, (iii) three registered market-makers for the shares or ADRs, and (iv) the initial Nasdaq bid price must be at least $4 per share. In addition to such criteria:

- under the first entry standard, the issuer must have (i) stockholders' equity of at least $5 million, (ii) a market value of publicly held shares or ADRs of $15 million, and (iii) an operating history of at least two years;
- under the second entry standard, the issuer must have (i) stockholders' equity of at least $4 million, (ii) a market value of listed securities [482] of $50 million, and (iii) a market value of publicly held shares or ADRs of $15 million; and
- under the third entry standard, the issuer must have (i) stockholders' equity of at least $4 million, (ii) net income from continuing operations of $750,000 in the most recently completed fiscal year (or in two of the last three fiscal

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years), and (iii) a market value of publicly held shares or ADRs of $5 million. [483]

The requirements for initial inclusion of securities in Nasdaq Global Market are similar to but more stringent than those for Nasdaq Capital Market. There are three entry standards that may be satisfied as a basis for inclusion of common stock (or ADRs representing such stock) in Nasdaq Global Market. Under each of these, there must be at least 1.1 million publicly held shares or ADRs worldwide and 400 round lot holders of record of the shares or ADRs, and the initial Nasdaq Global Market bid price must be at least $5 per share. In addition to such criteria:

- under the first entry standard, (i) the market value of publicly held shares or ADRs must be at least $8 million, (ii) there must be at least three registered market-makers for the security and (iii) the issuer must have stockholders' equity of at least $15 million and pre-tax income of at least $1 million in its most recently completed fiscal year (or in two of three of its most recently completed fiscal years);
- under the second entry standard, (i) the market value of publicly held shares or ADRs must be at least $18 million and (ii) the issuer must have stockholders' equity of at least $30 million and a two-year operating history; and
- under the third entry standard, (i) the market value of publicly held shares or ADRs must be at least $20 million, (ii) there must be at least four registered market-makers for the security and (iii) the issuer must have either a market capitalization of $75 million or total assets and total revenues of at least $75 million each in its most recently completed fiscal year (or in two of the last three fiscal years). [484]

Nasdaq/GSM has three entry standards that may be satisfied as a basis for inclusion of common stock (or ADRs representing such stock) in it. Under each of these, there must be at least three registered market-makers for the security and the initial Nasdaq/GSM bid price must be at least $5 per share. In addition to such criteria:

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- under the first entry standard, the issuer must have pre-tax income of at least $11 million in the prior three fiscal years (in the aggregate) and pre-tax income of at least $2.2 million in each of the two most recent fiscal years and positive pre-tax income in each of the prior three fiscal years. If the issuer does not have three years of publicly reported financial data, it may qualify under the first entry standard if it has reported aggregate pre-tax income of at least $11 million and positive pre-tax income in each reported fiscal year;

- under the second entry standard, the issuer must have (i) cash flows of at least $27.5 million in the prior three fiscal years (in the aggregate) and positive cash flows in each of the prior three fiscal years, (ii) an average market capitalization of at least $550 million over the prior 12 months (in the case of an initial public offering, compliance with the market capitalization requirement will be based on the issuer's market capitalization at the time of listing) and (iii) revenue in the previous fiscal year of at least $110 million; and
- under the third entry standard, the issuer must have an average market capitalization of at least $850 million over the prior 12 months (in the case of an IPO, compliance with the market capitalization requirement will be based on the issuer's market capitalization at the time of listing) and revenue of at least $90 million in the previous fiscal year.

Additionally, issuers must meet each of the liquidity requirements, or the applicable alternatives, in their specific category. The categories fall into the following groups: new company listings, seasoned companies, closed-end management investment funds and business development companies. Each category is required to have at least 1.25 million publicly held shares or ADRs worldwide. The required number of beneficial holders ranges from 450 to 2,200 depending on the category of issuer, and the market value of publicly held shares or ADRs ranges from $35 million to $110 million depending on the category of issuer. [485]

Issuers with securities listed on any of the three markets must comply with maintenance listing standards in order to retain their listing. [486] The maintenance standards are similar to, but less stringent than, the initial listing standards.

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Upon listing, the issuer is required to enter into a listing agreement with Nasdaq, which sets out the continuing obligations of the issuer to implement certain Nasdaq policies. [487] Nasdaq allows a foreign issuer to choose to follow home-country practice in lieu of certain corporate governance provisions and may, on a case-by-case basis, waive or modify obligations that relate to financial reporting or certain other corporate governance matters, other than corporate governance obligations imposed by the Sarbanes-Oxley Act and related Nasdaq rules. [488]

Footnotes

437 This section specifically addresses the listing of foreign companies' equity securities. *See* § 3.05 regarding special issues relating to the issuance of debt securities.

438 *See* § 5.02[1] regarding listed company audit committee requirements and § 5.05 discussing corporate governance requirements applicable to listed companies.

439 Prior to becoming a national securities exchange, Nasdaq rules required registration under § 12(g) of the Exchange Act for the quotation of securities, even though § 12(g) itself would only require registration if the total assets and number of shareholders of the issuer exceeded the thresholds specified in § 12(g). *See* § 12(g) of the Exchange Act and Rule 12g-1 thereunder. As a result of Nasdaq's transition to a national securities exchange, the Nasdaq-listed securities previously registered under § 12(g) of the Exchange Act have become registered under § 12(b) of the Exchange Act. *See* SEC Release No. 34-54240 (July 31, 2006). OTC Bulletin Board rules generally require the issuer to be subject to the reporting requirements of the Exchange Act. *See* FINRA Rules, Rule 6530, FINRA MANUAL. *See supra* Note 33 (discussing OTC markets).

440 The exemption from Exchange Act registration provided by Rule 12g3-2(b) is not available for listed securities.

441 The relevant exchange must, as a condition to the SEC's making the related Exchange Act registration statement effective, certify its approval and request that the SEC accelerate the effective date of the registration statement. *See* § 12(d) of the Exchange Act. In circumstances where exchange listing is

concurrent with a registered equity offering, the effectiveness of the Securities Act registration and the Exchange Act registration is coordinated.

Rule 12g-3 under the Exchange Act provides a limited exception to the requirement that the registration statement be declared effective where securities of an issuer not already registered pursuant to § 12 of the Exchange Act are issued, in connection with a succession by merger, consolidation, exchange of securities, acquisition of assets or otherwise, to the holders of any class of securities of another issuer registered pursuant to either § 12(b) or § 12(g) of the Exchange Act. *See* § 4.02[3][a][iii].

442 *See* SEC Release No. 33-6437 (Nov. 19, 1982).

443 *See* SEC Release No. 33-6499 (Nov. 17, 1983); SEC Release No. 33-6459 (Mar. 18, 1983); SEC Release No. 33-6383 (Mar. 3, 1982); SEC Release No. 33-6423 (Sept. 2, 1982); Securities Offering Reform Release. Shelf registration is discussed in § 3.02[2][c].

444 Previously, because of certain compromises made at the time the integrated disclosure system was adopted for foreign issuers, *see* SEC Release No. 33-6437 (Nov. 19, 1982), certain accounting requirements for financial statements prepared for most Securities Act registration statements were more rigorous than the accounting requirements for financial statements prepared for an Exchange Act filing. The SEC has now eliminated this differentiated treatment, and the more complete financial statements are required for foreign issuers in both Securities Act and Exchange Act filings. *See* SEC Release No. 33-7745 (Sept. 28, 1999); *see also* SEC Release No. 33-8959 (Sept. 23, 2008). For fiscal years ending on or after December 15, 2011, all financial statements included in annual reports on Form 20-F or in Securities Act registration statements must comply with Item 18 of Form 20-F, other than for Canadian Multi-Jurisdictional Disclosure System ("MJDS") filers. SEC Release No. 33-8959 (Sept. 23, 2008).

445 *See* SEC Release No. 33-7745 (Sept. 28, 1999) (the "20-F Release"). Corresponding changes were also made to the forms for the registration of offerings under the Securities Act.

446 Foreign issuers using U.S. GAAP or IFRS are required to provide their financial statements to the SEC in Extensible Business Reporting Language ("XBRL"), an interactive data format, when they file annual reports on Form 20-F. SEC Release No. 33-9002 (Jan. 30, 2009). Interactive data files are filed as exhibits that supplement, but do not replace, the financial statements otherwise required to be filed under Form 20-F. Foreign issuers are not required to include an interactive data file when using Forms 20-F to register securities under the Exchange Act, but are required to present financial statements in this format in connection with their first annual report on Form 20-F. Rule 405(g) of Regulation S-T requires that a foreign issuer subject to the interactive data requirement provide the same information on its corporate website, if it has one. Interim financial data reported on Form 6-K is not subject to the interactive data requirements, although revisions of annual financial statements do require interactive data exhibits, even if filed on Form 6-K. *See* Form 6-K, General Instruction C.6.

447 An industry guide had been in effect for oil and gas companies. However, on or after January 1, 2010 and for Exchange Act annual reports for years ending on or after December 31, 2009, a detailed set of substantially revised disclosure rules replaced the industry guide but remain applicable to foreign oil and gas companies. In a 2016 concept release, the SEC requested public comment on whether the industry guides improve disclosure or should be revised and whether industry guide requirements should be codified in Regulation S-K. *See* SEC Release No. 33-10064 (Apr. 13, 2016). Additionally, the SEC has proposed certain changes to Industry Guide 7 relating to mining companies. *See* SEC Release No. 33-10098 (June 16, 2016).

448 *See generally* Chapters 4 and 5.

449 *See generally* Chapters 4 and 5. For example, certifications by principal executive officers and principal financial officers and disclosure regarding internal controls, codes of ethics and audit committee financial experts, required by §§ 302, 404, 406 and 407 of the Sarbanes-Oxley Act, respectively, and the rules issued by the SEC thereunder, are required to be included in annual reports filed under the Exchange Act but not in Securities Act registration statements. This distinction may well be based on the greater liability under Securities Act registration statements to which issuers, their directors and those members of senior

management required to sign the registration statement are subject. It may also be based on an SEC conclusion that it was appropriate in some cases not to impose additional requirements in connection with initial public offerings registered under the Securities Act.

450 *See* Form 20-F, Item 16G; SEC Release No. 33-8959 (Sept. 23, 2008). Such disclosure became required by the SEC in December 2008 and was already required under NYSE and Nasdaq rules.

451 ADR disclosure, including (i) the fees and charges that holders of ADRs pay for general depositary services (particularly those that must be paid on an annual basis), (ii) whether the depositary has the right to collect fees and other charges by offsetting them against dividends or against deposited securities and (iii) information concerning any payments made from the depositary to the issuer; *see* Form 20-F, Item 12D.3 and Item 12D.4. Additionally, disclosure of the fees and charges that holders of ADRs may have to pay must now be included in an annual report, not only in registration statements as previously required.

452 *See* Form 20-F, Item 16F. This disclosure must include any indication that the auditor will not stand for reelection and any change in any subsidiary auditor on which the principal auditor has expressed reliance in its report. Because part of the purpose of Item 16F is to require disclosure of opinion shopping, this item requires disclosure of adverse, disclaimed or qualified opinions; disagreements with the prior auditor; specified types of audit-related problems of which the prior auditor had advised the issuer; and certain kinds of pre-engagement consultations with the new auditor. Item 16F also requires that the prior auditor provide a letter to the SEC stating whether it agrees with the disclosure in Item 16F, which must be filed as an exhibit to the annual report or registration statement containing such disclosures.

453 *See* SEC Release No. 33-8959 (Sept. 23, 2008).

454 *See* SEC Release No. 34-63549 (Dec. 15, 2010) (the "Mine Safety Release"). *See also* § 4.07[4].

455 *See* SEC Release No. 34-67716 (Aug. 22, 2012). *See also* § 4.08.

456 *See* SEC Release No. 34-78167 (June 27, 2016). *See also* § 4.08.

457 The SEC adopted Regulation NMS under the Exchange Act. Regulation NMS addresses four main topics: (i) order protection (or prohibitions on "trade-through"), (ii) aftermarket access, (iii) sub-penny pricing, and (iv) market data. *See* SEC Release No. 34-51808 (June 9, 2005). The Order Protection Rule (Rule 611) requires market centers to establish, maintain and enforce written policies and procedures that are reasonably designed to ensure the market centers do not execute trades at lower prices than the best automated quotations received.

458 In spite of these advantages, many trades do not occur on the NYSE, Nasdaq, or any other exchange. A substantial percentage of trading in securities occurs off-exchange, in dark pools, alternative trading systems, and high-frequency trading platforms.

459 *See* § 3.04, Note 498 for a discussion of the global share programs for the listing of ordinary shares.

460 A company is also required to list the shares underlying listed ADRs, although the share listing is not for trading purposes.

461 *See* NYSE LISTED COMPANY MANUAL § 103.00. A company's ADRs must be sponsored in order to qualify for listing. NYSE LISTED COMPANY MANUAL § 103.04. Where a foreign issuer does not have a broad liquid market for its shares in its home country, it may nevertheless list ADRs on the NYSE if it satisfies the NYSE's domestic listing standards, which call for a minimum distribution of ADRs in the United States. *See infra* Note 468.

462 In calculating publicly held shares, shares held by directors, officers or their immediate families and concentrated holdings of 10% or more are excluded. NYSE LISTED COMPANY MANUAL § 103.01.

463 For initial public offerings, if necessary, the NYSE may accept a written commitment from an underwriter with respect to the estimated value of the company's offering to determine compliance with the listing standards. If an issuer has a significant concentration of shares or an issuer's public market value has been adversely affected by market forces and would otherwise qualify for a listing, the NYSE will consider stockholders' equity of at least $100 million as an alternate measure of size, if the issuer's public market value is at least $90 million. *See* NYSE LISTED COMPANY MANUAL § 103.01.

464 For initial public offerings, an underwriter must provide a written representation that demonstrates the issuer's ability to meet any applicable market capitalization requirement. NYSE LISTED COMPANY MANUAL § 103.01.

465 A foreign issuer that qualifies as an EGC and avails itself of the provisions permitting EGCs to report only two years of audited financial statements may qualify with pre-tax earnings from continuing operations after minority interest, amortization and equity in the earnings or losses of investees, and as adjusted for certain specified items, of at least $100 million in the aggregate for the last two fiscal years with a minimum of $25 million in each year. NYSE LISTED COMPANY MANUAL § 103.01.

466 Reconciliation to U.S. GAAP for the third year would only be required if the NYSE determines it is necessary to demonstrate that the $100 million threshold is satisfied. NYSE LISTED COMPANY MANUAL § 103.01.

467 Reconciliation to U.S. GAAP for the third year would only be required if the NYSE determines it is necessary to demonstrate that the $100 million threshold is satisfied. NYSE LISTED COMPANY MANUAL § 103.01.

468 NYSE LISTED COMPANY MANUAL § 103.01. A foreign issuer can also elect to qualify under the NYSE's domestic listing standards, which impose substantially less stringent financial tests but require a minimum of (i) 400 U.S. holders of a unit of trading, generally 100 shares ("round lot holders"), or (ii) 2,200 total U.S. stockholders and average monthly U.S. trading volume of 100,000 shares during the most recent six months, or (iii) 500 total U.S. stockholders and average monthly U.S. trading volume of one million shares during the most recent 12 months and a minimum of 1.1 million shares publicly held in the United States, with a market value of at least $40 million in the case of companies that list at the time of their initial public offerings or as a result of spin-offs or under the affiliated company standard, or $100 million for other companies, excluding shares held by directors, officers, their immediate families or 10% or greater shareholders. A per share closing price of at least $4 at the time of an initial public offering is also required. *See* NYSE LISTED COMPANY MANUAL § 102.01. (If an issuer has a significant concentration of shares or an issuer's public market value has been adversely affected by market forces and would otherwise qualify for a listing, the NYSE will consider stockholders' equity of at least $40 million or $100 million, as applicable, as an alternate measure of size, if the issuer's public market value is no more than 10% below the minimum of $40 million or $100 million, as applicable.) For initial public offerings, if necessary, the NYSE may accept a written commitment from an underwriter with respect to the estimated value of the company's offering to determine compliance with the listing standards. *See* NYSE LISTED COMPANY MANUAL § 103.01.

Under the domestic listing standards, the NYSE also requires companies to meet one of three alternative financial standards (determined under U.S. GAAP) based on earnings, operating cash flow or global market capitalization, as follows: (i) to have aggregate pre-tax earnings from continuing operations, after minority interest, amortization and equity in the earnings or losses of investees, and as adjusted for certain specified items, of $10 million in the aggregate for the last three fiscal years, together with a minimum $2 million in each of the preceding two fiscal years and positive amounts in all three years, or (ii) to have aggregate pre-tax earnings from continuing operations, after minority interest, amortization and equity in the earnings or losses of investees and as adjusted for certain specified items, of $12 million in the aggregate for the last three fiscal years, with a minimum of $5 million in the most recent fiscal year and $2 million in the next most recent fiscal year (with an underwriter providing a written representation that demonstrates the company's ability to meet the market capitalization requirement upon completion of the offering), or (iii) a global market capitalization of at least $200 million. A company that qualifies as an EGC and avails itself of the provisions permitting EGCs to report only two years of audited financial statements can qualify under a separate test with pre-tax earnings from continuing operations after minority interest, amortization and equity in the earnings or losses of investees, and as adjusted for certain specified items, of at least $10 million in the aggregate for the last two fiscal years with a minimum of $2 million in each year. *See* NYSE LISTED COMPANY MANUAL § 102.01.

469 *See* NYSE LISTED COMPANY MANUAL § 103.01.

470 *See* NYSE MARKET COMPANY GUIDE § 101 for the domestic standards.

471 In calculating publicly held shares, shares held by directors, officers or their immediate families and concentrated holdings of 10% or more are excluded. NYSE LISTED COMPANY MANUAL § 102.

472 *See* NYSE COMPANY GUIDE § 110.

473 *See* NYSE LISTED COMPANY MANUAL § 104.00.

474 The total fees that may be billed to an issuer in a calendar year are capped at $500,000. NYSE LISTED COMPANY MANUAL § 902.02. In the case of a listing of ADRs, the NYSE fees are determined on the basis of the number of ADRs outstanding rather than the number of shares.

475 *See* NYSE LISTED COMPANY MANUAL § 703.00.

476 For a discussion of the NYSE policies applicable to listed foreign issuers, *see* §§ 5.02[1] and 5.05.

477 *See generally* Chapter 5 for a detailed discussion of the corporate governance requirements applicable to NYSE-listed foreign issuers.

478 In February 2008, Nasdaq acquired the OMX Group to become The Nasdaq OMX Group, Inc.

479 Nasdaq/GSM has higher initial listing standards than Nasdaq Global Market, while the continued listing standards are the same for both. The principal difference between Nasdaq Global Market and Nasdaq Capital Market is that the former presents the last sale prices of a security on an immediate basis, while the latter reports only current bid and offered quotations. Nasdaq and the AMEX merged in 1998. In January 2005, the members of the AMEX repurchased the exchange from Nasdaq, as a result of which Nasdaq and the American Stock Exchange re-separated. *See* Press Release, The American Stock Exchange, Transaction Closes Transferring Control of AMEX to Members (Jan. 3, 2005). On October 1, 2008, the NYSE Euronext completed its purchase of the AMEX, which is now known as NYSE MKT.

480 *See generally* NASDAQ Marketplace Rules, Rules 5300, 5300 and 5400, NASDAQ Manual .

481 For this purpose, any shares held by officers and directors of the issuer or by holders of more than 10% of such shares are deemed not to be publicly held.

482 Under NASDAQ Marketplace Rule 5000(a)(21), "listed securities" is defined as "securities listed on Nasdaq or another national securities exchange."

483 NASDAQ Marketplace Rules, Rules 5500, 5215(a), NASDAQ MANUAL. Rule 5500 is applicable to U.S. domestic and Canadian issuers, and Rule 5215(a) is applicable to non-Canadian foreign issuers. Both rules provide for essentially the same requirements. In the case of ADRs, however, the underlying shares will be considered when determining the ADR's qualification for listing on Nasdaq.

484 NASDAQ Marketplace Rules, Rule 5000 and 5700, NASDAQ MANUAL.

485 NASDAQ Marketplace Rules, Rule 5315, NASDAQ MANUAL.

486 NASDAQ Marketplace Rules, Rules 5225, 5300, 5400, 5500, NASDAQ MANUAL. The maintenance listing standards for the Nasdaq/GSM and the Nasdaq Global Market are the same. Under Rule 5215(a), non-Canadian foreign issuers listed on the Nasdaq Capital Market are subject to the same minimum $1 bid price and $1 million market value of publicly held shares requirements for continued listing as are applicable to U.S. domestic and Canadian issuers. *See* SEC Release No. 34-51221 (Feb. 17, 2005).

487 For a discussion of the Nasdaq policies applicable to listed foreign issuers, *see* §§ 5.02[1] and 5.05.

488 *See generally* Chapter 5 for a detailed discussion of the corporate governance requirements applicable to Nasdaq-listed foreign issuers.

U.S. Regulation of the International Securities and Derivatives Markets, § 3.04, AMERICAN DEPOSITARY RECEIPT PROGRAMS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 3.04 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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ADR programs permit U.S. investors to invest in foreign securities in a form that trades in dollars with standard settlement timing [489] in the United

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States. [490] They also make available services such as conversion of dividend payments into dollars and distributions of proxy materials. [491] The SEC permits foreign companies, with the assistance of U.S. depositary banks, to create OTC ADR programs for shares already outstanding if the foreign company, among other things, makes available certain information in English on its website that it makes publicly available in its home country. As long as the issuer makes such information available, does not offer or sell its securities publicly in the United States or list its securities on a U.S. exchange and maintains a listing of the relevant class of its equity securities on one or more non-U.S. exchanges that are, in the aggregate, the primary trading market for that class of securities, it is exempt from the requirement that it register its equity securities under the Exchange Act by reason of the number of U.S. holders. [492] If an issuer offers or sells its ADRs publicly in the United States, or lists its ADRs on a U.S. exchange, the ADRs and the underlying securities must, as in the case of other public offerings or exchange listings, be registered under the Securities Act and the

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Exchange Act, respectively, as a result of which the issuer of the underlying securities becomes subject to SEC reporting and disclosure requirements, including the requirements of the Sarbanes-Oxley Act and the Dodd-Frank Act. [493]

Many applications for ADRs exist. ADRs have been used in connection with mergers and acquisitions, [494] restructurings, [495] privatizations [496] and employee benefit and compensation plans. [497] In addition, many offerings of ADRs have been made under Rule 144A under the Securities Act.

As an alternative to establishing an ADR program, a foreign issuer that is making arrangements for a U.S. listing may list its ordinary shares directly, including through a "global registered share" (or "global share") program (under which ownership of shares is recorded in a single global register regardless of whether the particular shares are acquired on a U.S. exchange or a foreign exchange) [498] or in a form adapted to the needs of U.S. investors (for instance "shares of New York Registry," such as those issued by Koninklijke Philips N.V. and ArcelorMittal). For a variety of reasons, issuers have generally preferred establishing ADR programs rather than listing their shares directly, and ADR listings are far more common than direct listing of foreign issuers' shares on U.S. exchanges.

[1] Principal Features of ADRs

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ADRs are instruments issued in registered form that evidence interests in securities of a foreign issuer. ADRs are usually issued by a U.S. commercial bank (the "Depositary") with whose foreign correspondent (the "Custodian") the underlying shares have been deposited. An ADR holder generally can exchange ADRs for the underlying shares at any time, and similarly, additional shares generally can be deposited against issuance of additional ADRs. [499]

Each ADR can represent, at the option of those creating the ADR program, one foreign share or a greater or lesser number of foreign shares, including fractions. The principal consideration in fixing the ratio of ADRs to shares is to arrive at a price per ADR that is believed to be attractive to U.S. investors.

The ADR mechanism was developed to overcome certain practical difficulties confronting residents of the United States who invest in shares of foreign companies. Some of these difficulties arise when these shares are available only in bearer form. Bearer shares are generally ineligible for a direct U.S. listing. [500] Additionally, dividends and other payments in respect of bearer shares are usually announced in foreign financial newspapers, and U.S. shareholders thus may not know when dividends are payable or how to obtain payment. ADR Depositaries collect the dividends paid on the shares on deposit with the Custodian, convert them into dollars if they are paid in a foreign currency and make payments to the holders of the ADRs. [501] ADRs also appeal to certain institutional investors whose investment restrictions limit them to securities that trade and settle in dollars.

The Depositary customarily informs ADR holders of important developments announced by the issuer of the underlying shares, such as recapitalization plans, exchange offers and subscription rights. In most cases, the Depositary

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informs ADR holders of matters submitted for the vote of shareholders. Depositaries will vote the shares they hold in accordance with instructions from ADR holders, and are often willing, subject to certain conditions, to vote shares for which no instruction is given in accordance with management's direction or in the same proportion that all other outstanding shares are voted. [502]

ADRs also facilitate the transfer of ownership. Whereas a holder of registered shares of a foreign company may be required to follow burdensome transfer procedures (including sending the certificates abroad for transfer and paying transfer taxes), ADRs may be transferred on the books of the Depositary in the United States in the same manner as shares of U.S. issuers. [503]

The Depositary ordinarily assists ADR holders with filings necessary for any reduction in foreign withholding tax on dividend payments that may be available under a tax treaty. The United States has entered into tax treaties with most of its major trading partners under which the rate of withholding tax imposed on dividends is generally limited to 15% for portfolio investors (*i.e.*, shareholders that do not hold substantial positions in the stock of the company paying the dividend). [504] The marketability of ADRs in the United States can be enhanced to the extent that the issuer makes arrangements with the Depositary for expedited procedures for claiming a reduced withholding rate and any other benefits to which a U.S. holder is entitled under a tax treaty. [505]

[2] Sponsorship

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A foreign company that wishes to "sponsor" an ADR program enters into a deposit agreement with the Depositary. The deposit agreement sets out the rights and obligations of the company, the Depositary and the ADR holders with respect to the creation and maintenance of the deposit facility. It covers such matters as the issuance of ADRs upon deposit of underlying shares (and the withdrawal of underlying shares upon presentation of ADRs), the treatment of dividends and other distributions, the procedure for voting the underlying shares and how the deposit agreement can be amended or terminated. Generally, the company agrees to indemnify the Depositary for liabilities arising in connection with the program. The deposit agreement also specifies the fees the Depositary will charge ADR holders, which are typically limited to charges for issuing and canceling ADRs.

An ADR program may also be "unsponsored," meaning that it is set up by a Depositary without the company's participation or even its consent. A Depositary will typically establish an unsponsored ADR program only if it believes that there is sufficient interest in the company's shares to generate adequate fee income, or if a broker-dealer has requested such a program and agreed to assist with the expense. While unsponsored ADRs are issued without the foreign issuer's cooperation, the foreign issuer must be a reporting company under the Exchange Act or exempt under Rule 12g3-2(b) [506] from the reporting requirements of that Act. Typically, the Depositary will request a letter of nonobjection from the issuer before establishing the program. Furthermore, the SEC staff takes the position that an SEC-registered unsponsored program may not coexist with an SEC-registered sponsored program for the same securities because of the potential for resulting market disorder. [507]

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In the case of a sponsored ADR program, the deposit agreement will specify the Depositary's fees for its services. Although the Depositary may seek reimbursement from the issuer for all or part of its expenses in establishing the program and payment of an administrative fee covering many of its ongoing services, additional fees for certain other services and reimbursement of its ongoing out-of-pocket expenses (postage, for example, in connection with mailing reports to ADR holders), in many cases depositaries will waive these fees and expenses and provide additional services or cash payments to the issuer in order to secure the opportunity to administer an ADR program. The details of the agreement between the issuer and the Depositary regarding fees, expenses and services are usually documented in a separate fee letter. [508] Depositaries for unsponsored ADRs generally charge fees to holders for the issuance and cancellation of ADRs and for services of the Depositary principally for the distribution of dividends.

[3] Registration

The creation of an ADR program where ADRs, whether sponsored or unsponsored, are newly issued and sold to the public, requires the registration of the ADRs under the Securities Act, since the SEC views the ADRs as newly issued securities separate from the underlying shares. [509] The establishment of an ADR program for underlying shares that are already outstanding and freely tradeable does not, however, require registration of the underlying shares under the Securities Act. [510]

The registration statement form for ADRs (which is separate from the registration statement for the shares to be deposited, if required as discussed below),

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Form F-6, is simple. [511] It requires certain information concerning the depositary arrangements and consists of little more than the deposit agreement (if the program is sponsored) and a sample ADR certificate (which constitutes the prospectus for purposes of the Securities Act). [512]

Use of Form F-6 is subject to three conditions. First, holders of the ADRs must generally be entitled to withdraw the underlying securities at any time. This right of withdrawal may be subject to (i) temporary delays caused by closing the transfer books of the Depositary or the issuer of the underlying shares in connection with voting at a shareholders' meeting or the payment of dividends, (ii) the payment of fees, taxes and similar charges and (iii) compliance with any laws or governmental regulations relating to ADRs or to the withdrawal of deposited shares. While this condition is intended to assure fungibility between the ADRs and the underlying securities, the third exception permits the creation of ADRs where the local law of the country of the issuer of the underlying shares restricts foreign ownership of the shares themselves. Second, the shares to be deposited must either be registered under the Securities Act or be freely tradeable by the depositors. Finally, the issuer of the underlying shares must (i) be a reporting company under the Exchange Act or (ii) be exempt from such reporting pursuant to Rule 12g3-2(b) thereunder. [513]

An issuer should consider the advantages and disadvantages of a Rule 12g3-2(b) exemption where it is not otherwise required. On the one hand, for example, apart from permitting the establishment of an ADR facility, a Rule 12g3-2(b) exemption can also be useful in facilitating access to the U.S. capital

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markets through Rule 144A placements. [514] On the other hand, if an issuer has a Rule 12g3-2(b) exemption but does not have a sponsored ADR program, Depositaries will be able to establish their own unsponsored ADR facilities without the issuer's consent, even though typically Depositaries request a letter of nonobjection from the issuer prior to establishment of their ADR facilities. The existence of unsponsored ADR facilities may become an obstacle to an issuer's registering a sponsored ADR facility later on, since it is the SEC's position that a sponsored ADR facility may not be registered unless all registered unsponsored ADR facilities relating to the same underlying securities are terminated. In such case, negotiated fees for cancellation of the unsponsored ADRs must be paid to their Depositaries; these fees can be significant and are typically borne by the issuer or by the Depositary of the new sponsored facility. According to the SEC, "[s]ometimes these fees have been disputed and the processing of withdrawal requests and establishment of the sponsored facility are delayed until negotiations are concluded." [515]

[4] Pre-Release

When a broker or other purchaser buys shares of a foreign corporation, its receipt of the shares may be delayed as a result of settlement procedures in the foreign country. Depositaries often reserve the right to "pre-release" ADRs, *i.e.*, to issue ADRs in respect of shares that have not yet been deposited with the Custodian, to enable these purchasers to sell ADRs representing the shares in the United States prior to the settlement date for the shares. Depositaries may also reserve the right to pre-release shares underlying the ADRs to allow purchasers of ADRs to sell the underlying shares prior to the settlement date for the ADRs. In the ADR Concept Release, the SEC noted the following with respect to pre-releases:

> Certain depositaries have established guidelines as to the amount of pre-release lending they will undertake, *e.g.*, 15% to 20% of the total amount of ADRs outstanding in the facility, although such limitations are not absolute. At least some depositaries undertake pre-release lending only upon the deposit of collateral that is marked to
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> market daily and after certification from the borrower that it has purchased the securities and will deposit them upon settlement. While some depositaries provide the right to demand the return of an ADR issued in a pre-release lending situation (either after a pre-determined period or after notice), few appear to prevent the borrower from transferring the pre-released ADR or withdrawing the not yet deposited security before it has been deposited. Withdrawal requests in that case presumably are satisfied by delivery of a security deposited by another ADR holder. [516]

Since no regulatory limitations are imposed on the amount of ADRs that may be issued on a pre-released basis, pre-release can reach levels far in excess of the self-imposed guidelines described above.

Pre-release agreements should contain provisions that ensure pre-released ADRs will be treated the same as the underlying shares for U.S. and foreign tax purposes. If pre-released ADRs are not treated the same as the underlying shares for such purposes, because, for example, the Custodian is not the owner of the shares while the pre-release is outstanding, ADR holders may not be eligible for the U.S. and foreign tax benefits associated with the ADRs, and in particular may not be able to claim the reduced tax rate applicable to some dividends earned by U.S. individuals, tax treaty benefits (such as a reduced rate of withholding tax, and the additional payments available under some treaties) or U.S. tax credits for foreign taxes withheld from dividend distributions. [517] If, however, the person obtaining the pre-released ADRs in fact owns the underlying shares and agrees to transfer its ownership interest in the shares to the Depositary pursuant to the pre-release transaction, the Depositary should be treated as the owner of the underlying shares for U.S. tax purposes even if it is not the registered holder of the shares. As described above, ADR programs typically incorporate provisions that are intended to ensure this result. [518]

Footnotes

489 Rule 15c6-1 under the Exchange Act makes three business days (T+3) the standard settlement time for securities trades that involve broker-dealers, subject to specified exceptions. SEC Release No. 34-35705 (May 11, 1995) (the "T+3 Release"). The SEC has proposed an amendment to Rule 15c6-1(a) under the Exchange Act that would shorten this standard settlement cycle from three business days after the trade date to two business days (T+2). SEC Release No. 34-78962 (Sept. 28, 2016) (the "T+2 Proposing Release"). Among other exceptions to T+3 settlement, Rule 15c6-1 makes four business days (T+4) the standard settlement time in the case of sales for cash of securities that are sold by an issuer to an underwriter on a firm commitment basis in an offering registered under the Securities Act, or sold to an initial investor by a broker-dealer participating in such an offering, if the securities are priced after 4:30 P.M. Eastern time. The T+2 Proposing Release does not include any proposed change to the T+4 settlement cycle applicable to such transactions (but does solicit comment on whether any adjustment should be made). Rule 15c6-1 under the Exchange Act allows broker-dealers and their customers to agree to a different settlement cycle if the agreement is express and is reached at the time of the transaction. The rule states that such an express agreement will be deemed to have been made by all parties contracting for the sale of securities that are sold for cash pursuant to a firm commitment offering if the managing underwriter and the issuer have agreed upon an alternate settlement cycle for the securities sold pursuant to the offering and the parties do not agree otherwise between themselves.

The SEC recognized that using a standard U.S. settlement cycle could create difficulties for broker-dealers that purchase and sell securities in non-U.S. markets because the purchase or sale executed in the non-U.S. market will settle in accordance with the local settlement cycle. SEC Release No. 33-7170 (May 22, 1995) (the "Non-U.S. Securities Release"). Where the local settlement cycle is longer than the standard U.S. settlement cycle, the broker-dealer will be unable to meet its obligations to its U.S. customers. In the Non-U.S. Securities Release, the SEC accordingly provided limited exemptions from Rule 15c6-1 for (i) securities of foreign issuers for which there is no transfer agent in the United States and that are not eligible for deposit at a registered clearing agency, (ii) securities of foreign issuers for which transfer or delivery facilities exist both inside and outside the United States, if the annual trading in such securities in the United States constitutes less than 10% of the aggregate worldwide trading volume, and (iii) contracts for the purchase and sale of securities of foreign issuers that are executed by a U.S. broker-dealer outside the United States and that provide for delivery or payment outside the United States. For purposes of these exemptions, an ADR is considered a separate security from the underlying instrument. This may have a number of implications. For example, if there are transfer facilities in the United States for an issue of ADRs, but not for the underlying instrument, transactions in the underlying instrument will be exempt from the rule pursuant to the exemption described in (i) above, but transactions in the ADRs would not be. If none of the exemptions set forth in the Non-U.S. Securities Release is available, a broker-dealer engaged in a foreign securities transaction may still agree with its customer on a settlement period longer than three business days, pursuant to the provisions of Rule 15c6-1 itself described above. The T+2 Proposing Release notes the relief granted in the Non-U.S. Securities Release without proposing any changes to that relief.

490 The SEC's regulations make a distinction between ADRs and American Depositary Shares ("ADSs"). According to the SEC, "under this distinction, an ADR is the physical certificate that evidences ADSs (in much the same way a stock certificate evidences shares of stock), and an ADS is the security that represents an ownership interest in deposited securities (in much the same way a share of stock represents an ownership interest in a corporation). Although conceptually accurate, some confusion has resulted from this distinction, and it appears that ADR market participants largely do not differentiate between ADRs and ADSs." SEC Release No. 33-6894 (May 23, 1991) (the "ADR Concept Release"). This book follows the approach of the ADR Concept Release. The term "ADS" is not used, and the term "ADR" may, depending

on its context, refer to either the physical certificate or the security evidenced by such certificate.

Since ADRs are rarely issued to represent debt securities, the following discussion assumes that the securities underlying ADRs are equity securities. The mechanics of an ADR program for debt securities are, nevertheless, basically the same as those described in the text.

491 Foreign issuers are exempt from the proxy solicitation rules under § 14 of the Exchange Act. *See* § 4.02[3][c][v].

492 *See* Rule 12g3-2(b) under the Exchange Act and the discussion in § 4.02[3][a][iv].

493 *See* Chapters 4 and 5. To obtain a quotation on the OTC Bulletin Board for their equity securities, issuers must generally be subject to the periodic reporting requirements of the Exchange Act, which, among other things, also subjects them to the Sarbanes-Oxley Act and the Dodd-Frank Act. *See supra* Note 31 for discussion of the OTC Bulletin Board. An issuer would not become subject to the reporting requirements of the Exchange Act or to the Sarbanes-Oxley or Dodd-Frank Acts by sponsoring an ADR program that is not accompanied by an exchange listing or quotation on the OTC Bulletin Board.

494 Two significant examples of an acquisition involving the issuance of ADRs are the 1998 acquisition by The British Petroleum Company p.l.c. of Amoco Corporation and the 2000 acquisition of Seagram by Vivendi. Other examples of mergers and acquisitions involving the issuance of ADRs are set out in the ADR Concept Release.

495 Racal Electronics spun off its cellular telephone subsidiary, Racal Telecom, in a 4.5 million ADR issue valued at $150 million. *See* Beth McGoldrick, *For ADRs, It Pays to Get Into Debt*, EUROMONEY 103, 104 (Dec. 1988) (cited in the ADR Concept Release).

496 For example, in 1996 the Italian government, in connection with the privatization of its state-owned insurance company INA, issued notes that were exchangeable for INA shares or for ADRs representing such shares.

497 For example, an ADR-funded benefit plan was said to help British Airways maintain favorable relations with U.S. employees by ensuring equal treatment with U.K. employees. Barbara Loos, *Deflecting the Raging Bull*, EUROMONEY SPECIAL SUPPLEMENT 21, 5, 25 (Feb. 1988) (cited in the ADR Concept Release).

498 DaimlerChrysler AG (now Daimler AG) was the first to issue global shares, in November 1998, though its shares no longer trade in that form. Only a small number of global share programs have ever been established, and half of those no longer exist (although shares of UBS Group AG, initially listed as UBS AG, and Deutsche Bank Aktiengesellschaft continue to trade in the form of global shares).

499 In certain foreign jurisdictions, however, laws or local practice relating to foreign ownership of domestic companies may limit ADR program sizes by prohibiting the deposit of additional shares and the resulting creation of additional ADRs. Form F-6 requires ADR holders to be permitted to withdraw deposited securities at any time, subject to limitations imposed for procedural reasons or to comply with local law. Form F-6, General Instruction I.A.1.

500 Shares in bearer form are generally ineligible for listing on the principal U.S. securities exchanges because of the difficulty of demonstrating that there are a sufficient number of U.S. shareholders to satisfy the exchange's listing requirements. The ADR mechanism allows the issuer of shares available only in bearer form to overcome the difficulty of demonstrating that it has sufficient U.S. shareholders to qualify for a listing in the United States. In addition, the requirements of the NYSE and Nasdaq with respect to registrars and transfer agents are such that only registered shares can be listed. *See* NYSE LISTED COMPANY MANUAL § 601.01.

501 The NYSE and Nasdaq permit charging ADR depositary dividend and servicing fees to investors. *See* SEC Release No. 34-53978 (June 13, 2006). Nonetheless, the ability of the Depositary to charge these fees to ADR holders is governed by the terms of the relevant deposit agreement.

502 On July 1, 2009, the SEC approved NYSE amendment number four to NYSE Rule 452, which took effect on January 1, 2010 and eliminated a practice known as broker discretionary voting with respect to director elections. *See* SEC Release No. 34-60215 (July 1, 2009). Rule 452 applies to all NYSE member

organizations, including with regard to the securities of foreign issuers. As such, NYSE member brokers voting shares in an election of a director at any public company (except for companies registered under the Investment Company Act of 1940) may not vote the shares held in their clients' accounts without having first received voting instructions from the beneficial holders of such shares. *See* SEC Release No. 34-60215 (July 1, 2009). The Dodd-Frank Act also imposed a prohibition on broker discretionary voting for matters relating to executive compensation and for other significant matters. *See* § 957 of the Dodd-Frank Act (prohibiting member organizations from voting shares on executive compensation matters without specific client instructions). However, neither NYSE Rule 452 nor § 957 of the Dodd-Frank Act affects the ability of the Depositary to vote or grant proxies pursuant to the ADR deposit agreement, since neither NYSE Rule 452 nor § 957 of the Dodd-Frank Act extends beyond NYSE members and the Depositary generally is not a NYSE member.

503 In order to be eligible for listing on the principal U.S. securities exchanges, the shares of a foreign company must be able to trade "regular-way" (*i.e.*, with settlement in three days under current rules or two days if the amendment proposed in the T+2 Proposing Release is adopted). If the home market of a foreign company does not have three-day settlement, the company can meet this requirement by establishing a share register in New York City or, alternatively, by creating an ADR program. *See supra* Note 489 for a discussion of the securities trade settlement schedule.

504 The 15% rate applies, for example, under the U.S. income tax treaties with France, Germany and Japan.

505 For example, certain tax treaties allow U.S. shareholders to claim a payment in respect of certain taxes paid by the company in its home jurisdiction (generally corresponding to tax credits that are available to local shareholders). The process of claiming such payments, as well as the process of obtaining a reduction of withholding taxes to the designated treaty rate, may in some cases be somewhat complex. In such cases, the Depositary may be able to facilitate ADR holders' ability to obtain such relief, for example by submitting the requisite documentation directly to the local tax authorities on behalf of all eligible U.S. holders.

506 Prior to August 2008, foreign companies were required to affirmatively seek an exemption under Rule 12g3-2(b) by making certain filings with the SEC. Since then, a foreign company is automatically exempt from registering a class of securities under § 12(g) of the Exchange Act if it (i) has no active reporting obligations under § 13(a) or § 15(d) of the Exchange Act (this means essentially that the foreign company has not listed or publicly offered securities in the United States), (ii) maintains a listing of such shares on one or more non-U.S. exchanges that are, in the aggregate, its primary trading market and (iii) publishes on its website, in English, the material information that it makes public in its home country, files with the principal exchange(s) in its primary trading market or distributes to its securityholders. *See* SEC Release No. 34-58465 (Sept. 5, 2008).

507 ADR Concept Release. Programs that are not SEC-registered, whether or not sponsored, may coexist. Unregistered programs generally consist of Rule 144A or Regulation S facilities. *See* §§ 7.02[3] for a discussion of Rule 144A, 8.02 for a discussion of Regulation S and 8.02[1][e] for a discussion of the interaction between Regulation S and Rule 144A.

508 Issuers must disclose in registration statements and annual reports on Form 20-F information concerning any payments made from the Depositary to the issuer. *See* Form 20-F, Item 12D.4.

509 When U.S. commercial banks first issued ADRs, they took the position that the ADRs were securities issued by U.S. banks and thus exempt from registration under § 3(a)(2) of the Securities Act (which exempts from registration securities issued or guaranteed by banks, as discussed in § 3.05[2]). However, the SEC rejected this position (because the security did not represent any interest in the bank but rather an interest in a third party or its obligation) and began to seek registration of ADRs. The commercial banks objected to the attempt to make them subject to the civil disclosure liability provisions of the Securities Act and the Exchange Act with respect to the ADRs and the underlying shares. As a compromise, the SEC decided to permit Depositaries to register ADRs on behalf of the ADR program itself, which is considered the issuer of the ADRs. As a result, the banks have no such liability with respect to the registration

statement; the liability is that of the program itself. *See* the ADR Concept Release.

510 *See* the discussion of registration under the Securities Act in § 3.04[3]. Unregistered ADR facilities can be created for the issuance of restricted ADRs in private placements under the Securities Act (*e.g.*, in accordance with Rule 144A). The establishment of such unregistered, restricted facilities in connection with private placements that are conducted in conjunction with Euro-offerings, followed by the filing of registration statements on Form F-6 for public U.S. ADR programs, has given rise to concerns on the part of the SEC regarding "leakage" of securities from the restricted to the public program.

511 A filing fee is collected by the SEC in connection with registration under the Securities Act. For registration statements on Form F-6, the fee is calculated on the maximum aggregate charges to be imposed in connection with the issuance of the ADRs. Rule 457(k) under the Securities Act. For a discussion of Securities Act filing fees, *see supra* Note 63.

512 If the deposit agreement to be used contains terms identical to those in effect for a program the Depositary has already registered, the Depositary may generally designate a date and time for the registration statement on Form F-6 to become effective. Rule 466 under the Securities Act. However, because the SEC applies this rule quite strictly, Depositaries derive little benefit from it. Notably, although § 15(d) of the Exchange Act generally imposes periodic reporting obligations on an issuer that has filed a registration statement that has become effective under the Securities Act, periodic reports are not required with respect to ADRs registered on Form F-6. Rule 15d-3 under the Exchange Act. The Depositary must, however, furnish semi-annually to the SEC information about the number of ADRs issued and canceled during the period, and make available at its principal office for inspection all reports and communications received by the Depositary as record owner of the underlying shares (if the underlying shares are issued in registered form).

513 Form F-6, General Instruction I.A.3. *See* § 4.02[3][a] for a discussion of the Exchange Act registration requirements, including the related Rule 12g3-2(b) exemption.

514 *See* Rule 144A(d)(4)(i) under the Securities Act.

515 ADR Concept Release, American Depositary Receipts, 56 Fed. Reg. 24,420, 24,425 (May 30, 1991). The SEC has considered the functioning and characteristics of the ADR marketplace and its regulation under the federal securities laws, including the issue of whether sponsored and unsponsored ADR facilities relating to the same underlying securities should be allowed to coexist. The ADR Concept Release contains a full discussion of the differences between sponsored and unsponsored programs. The SEC did not propose or adopt any rules as a result of the ADR Concept Release. *See* SEC Release No. 33-8287 (Sept. 11, 2003).

516 ADR Concept Release, American Depositary Receipts, 56 Fed. Reg. 24,420, 24,426 (May 30, 1991).

517 *See supra* Note 505 and accompanying text.

518 A typical provision in a deposit agreement limiting pre-release provides as follows:

> Neither the Depositary nor the Custodian will lend Deposited Securities. The Depositary may issue Receipts against rights to receive Shares from the Company, or any registrar, transfer agent, clearing agency or other agent of the Company recording Share ownership or transactions. The Depositary will not issue Receipts against other rights to receive Shares unless (i) such Receipts are fully collateralized (marked to market daily) with cash or U.S. government securities until such Shares are deposited, (ii) the applicant for such Receipts represents in writing that it was the beneficial owner of such Shares before the issuance of such Receipts, and has assigned all beneficial right, title and interest in such Shares to the Depositary for the benefit of the Holders and will hold them for the account of the Depositary until delivery upon the Depositary's request and (iii) all such Receipts represent not more than 20% of the Shares actually deposited. Such collateral, but not the earnings thereon, will be

> held for the benefit of the Holders. The Depositary may retain for its own account any compensation for the issuance of Receipts against such other rights to receive Shares, including without limitation earnings on the collateral securing such rights.

While this provision limits pre-release to 20% of the shares outstanding, many agreements do not have a firm percentage limitation. In addition, there are often further limitations on pre-release contained in a pre-release side letter (which, in SEC-registered ADR programs, generally is filed as an exhibit to the Form F-6 registration statement pursuant to Item 3(b)).

U.S. Regulation of the International Securities and Derivatives Markets, § 3.05, DEBT OFFERINGS IN THE UNITED STATES

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 3.05 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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The requirements discussed in § 3.02 regarding registration of equity securities are also generally applicable to registration of public offerings of debt securities in the United States. However, there are certain special considerations relating to registration of debt offerings.

[1] Foreign Sovereign Issuers, Supranational Issuers, Issuers of Foreign Government-Backed Securities

Foreign sovereign issuers, certain supranational issuers and certain issuers of foreign government-guaranteed securities are permitted to provide less (and different) information than foreign private issuers. The applicable requirements are set out in Schedule B to the Securities Act. [519]

The Securities Act provides that Schedule B applies to "a security issued by a foreign government or political subdivision thereof," [520] which has been read to include national governments and governments of states, provinces and

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municipalities. The SEC staff has also interpreted this provision to permit certain supranational organizations [521] and certain issuers of foreign government-guaranteed securities to use Schedule B for the registration of their securities. [522]

The SEC staff has also historically viewed certain issuers as political subdivisions of, or as agencies or instrumentalities of, their nation's governments and thus eligible to employ Schedule B because investments in such issuers are secure from default to a degree equivalent to that of a sovereign credit. [523] In taking this position, the staff has generally given primary consideration to the interplay of three criteria: (i) guarantees or support of the issuer's securities by the sovereign credit, (ii) government ownership of the issuer, and (iii) government control of the issuer. With respect to the government guarantee, the SEC staff has accepted express guarantees, statutory guarantees and statutory provisions or legal requirements to provide the issuer with sufficient funds to enable the issuer to meet its obligations, which in the last case do not necessarily confer on the securityholders a direct right against the government. Whatever the mechanism for the government backing, the SEC has generally taken the position that the support of the foreign government for the issuing entity must carry with it the "full faith and credit" of the foreign government, and the SEC has looked to the legal opinion of local counsel as authority for the foreign government's guarantee or other necessary support. However, under certain circumstances (and always on a case-by-case basis), the SEC has granted Schedule B status where

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the foreign government's (or governments') support took the form of a "keepwell" arrangement, which unlike a guarantee cannot be enforced by the beneficiary. [524] Such "keepwell" arrangements are generally evidenced by statutes, general principles of administrative law and international agreements, such as an undertaking by member countries party to an international agreement establishing the issuer to make payment on callable capital. [525]

While Schedule B issuers have generally been wholly or substantially wholly owned by the related government, the SEC staff has permitted a few widely held, publicly listed issuers to use Schedule B. The staff has generally accepted as sufficient various combinations of general supervision, budgetary control and appointment of directors, officers or examiners by the related government. In determining whether an issuer should be treated as a part of a foreign government, the SEC staff has applied these criteria of government support, ownership and control as a whole on the basis of all the relevant facts and circumstances. Out of concerns for comity, the staff has historically avoided deciding an issuer's eligibility for Schedule B on the basis of the nature of its operations.

Where an instrumentality of a foreign government has been permitted to register under Schedule B, both the instrumentality as issuer and the government as guarantor or provider of other support have been required to register under Schedule B and sign the registration statement. [526] The issuer's authorized representative in the United States must also sign the registration statement. In these cases, as discussed below, the issuer is not required to meet all of the requirements of the detailed SEC rules applicable to disclosure by foreign private issuers.

There is no specific SEC form for disclosure for offerings falling within Schedule B. However, over the years the disclosure format for a sovereign issuer

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has become highly standardized, and includes substantial information not specifically called for by Schedule B about the country concerned, its form of government and general political situation, the principal features of its economy, its natural resources, population, trade, balance of payments, public sector finances and indebtedness, other factors affecting the availability of the currency in which the proposed U.S. public offering is to be made, the terms of the securities, risk factors, where appropriate, and any other information that would be considered material by investors in deciding whether to invest in the securities being offered or that is needed to ensure that the statements made in the prospectus are not misleading. Although Schedule B expressly requires as exhibits to the registration statement only the underwriting agreement and opinions as to the legality of the securities, customary practice includes filing fiscal agency agreements, indentures and certain other documents.

In the case of securities that are guaranteed by a foreign government, essentially the same disclosure requirements apply to the government. [527] Disclosure is also required about the issuer of the securities, [528] the sovereign and the issuer's relationship to its government, [529] but the specific requirements of Form 20-F (applicable to foreign private issuers) do not apply to an issuer that the SEC staff views as eligible to use Schedule B, although such requirements may provide useful guidelines as to information that would be considered material to investors. In particular, Regulations S-K and S-X do not generally apply to Schedule B filers, although some provisions are generally followed by analogy, and debt securities issued or guaranteed by a Schedule B filer are exempted from the provisions of the Trust Indenture Act. Schedule B filers are also exempt from Sarbanes-Oxley Act certification and auditor attestation requirements. The financial statements of such a foreign issuer are not required to be reconciled to U.S. GAAP, but instead such an issuer may provide its most recent available financial statements in the form in which they are ordinarily prepared and presented (translated into English), with no independent audit requirement. The SEC has accepted filings with financial statements prepared in accordance with IFRS as

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adopted by the EU, which it does not accept for private issuers that use IFRS (they are required to use the version of IFRS published by the IASB). Moreover, a considerable amount of other disclosure mandated by Form 20-F is in practice not included, or is provided only in reduced form, on the theory that the most important disclosure in connection with the offering pertains to the related government.

[2] Securities Issued or Guaranteed by Banks

Section 3(a)(2) of the Securities Act exempts from registration all securities issued or guaranteed by a bank organized under the laws of the United States or any state. [530] This exemption is not available to securities issued or guaranteed by a bank holding company that is not itself a bank; those securities must be registered with the SEC if issued to the public.

The SEC, implementing its policy of national treatment, has determined that U.S. federal or state branches or agencies of foreign banks should have the same right to issue or guarantee securities as their U.S. counterparts. [531] Thus, many U.S. branches and agencies of foreign banks have publicly offered and sold notes in the United States, in some cases with all or a portion of the proceeds remitted to the home office, without being required to register such offer and sale under the Securities Act. [532] The foreign bank itself, issuing from its home office, would not be entitled to the exemption under § 3(a)(2) of the Securities Act, although it is generally possible for a home office issuance of debt obligations to be eligible for the § 3(a)(2) exemption by having a U.S. branch or agency of the bank issue a letter of credit or some other form of guarantee of the home office's obligations. [533]

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In addition, many U.S. branches of foreign banks have issued letters of credit with respect to the obligations of U.S. commercial and municipal borrowers. Since a letter of credit is treated as a bank guarantee for the purposes of § 3(a)(2), neither the letter of credit nor the underlying "guaranteed" obligation need be registered. To date, obligations issued by U.S. branches of foreign banks have been debt. It is probably not possible for equity securities, including preferred stock, to be issued or guaranteed by a U.S. branch relying on the § 3(a)(2) exemption, since conceptually such instruments are not obligations of the U.S. branch, but rather represent ownership interests in the issuing entity as a whole. [534]

Although securities issued or guaranteed by a bank are exempt from registration, a disclosure document is generally prepared, in part for marketing reasons. It is, however, typically much less comprehensive than the prospectus for a registered offering. Because detailed SEC rules for registration statements do not apply, the amount of disclosure depends upon the circumstances of the individual offering, the concerns of the issuer and the underwriters and the requirements of the bank regulators. While liability pursuant to Rule 10b-5 under the Exchange Act attaches with respect to misstatements or omissions in any such disclosure document, the liability is not absolute or predicated on negligence, but based on actual fraud or reckless disregard for the truth. [535]

The SEC has submitted legislation to the U.S. Congress on various occasions to eliminate the § 3(a)(2) exemption, but to date it remains. If the exemption were eliminated, then all securities issued or guaranteed by a bank or its holding company would have to be registered (unless sold in transactions exempt from registration). [536]

The Office of the Comptroller of the Currency (the "Comptroller"), which regulates disclosure in connection with offers and sales of securities by national banks and federally licensed U.S. branches and agencies of foreign banks, [537] adopted regulations in 1994 that in many cases effectively require such issuers to comply with the registration requirements of the Securities Act. [538] Under these

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regulations, national banks and federal branches and agencies of foreign banks (but not state-licensed branches or agencies) conducting public offerings of securities are required to register the securities with the Comptroller, using the same form and providing the same information that they would use to register securities under the Securities Act if they were not exempt from such registration. Because the Comptroller's regulations in effect incorporate the SEC rules by reference rather than restate them, as in the past, they automatically remain current as the SEC adopts amendments to its rules. [539]

The regulations also contain a definition of "security," which cross-references the definition of that term in the Securities Act. Although the definition does not specifically exclude traditional bank products such as insured and uninsured deposits, letters of credit, banker's acceptances or repurchase agreements, the Comptroller explained in the related adopting release that it does not intend that the definition cover such products. The

Comptroller added that judicial precedents have generally found these products not to be securities. [540] Thus, letters of credit, and third-party securities backed by letters of credit, do not fall within the Comptroller's requirements so long as they qualify for the exemption from Securities Act registration provided by § 3(a)(2) (discussed above).

The regulations provide an exemption from the registration requirements if the securities would be exempt from registration under the Securities Act other than by reason of §§ 3(a)(2) or 3(a)(11) [541] thereof, or the securities are offered in transactions that satisfy certain exemptions under the Securities Act, such as Regulation D, Rule 144, Rule 144A or Regulation S. Although securities that are exempt from registration under § 3(a)(2) of the Securities Act are not generally exempt from the Comptroller's regulations, those regulations do contain an exemption for offers and sales of nonconvertible debt securities if a number of conditions are met, [542] including that:

- the issuer or its parent bank holding company has a class of securities registered under § 15(d) of the Exchange Act, [543] or, in the case of issuances by a federal branch or agency of a foreign bank, such federal branch or agency files with the Comptroller the information specified in Rule 12g3-2(b) under

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  the Exchange Act [544] and provides investors with the information specified in Rule 144A(d)(4)(i) under the Securities Act; [545]
- all offers and sales are to "accredited investors," as defined in Rule 501 under the Securities Act;
- the securities are investment grade; [546]
- the securities are sold in a minimum denomination of $250,000 and are legended to provide that they cannot be exchanged for securities in smaller denominations;
- prior to or simultaneously with the sale of the securities, the purchaser receives an offering document that contains a description of the terms of the securities, the use of proceeds and the method of distribution, and incorporates certain financial reports or reports filed under the Exchange Act; and
- the offering document and any amendments are filed with the Comptroller no later than the fifth business day after they are first used. [547]

The regulations also incorporate the periodic reporting requirements of the Exchange Act. Thus, a bank that is required to register its securities with the Comptroller will be subject to the same requirements as a company with a class of securities registered under § 15(d) of the Exchange Act. As a result, a federal branch or agency of a foreign bank required to register its securities with the Comptroller will be obliged to file with the Comptroller a Form 20-F and present financial statements prepared in accordance with, or reconciled to, U.S. GAAP, to the extent and as required for other foreign private issuers, on an ongoing basis. [548] However, these periodic reporting requirements do not apply if the bank is a subsidiary of a one-bank holding company, the financial statements of the bank and the parent bank holding company are substantially the same and

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the parent bank holding company complies with reporting requirements under the Exchange Act.

Another important feature of the regulations is the extension of shelf registration procedures to national banks and federal branches and agencies of foreign banks.

The regulations effectively eliminate the § 3(a)(2) exemption for public offerings by federally regulated banks, including federal branches and agencies of foreign banks, with respect to all but the most traditional banking products such as deposit instruments and letters of credit. Since the Comptroller's regulations have been in place, though, there has been no noticeable trend by the various state banking authorities to implement comparable measures that would affect banks regulated under state laws (including state-licensed branches and agencies). For example, New York State does not impose any specific securities offering disclosure rules for issuances by New York State-chartered banks or New York State-licensed branches and agencies of foreign banks.

[3] Commercial Paper

Commercial paper is a term that, although not defined in the securities laws, generally describes promissory notes with a maturity of nine months or less, and typically of 30 days or less. It is generally unsecured, issued in large denominations and sold in bearer (or book entry) form at a discount from face value. Commercial paper is normally issued pursuant to a commercial paper "program" established by the issuer, one or more commercial paper dealers and an issuing and paying agent. Under such a program, commercial paper is issued from time to time depending on a variety of factors, including the issuer's funding needs and customer demand. The documentation has become quite standard, and the costs of establishing a program are not substantial, except in cases where commercial paper is used in connection with a complex financing such as a structured receivables program. The process was further simplified by the introduction in the early 1990s of a book-entry system for the issuance and payment of commercial paper administered by The Depository Trust Company, under which practically all commercial paper is now issued. Commercial paper programs are not registered with the SEC under the Securities Act because of the availability of three exemptions: § 3(a)(3) of the Securities Act, § 4(a)(2) of the Securities Act and Regulation S under the Securities Act.

Commercial paper that satisfies certain criteria is exempt from the registration requirements pursuant to § 3(a)(3) of the Securities Act. Section 3(a)(3) itself is brief and does not provide much guidance as to its scope. It exempts any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine

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months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

The SEC's basic discussion of the scope of the § 3(a)(3) exemption was initially set forth in a 1961 interpretive release. [549] That release, together with subsequent no-action letters issued by the Office of the Chief Counsel of the SEC's Division of Corporation Finance (the "Division"), have established the criteria for exemption under § 3(a)(3). To qualify, commercial paper must:

- be of prime quality and negotiable;
- be of a type not ordinarily purchased by the general public;
- have a maturity not exceeding nine months; and
- be issued to facilitate current transactions.

Although the term "prime quality" has not been formally defined, issuers have customarily satisfied the prime quality requirement on the basis of ratings of their commercial paper by the nationally recognized rating services; such ratings depend on the creditworthiness of the issuer or the guarantor, if any. There are a few examples of no-action letters issued by the Office of the Chief Counsel of the Division for unrated commercial paper (including commercial paper of issuers with long-term ratings less than investment grade) on the basis of back-up bank facilities, but there is doubt whether the Division would currently issue such a letter. An alternative in a situation in which the commercial paper is not rated is for one of the sponsoring dealers to indicate, in a letter to counsel for the issuer (or the dealers), that in such dealer's view the paper would, if rated, be given a rating recognized as "prime" and for counsel to use such letter as a basis for opining that the paper is entitled to the § 3(a)(3) exemption. [550]

The important factors relevant to the requirement that the commercial paper be of a "type not ordinarily purchased by the general public" are denomination, purchasers and manner of sale. A minimum denomination of $100,000 is typical in transactions described in no-action letters, although the denominations of commercial paper are ordinarily substantially higher. To qualify for the § 3(a)(3) exemption, the purchasers of commercial paper should be institutions

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or sophisticated individuals who could qualify as purchasers in a private placement. No-action letters often refer to sales to "institutions or individuals who normally purchase commercial paper." The marketing of exempt commercial paper should be clearly aimed at such purchasers and, for example, should avoid advertising in publications of general circulation. [551]

Commercial paper programs are easily structured to satisfy the requirement of a "maturity not exceeding nine months" by limiting the permitted maturity to 270 days in the documentation establishing the program. [552]

The "current transactions" test has been the focus of most of the requests by issuers for no-action letters pertaining to § 3(a)(3). For corporate issuers, it is often relatively clear that the proceeds of commercial paper will be used for "current transactions" (*e.g.*, inventory or accounts receivable finance or recurring operating expenses). In many cases, however, issuers have explained that it is not possible to trace particular proceeds to particular uses. Utility companies, and subsequently other companies, have addressed this concern by representing that they would limit the amount of commercial paper issued according to formulas based on various categories of current transactions, and this approach has been accepted by the Division in a long line of no-action letters. The more expansive of the formulas favorably received by the Division include limiting the amount of commercial paper outstanding at any one time to not more than the aggregate amount utilized by the issuer for specified current transactions. [553] The principal

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use of proceeds that clearly does not qualify for "current transaction" status is to finance the purchase of securities, whether in connection with a takeover, for investment purposes or as issuer repurchases. [554]

Commercial paper is also sold in the United States without registration under the Securities Act in reliance on the exemption provided by § 4(a)(2) and, to some extent, the resale exemption provided by Rule 144A thereunder. Commercial paper sold pursuant to such exemptions is not required to satisfy the "current transactions" or nine-month maturity requirements of § 3(a)(3), although the term of such paper almost never exceeds one year. Some issuers have simultaneously maintained § 3(a)(3) commercial paper programs and § 4(a)(2) commercial paper programs in the United States and have issued commercial paper under the § 4(a)(2) commercial paper program, for example, when raising money for the purchase of a fixed asset (*e.g.*, for takeover financing). [555]

Finally, issuers that are unable to issue commercial paper on the basis of their own credit sometimes obtain bank letters of credit to assure payment of their commercial paper. In these circumstances, both the letter of credit (if it is deemed a security) and the commercial paper will (as discussed in § 3.05[2]) be exempt from registration under the Securities Act on the basis of § 3(a)(2) without regard to the use of proceeds.

[4] The Trust Indenture Act of 1939

Debt securities that must be registered under the Securities Act (except for foreign government securities registered on Schedule B to the Securities Act) must also be issued under a trust indenture that has been qualified in accordance with the Trust Indenture Act. In order to protect the rights of holders of debt, the Trust Indenture Act imposes standards of independence and responsibility upon the trustee and incorporates certain minimum protections into the related indentures. Trustees must meet certain financial and other qualifications and may not have certain interests that might conflict with the exercise of their duties. [556] The Trust Indenture Act also guarantees certain rights of securityholders, including

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rights to receive certain reports, to have access to trustees' lists of holders for correspondence and to sue individually for nonpayment of principal or interest.

Foreign issuers offering their debt securities to the public in the United States should be able to comply without difficulty with the Trust Indenture Act provided they govern the debt securities and the indenture under a body of U.S. law, such as New York law. If they wish to make a global offering of fungible securities that includes their home jurisdiction, however, they will have to choose generally between a U.S. body of governing law and their local law. [557] Although the Trust Indenture Act permits debt securities issued under a qualifying indenture, and the indenture itself (subject to the mandatory incorporation of certain provisions of the Act required by § 318), to be governed by foreign law, there are jurisdictions in which local law is not compatible with one or more of the mandatory provisions of the Act. [558]

Even where foreign law is not incompatible with the Trust Indenture Act, issuers and underwriters may conclude that a U.S.-style indenture is not consistent with market practice in the home jurisdiction. Two major European issuers, Daimler Benz (in 1997) and Ericsson (in 1993), have used a structure involving the creation of a U.S. depositary facility to permit an entire issue of debt securities to be governed by local law without a qualifying indenture while at the same time subjecting the depositary securities sold in the United States (representing these debt securities) to an indenture governed by New York law

complying with the Trust Indenture Act. In each case, an exemptive order from the SEC pursuant to § 304(d) of the Trust Indenture Act was obtained. [559]

Following its amendment by the Trust Indenture Reform Act of 1990, [560] it was thought that the Trust Indenture Act might better accommodate issues by foreign companies. First, as amended the Trust Indenture Act allows the SEC, pursuant to such rules or regulations as it may prescribe or by order on application, to permit a foreign financial institution to act as sole trustee under an indenture qualified pursuant to the Trust Indenture Act if such entity (i) is authorized under the laws of the jurisdiction where it is organized to exercise corporate trust powers and (ii) pursuant to such laws, is subject to supervision or examination that is substantially equivalent to the supervision or examination applicable to U.S. institutional trustees. [561] One of the factors to be considered by the SEC when promulgating any such rules or regulations or making any such order is whether the relevant foreign jurisdiction would allow a U.S. entity to act as sole trustee under an indenture relating to securities sold in that jurisdiction. [562]

Second, an indenture trustee (for issues by either a domestic or a foreign issuer) is now considerably less likely to have a disqualifying conflicting interest. A trustee is deemed to have a conflicting interest with respect to an issuer's indenture if the trustee has one of ten prohibited relationships with the issuer or an underwriter of the issuer. [563] Those prohibited relationships generally arise when the relevant indenture securities are in default and (i) the trustee is a trustee for two or more classes of the issuer's securities that rank differently in seniority, (ii) the trustee has a specified direct or indirect affiliation (*e.g.*, through a control relationship, interlocking management or personnel, or securities holdings) with the issuer or an underwriter [564] of the issuer or (iii) the trustee is otherwise a creditor of the issuer. If a trustee has or acquires a conflicting interest, it must generally, within 90 days after ascertaining that it has such conflicting interest,

either eliminate such conflicting interest or resign. If, however, the default giving rise to the conflict of interest is not a payment default, the trustee will not be required to resign if it can satisfy the SEC that (i) the default may be cured or waived within a reasonable period and (ii) a stay of the trustee's duty to resign will not be inconsistent with the interests of holders of the indenture securities. [565] Additionally, the Trust Indenture Act prohibits an obligor on the indenture securities or a person directly or indirectly controlling, controlled by or under common control with such an obligor from acting as trustee under a qualified indenture regardless of whether the indenture securities are in default. [566]

To provide flexibility in administration and allow the SEC to adapt to future developments, the Trust Indenture Act also gives the SEC broad authority to provide, upon its own motion or by order on application by an interested person, conditional and unconditional exemptions from any or all of the provisions of the Trust

Indenture Act. [567]

[5] Credit Ratings

Ratings assigned by credit rating agencies such as Moody's Investors Service, Standard & Poor's and Fitch Ratings play a key role in the pricing of debt securities, particularly investment grade debt securities. While such ratings have historically also figured prominently in the regulatory treatment of debt securities, their use is being phased out in response to public policy considerations.

In 2003, in response to the mandate contained within § 702 of the Sarbanes-Oxley Act, the SEC submitted to Congress a detailed report on credit rating agencies. The report addressed the topics identified for study in § 702, including the role of rating agencies and their importance to the securities markets, impediments faced by rating agencies in performing that role, measures to improve information flow to the market from rating agencies, barriers to entry into the ratings business and conflicts of interest faced by rating agencies. The report also addressed certain issues regarding rating agencies, such as allegations of anticompetitive or unfair practices, the level of diligence of rating agencies and the extent and manner of SEC oversight, that went beyond those specifically required by the Sarbanes-Oxley Act. The SEC followed up on issues raised by the report by issuing a concept release on the topic. [568]

In 2006, Congress responded by enacting the Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291, 120 Stat. 1327 (2006) (the "Rating Agency Act"), and in 2007 the SEC adopted new rules to implement it. The Rating Agency Act and the SEC rules established a program for NRSRO registration and oversight by the SEC. Under these provisions, a credit rating agency seeking to be treated as an NRSRO must apply for, and be granted, registration with the SEC, make public in its application certain information to help persons assess its credibility, and implement procedures to manage the handling of material nonpublic information and conflicts of interest. [569]

As a result of the subprime mortgage crisis and ensuing credit crunch that began in mid-2007, the SEC in 2008 proposed a number of reforms relating to the regulation of NRSROs. The rules were adopted in 2014. Among other things, the rules are designed to address conflicts in the ratings process; mandate public disclosure of ratings-related information; require differentiation of structured product ratings from corporate debt ratings; and avoid encouraging "undue reliance" on ratings. [570]

Pursuant to § 939A of the Dodd-Frank Act, the SEC was charged with removing from SEC regulations all references to or requirements of reliance on credit ratings. In rules proposed in February 2011 and adopted in July 2011, the SEC replaced each of the qualifications in Forms S-3, F-3, S-4 and F-4 and Rules 138, 139 and 168 under the Securities Act that required an investment grade rating with a qualification that is met if the registrant has issued at least $1 billion of nonconvertible, SEC-registered securities (other than common equity) for cash during the prior three years when the registrant seeks to rely on the safe harbor of any such rules.

The Dodd-Frank Act also eliminated former Rule 436(g) under the Securities Act. Under that rule, an issuer that referred to credit ratings in a Securities Act registration statement or a prospectus for a registered offering did not need to file the consent of the rating agency. This allowed the rating agencies to avoid expert liability under § 11 of the Securities Act. The effect of the elimination of Rule 436(g) is, with certain exceptions outlined below, to require NRSROs to file consents to be named as experts each time their ratings are used in a prospectus or registration statement. Prior to the passage of the Dodd-Frank Act, the rating agencies consistently took the position that the ratings they provided were not expertized information as described in §§ 7 and 11 of the Securities Act. They argued that ratings are inherently forward-looking in nature and are based on assumptions and predictions that by their very nature cannot be verified. [571] In response to the passage of the Dodd-Frank Act and the concurrent repeal of Rule 436(g), the major rating agencies reiterated this stance and stated that they would

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not consent to the inclusion of their ratings in prospectuses and registration statements. [572]

One important exception to the requirement that NRSROs file consents is that a company that is not subject to Regulation AB disclosure requirements is not required to seek NRSRO consent for ratings-related information included in a registration statement or prospectus if such information is included to satisfy certain general disclosure requirements (such information being referred to as "issuer disclosure-related information"). [573] Issuer disclosure-related information is comprised of changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings. Registrants should therefore not have to alter their practices regarding ratings disclosure in, for example, a risk factor that outlines the adverse effect that a hypothetical downgrade would have, in the liquidity portion of the MD&A and in descriptions of debt covenants tied to credit ratings.

Footnotes

519 For this reason, such issuers are often referred to as "Schedule B issuers." Schedule B requires disclosure of the following:

- the estimated net amount and proposed use of the proceeds of the offering;
- the amount and the principal terms of the sovereign's "funded" (long-term) and "floating" (short-term) debt (both foreign and domestic);
- any defaults on external securities during the preceding 20 years;
- the registrant's revenues and expenditures (including deficits) during the three most recent fiscal years;
- the name(s) of any authorized agent(s) in the United States;
- the name(s) of counsel who pass upon the legality of the issue;
- the terms of the distribution, including the underwriting arrangements, if any, and the names of the underwriters;
- the price at which the securities are to be offered (or the method by which the price is to be determined);
- the commissions or other compensation to be paid to underwriters; and
- other expenses of the offering.

520 § 7 of the Securities Act.

521 The rationale for permitting supranational organizations to use Schedule B has generally been that these organizations have sovereign nations as their members, serve a governmental function and have the right to make capital calls on their member countries in the event that the organizations cannot meet their obligations under their debt securities. *See*, *e.g.*, *Nordiska Investeringsbanken* (avail. Feb. 1, 1982); and *European Economic Community* (avail. June 21, 1976), allowing the European Economic Community ("EEC") to register using Schedule B, "without deciding whether the EEC [was] a 'foreign government or political subdivision thereof' within the meaning of Section 7 of the Securities Act"). Securities offerings of certain supranational organizations, including the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the Council of Europe Development Bank ("CEB") and the International Bank for Reconstruction and Development (known as the World Bank), are governed by specific statutes enacted by Congress and regulations that exempt their securities from SEC registration and are thus even more favorable than Schedule B. *See*, *e.g.*, General Rules and Regulations Pursuant to § 9(A) of the European Bank for Reconstruction and Development Act, 17 C.F.R. §§ 290.1 *et seq*.

522 As discussed above, *see supra* Note 519 and accompanying text, the SEC staff has permitted the registration under Schedule B of securities that are supported by statutory "keepwell" arrangements, as well as those backed by an express or statutory guarantee.

523 Certain foreign banks that are eligible to use Schedule B may also be able to take advantage of the exemption in § 3(a)(2) of the Securities Act, if they issue their securities through a U.S. federal or state branch. *See* § 3.05[2].

524 A number of central banks have been permitted to register debt securities on Schedule B even though such obligations did not carry the full faith and credit of the sovereign or benefit from a formal sovereign guarantee or "keepwell" arrangement. In *Bank of Greece* (avail. June 2, 1993), the only no-action letter in which this issue has been addressed, the staff stated that it would raise no objection to that central bank's use of Schedule B, but noted particularly (i) the bank's status as the central bank of Greece and (ii) that the Republic of Greece would sign the registration statement. The SEC permitted a Schedule B filing under similar circumstances by Bangko Sentral ng Pilipinas, the central bank of the Philippines, in 1997.

525 In the case of the CEB, an international organization established by member states of the Council of Europe, the Schedule B filing specifically states that neither the Council of Europe nor the CEB's member states guarantee the securities being issued. Furthermore, the CEB may make calls upon subscribed and unpaid capital in order to enable the CEB to meet its obligations, but member states are not required to subscribe to capital increases.

526 Where the issuer is not an instrumentality of a specific foreign government but rather has been established under international agreements among various sovereigns, the issuer alone (along with its authorized U.S. representative) may sign the registration statement.

527 As a technical matter, whether the government's support for the securities represents a guarantee of the securities that is itself a separate security that must be registered under the Securities Act may depend on the nature of the support. In any case, the registration statement will include the above disclosure and the government will be required to co-sign the registration statement and to provide legal opinions with respect to its support for the securities or the issuer.

528 Although foreign governments are subject to essentially the same requirements as foreign private issuers, foreign governments are not eligible for a number of the safe harbors relating to publicity and research reports that are available to foreign private issuers. Accordingly, special considerations apply in these areas in the context of an offering by a foreign sovereign.

529 A shelf issuer may incorporate by reference annual reports filed voluntarily on Form 18-K and amendments filed on Form 18-K/A instead of including country disclosure in the prospectus (included in the registration statement) or in a prospectus supplement, if the SEC issues a no-action letter allowing it to do so. *See*, *e.g.*, *Republic of Chile* (avail. April 27, 2015).

530 However, a class of § 3(a)(2) exempt securities that is listed on a national securities exchange must nevertheless be registered under the Exchange Act. *See* § 3.03[1][a].

531 SEC Release No. 33-6661 (Sept. 23, 1986). The release stipulates that in order for the § 3(a)(2) exemption to be available, the nature and extent of federal or state regulation and supervision of the issuing branch or agency must be "substantially equivalent" to that applicable to federal or state chartered domestic banks in the same jurisdiction. *See also* § Part IV.A.2.c of Robert L. Tortoriello, Derek M. Bush and Hugh C. Conroy, Jr., GUIDE TO BANK UNDERWRITING, DEALING AND BROKERAGE ACTIVITIES (21st ed. Thomson 2016).

532 A public offering of securities by a U.S. or foreign issuer that is exempt from federal securities registration requirements under § 3(a)(2) may nevertheless remain subject to review under FINRA Rule 5110. If the securities are not nonconvertible debt securities or nonconvertible preferred securities with an investment-grade rating or if an affiliate of the issuer is a FINRA member participating in the distribution of the securities, a filing must generally be made with and approval received from FINRA prior to proceeding with the offering. However, if an offering of securities issued by a U.S. or foreign bank (whether or not exempt from registration under § 3(a)(2)) is structured as a private placement under the Securities Act, such offering would not be subject to FINRA review.

533 *See*, *e.g.*, *Sumitomo Bank* (avail. Oct. 29, 1984).

534 However, equity-, index- and credit-linked "hybrid" securities, *see* U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, TWELFTH EDITION, DERIVATIVES MARKETS, §§ 2.03[5], 2.04[3], and

2.05[4], may generally be issued or guaranteed by a U.S. branch or agency of a foreign bank in reliance on the § 3(a)(2) exemption because they are generally classified as direct or contingent debt obligations of the branch or agency issuer or guarantor.

535 Securities issued or guaranteed by a bank are exempt from the liability provisions of § 12(a)(2) of the Securities Act.

536 Certain bank obligations (including, for example, certain certificates of deposit) are not "securities" within the meaning of the Securities Act and thus would not need to be registered even if the § 3(a)(2) exemption were eliminated. *See* § 12.01[2][c].

537 *See* Robert L. Tortoriello, Derek M. Bush and Hugh C. Conroy, Jr., GUIDE TO BANK UNDERWRITING, DEALING AND BROKERAGE ACTIVITIES (21st ed. Thomson 2016) for a fuller discussion of the regulation of securities activities of banks.

538 12 C.F.R. Part 16.

539 *But see* 12 C.F.R. Parts 11 and 16, as amended, to reflect those provisions of the Sarbanes-Oxley Act that the Comptroller is required to administer and enforce with respect to registered national banks.

540 Securities Offering Disclosure Rules, 59 Fed. Reg. 54,789, 54,791 (Nov. 2, 1994).

541 Section 3(a)(11) of the Securities Act exempts from registration offerings conducted entirely within a single state.

542 12 C.F.R. § 16.6.

543 *See* § 4.02[2].

544 *See* § 4.02[3][a][iv].

545 *See* § 7.02[3][d].

546 Pursuant to § 939A of the Dodd-Frank Act, the Comptroller has removed all references to or requirements of reliance on credit ratings. *See* Alternatives to the Use of External Credit Ratings in the Regulations of the Comptroller, 77 Fed. Reg. 35,253 (June 13, 2012) (to be codified at 12 C.F.R. Parts 1, 5, 16, 28, and 160). "Investment grade" for this purpose means the issuer of the security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the issuer is low and the full and timely repayment of principal and interest is expected. 12 C.F.R. § 16.2(g). *See* § 3.05[5].

547 Although the Comptroller has clarified that amendments that contain only pricing information relating to a particular transaction, updated financial information concerning the issuer or nonmaterial information relating to the issuance program need not be filed with the Comptroller. Comptroller Interpretive Letter No. 662 (May 31, 1995) Fed. Banking L. Rept. (CCH) ¶ 83,610.

548 *See* §§ 3.03[1][b], 4.02[3][c][i] and 4.05.

549 SEC Release No. 33-4412 (Sept. 20, 1961).

550 Pursuant to § 939A of the Dodd-Frank Act, the SEC was charged with removing from SEC regulations all references to or requirements of reliance on credit ratings. *See* § 3.05[5]. No action has yet been taken by the SEC regarding the "prime" requirement of the § 3(a)(3) exemption. The SEC has, however, amended Rule 2a-7 under the Investment Company Act to eliminate the requirement that money market funds, which have traditionally been major purchasers of commercial paper, invest only in securities in the two highest rating credit categories. Instead, a money market fund must rely on its own determination that the security has "minimal credit risks" after analyzing certain prescribed factors when investing. *See* SEC Release No. IC-31828 (Sept. 16, 2015) (effective Oct. 26, 2015).

551 The SEC staff has not objected to tombstone advertisements that announce the establishment of § 3(a)(3) programs.

The SEC staff also issued a no-action letter in July 1994 that provided it would not recommend any enforcement action by the SEC if GE Capital and certain of its affiliates publish limited advertisements about their commercial paper in publications with a general circulation so long as certain steps are followed.

General Electric Capital Corporation; General Electric Company; General Electric Capital Services, Inc. (avail. July 13, 1994). The letter outlined a number of steps that would be taken to ensure that individuals and unsophisticated institutions do not actually purchase the paper.

552 Debt instruments with maturities of one year or less are not required by TEFRA to be in registered form and thus technically are not subject to the TEFRA rules governing the offer and sale of bearer debt discussed in § 8.04[2]. However, in the case of a debt instrument with a term of more than 183 days, the "portfolio interest exception" from US withholding tax is available only for debt issued in registered form. Furthermore, even though debt instruments with terms of 183 days or less generally are not subject to US withholding tax, they are nonetheless subject to information reporting and backup withholding requirements. *See generally* § 8.04[2] for a discussion of rules imposed on offers of bearer debt.

553 For various reasons, non-U.S. companies often issue commercial paper in the United States through a finance subsidiary. Such commercial paper is generally guaranteed by, or benefits from, "keepwell" arrangements from the parent because the subsidiary on its own would not be sufficiently creditworthy to make its commercial paper marketable or to satisfy the "prime quality" test of the § 3(a)(3) exemption. In such a structure, the Division has issued a no-action response where the proceeds of the commercial paper were loaned or advanced to the guarantor (or its subsidiaries) and the guarantor represented that the aggregate amount of outstanding commercial paper would be less than various listed "current transactions" of the guarantor and its subsidiaries even though such proceeds would not be segregated or traceable to specific current transactions. *Meridian Bancorp, Inc., Meridian Funding Corp.* (avail. Sept. 21, 1984).

554 Other nonqualifying uses include: discharging existing indebtedness unless such indebtedness is itself exempt under § 3(a)(3); purchasing or constructing a plant; purchasing durable machinery or equipment; funding commercial real estate development or financing; purchasing real estate mortgages; financing mobile homes or home improvements; or purchasing or establishing a business enterprise. SEC Release No. 33-4412 (Sept. 20, 1961).

555 The SEC staff has issued letters to the effect that enforcement action on the basis of the integration doctrine would not be taken so long as the purpose and use of proceeds of the two programs are distinct. *See*, *e.g.*, *Security Pacific Corp.* (avail. Oct. 14, 1976). *See* § 7.02[6] for a discussion of the integration doctrine.

556 § 310 of the Trust Indenture Act.

557 This choice will not be available to all foreign issuers because there are jurisdictions, such as France, that restrict the issuance of debt securities within the jurisdiction governed otherwise than by local law.

558 Conflicts arising from "collective action clauses," pursuant to which debt security payment terms may be amended with the consent of the holders of a majority or supermajority of the outstanding principal amount (to be contrasted with the unanimous bondholder approval requirements of the Trust Indenture Act), are particularly prevalent in Europe and elsewhere overseas. French law, for example, confers upon the majority of the bondholders, acting through their representative, the right to consent to amendments to the terms of the securities governing payment of principal and interest. French law also requires that if a legal entity is to act as the bondholders' representative, such legal entity be incorporated in France. The Trust Indenture Act, as discussed below, permits foreign entities to act as sole trustee under a qualified indenture in limited circumstances (although to date no foreign entity has actually been granted an order allowing it to so act). In the event of a Trust Indenture Act conflict, the SEC may issue rulings allowing securities issuances to proceed. § 304(d) of the Trust Indenture Act; *see* SEC Release No. 2430 (Oct. 13, 2004) (order granting application for exemption from § 316(b) of the Trust Indenture Act to Petroleos Mexicanos and the Pemex Project Funding Master Trust to permit the inclusion of "collective action clauses" in certain indentures to be qualified under the Trust Indenture Act). Many foreign governmental issuers, which as Schedule B registrants are not required to have qualified indentures and generally issue their debt securities under fiscal agency agreements, have collective action clauses. Since 2013, sovereign issuers within the Eurozone have been required to include collective action clauses in bonds they issue with maturities exceeding one year. *See* Conclusions of the Heads of State or Government of the Euro Area of

Mar. 11, 2011.

559 *See* Daimler-Benz Aktiengesellschaft, SEC Release No. 39-2353 (Apr. 25, 1997) (Order) and LM Ericsson Telephone Company, SEC Release No. 39-2312 (June 1, 1993) (Order), which include a description of the deposit arrangements.

560 Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, 104 Stat. 2713 (1990).

561 No foreign financial institution has, however, yet been permitted to act as sole trustee. In at least one instance, the staff of the SEC has not been satisfied that the proposed foreign trustee was subject to supervision or examination that is substantially equivalent to the supervision or examination applicable to U.S. institutional trustees. This was attributable to the fact that U.S. trustees are typically commercial banks, while the proposed foreign trustee, like many other foreign trustees, was not a commercial bank.

562 § 310(a)(1) of the Trust Indenture Act.

563 § 310(b) of the Trust Indenture Act.

564 The term "underwriter," when used with reference to an obligor on indenture securities, is defined to mean every person who, within one year of the date of determination, was an underwriter of any security of such obligor outstanding at such date. § 310(b) of the Trust Indenture Act.

565 § 310(b) of the Trust Indenture Act.

566 § 310(a)(5) of the Trust Indenture Act.

567 § 304(d) of the Trust Indenture Act.

568 *See* SEC, Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets (Jan. 2003); SEC Release No. 33-8236 (June 4, 2003).

569 *See* SEC Release No. 34-55857 (June 5, 2007).

570 *See* SEC Release No. 34-72936 (Aug. 27, 2014).

571 *See* Press Release, Fitch Ratings, Fitch Comments on U.S. Financial Reform Act's Implication for Credit Rating Agencies (July 19, 2010).

572 Rating agencies are not required to consent to the inclusion of their ratings in a free writing prospectus, and should not be treated as experts under the Securities Act as a result of doing so. *See* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 233.06 (July 27, 2010). Accordingly, ratings are generally included in a free writing prospectus that provides the final terms of a registered offering of debt securities.

573 *See* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 233.04 (July 27, 2010).

U.S. Regulation of the International Securities and Derivatives Markets, § 3.06, FINRA

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 3.06 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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Several rules of the Financial Industry Regulatory Authority, Inc., or FINRA, [574] a U.S. securities industry self-regulatory organization that is charged with overseeing the activities of essentially all SEC-registered broker-dealers, have an impact on the conduct of public offerings in the United States and outside the United States to the extent a member of FINRA participates in the offering. Some of the more important FINRA provisions that may affect a public offering are summarized below.

[1] Conflicts of Interest

Special FINRA rules must be observed for U.S. public offerings in which a FINRA member affiliated with the issuer participates or in which a FINRA

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member otherwise is deemed to have a conflict of interest. [575] A FINRA member participating in a public offering has a conflict of interest under FINRA Rule 5121 if, among other things, (i) the securities are to be issued by the FINRA member or its affiliate, (ii) at least 5% of the offering proceeds, not including underwriting compensation, is intended to be directed to the FINRA member or certain of its related persons, or (iii) the issuer is controlled by or under common control with a FINRA member participating in the offering or certain related persons. [576]

When a conflict exists as a result of a FINRA member's interest in the securities being offered publicly, the nature of the conflict must be prominently disclosed in specific sections of the prospectus or other offering document and either (i) a qualified independent underwriter ("QIU") must participate in the due diligence process and preparation of the prospectus or other offering document or (ii) an exemption from the QIU requirement must apply. No QIU is required to participate in a public offering if (i) the FINRA member principally responsible for managing the offering does not have a conflict of interest and can meet certain other requirements, (ii) the securities being offered have a "bona fide public market" (as defined in FINRA Rule 5121), or (iii) the securities being offered are investment-grade rated or are in the same series as, or rank *pari passu* with, investment-grade rated securities that have equal rights and obligations. [577] Disclosure documents for all offerings requiring the participation of a QIU must be filed with FINRA for review, even if the offering would otherwise be exempt from filing under FINRA Rule 5110(b)(7). [578]

[2] Initial Public Offerings of Equity Securities

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[a] IPO Purchase and Sale Restrictions

FINRA Rule 5130 prohibits FINRA members from selling "new issues" of equity securities to certain "restricted persons." [579] Like its predecessors—NASD Conduct Rule 2790 and the NASD's interpretation on "free-riding and withholding" of "hot issues" (*i.e.*, where secondary trading commences at a premium relative to the offering price) (the "Interpretation")—FINRA Rule 5130 is designed to ensure that FINRA members: (i) make *bona fide* public offerings of new issues of equity securities at the offering price, (ii) do not withhold securities in a public offering for their own benefit or use the securities being offered to reward those who are in a position to direct future business to them, and (iii) do not exploit their insider position to purchase new issues at the expense of public customers. [580]

However, in contrast to the Interpretation, which applied to all "hot issues" (and, therefore, was potentially applicable to all securities offerings, since it was often impossible to know in advance with absolute certainty whether a particular securities offering would begin to trade at a premium in the secondary market), FINRA Rule 5130 applies only to IPOs of equity securities. [581] More specifically, FINRA Rule 5130 prohibits, subject to certain exceptions, a FINRA member (or

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an associated person thereof) [582] from: (i) selling a new issue to an account in which a restricted person has a beneficial interest, [583] (ii) purchasing a new issue for any account in which such member or associated person has a beneficial interest, and (iii) continuing to hold new issues acquired as an underwriter, selling group member or otherwise, in each case, except as expressly permitted by the rule. [584] For purposes of the rule, "restricted persons" include, among others, FINRA members and other broker-dealers, certain owners and associated persons of broker-dealers, finders, portfolio managers and certain immediate family members of the foregoing. [585]

In addition to these prohibitions, the rule imposes an affirmative obligation on FINRA members to comply with specified preconditions before selling a new issue. Specifically, within the 12 months prior to any such sale, a FINRA member must have obtained in good faith: (i) a representation from the holder of any account to which an offer will be made (or a person authorized to represent the beneficial owner of such an account) stating that the account holder is eligible to purchase new issues in compliance with FINRA Rule 5130, [586] and (ii) a representation from any U.S. or non-U.S bank, broker-dealer or investment adviser or other conduit that all purchases of new issues will be in compliance with FINRA Rule 5130. [587]

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Offerings excluded from the definition of "new issue," and thus excluded from the restrictions of FINRA Rule 5130, include:

- securities offered in private placements, including pursuant to Rule 144A under the Securities Act; [588]
- securities offered in rights offerings, exchange offers or offerings made pursuant to a merger or acquisition;
- offerings of debt securities;
- offerings of convertible securities;
- offerings of preferred securities;
- offerings of securities (in the form of ordinary shares or ADRs registered on Form F-6 under the Securities Act) that have a preexisting market outside the United States;
- offerings of investment-grade asset-backed securities;
- offerings of securities of an investment company registered under the Investment Company Act;
- offerings of exempted securities under § 3(a)(12) of the Exchange Act and the rules promulgated thereunder; and

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- offerings of securities of a commodity pool operated by a commodity pool operator as defined under § 1a(5) of the Commodity Exchange Act. [589]

In addition to the foregoing exclusions, FINRA Rule 5130 contains certain exemptions applicable to particular accounts or entities with large numbers of beneficial owners based on the premise that these types of accounts are likely to have only a small percentage of restricted persons as beneficial owners and thus are not the sort of accounts sales to which the rule should prohibit. [590] These exemptions include sales to, and purchases by, the following accounts or persons, whether directly or indirectly through accounts in which they have a beneficial interest:

- publicly traded entities (other than certain broker-dealers and broker-dealer affiliates) that are listed on a national securities exchange in the United States or that are foreign issuers whose securities meet the quantitative designation criteria for listing on such an exchange;
- an account in which the beneficial interests of restricted persons do not exceed 10% in the aggregate;
- investment companies registered under the Investment Company Act;
- subject to certain conditions, non-U.S. investment companies; [591]
- charitable organizations with tax-exempt status under § 501(c)(3) of the Internal Revenue Code;
- certain ERISA plans qualified under § 401(a) of the Internal Revenue Code;
- subject to certain conditions, common trust funds or similar funds, as defined in § 3(a)(12)(A)(iii) of the Exchange Act; and

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- subject to certain conditions, insurance company accounts. [592]

Certain restricted persons may also be able to acquire equity securities otherwise subject to FINRA Rule 5130, among other circumstances, (i) pursuant to detailed exemptions from the rule applicable to issuer-directed share programs (sometimes referred to as "friends and family" programs), (ii) where securities are directed by the issuer in offerings where, among other things, there is no underwriting, solicitation or sale by any broker-dealer, (iii) in certain purchases designed to prevent the dilution of equity stakes held for more than one year prior to an offering, (iv) pursuant to stand-by underwriting arrangements, or (v) by underwriters for their investment account in under-subscribed offerings. [593]

[b] Restrictions on New Issue Allocations

For more than a decade, the NASD, NYSE, FINRA and SEC often have expressed concern regarding IPO allocation abuses and their effects on public confidence in the capital markets. [594] In November 2010, FINRA Rule 5131—

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specifically prohibiting certain abuses in the allocation, pricing, distribution and trading of IPO securities—was approved. [595]

FINRA Rule 5131 prohibits FINRA members and associated persons from engaging in the following activities in connection with new issues [596] of equity securities:

- granting or threatening to withhold allocations of IPO shares as consideration or inducement for the receipt of excessive compensation for services; [597]
- allocating IPO shares to any account in which an executive officer or director of a public company or a covered nonpublic company (as defined in FINRA Rule 5131), or a member of the household of such officer or director, has a beneficial interest (i) if the company is a current investment banking client of the FINRA member or if the FINRA member has received compensation for investment banking services from the company within the 12 months preceding the allocation, (ii) if the person allocating the IPO shares knows or has reason to know that the FINRA member expects to receive investment banking business from, or intends to provide investment banking business to, the company in the next three

months, or (iii) on the express or implied condition that such executive officer or director, on behalf of the company, direct future investment banking business to the FINRA member (known as "spinning"). [598] The spinning prohibitions do not apply to (i) certain accounts that

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are also exempt from FINRA Rule 5130 pursuant to FINRA Rule 5130(c), [599] (ii) any account in which the beneficial interests of the officers and directors of a company do not, in the aggregate, exceed 25% of such account, [600] or (iii) issuer-directed shares, provided the FINRA member has no direct or indirect influence or other involvement in such allocation by the issuer; [601]

- imposing penalties to recoup sales commissions or credits from representatives who have sold shares to a customer who resold the shares within 30 days of the offering's effective date (known as "flipping"), unless the managing underwriter has imposed the penalties on the entire syndicate; [602] or
- accepting market orders (but not limit orders) for IPO shares prior to the commencement of secondary market trading following the IPO. [603]

In addition to prohibiting the activities described above, FINRA Rule 5131 places the following affirmative obligations on FINRA members in connection with IPO pricing and trading practices:

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- reports by the book-running lead manager to the issuer's pricing committee (or board of directors, if no pricing committee has been appointed) providing indications of interest and final allocations of IPO shares sold in the offering; [604]
- inclusion in any lock-up agreement relating to the offering of (i) a requirement that the lock-up apply to any issuer-directed shares to be received by the officer or director subject to the lock-up and (ii) an agreement by the book-running lead manager to notify the issuer and the public at least two business days in advance of any waiver of a lock-up, except when the waiver is only to permit transfer of the shares as a *bona fide* gift and the recipient agrees to be bound by the same lock-up terms; [605] and
- inclusion in the agreement among underwriters of certain procedures for handling shares that are returned to a syndicate member after secondary market trading commences when such shares are trading at a premium in the secondary market (such procedures are aimed at ensuring that reneged IPO shares are not used to benefit favored clients of the underwriters). [606]

Both FINRA Rule 5130 and Rule 5131 are applicable to FINRA members, which, in general, would not include a non-U.S. broker-dealer not registered with the SEC. Accordingly, these rules should have little effect on a non-U.S. underwriter acting as a lead manager or on other non-U.S. underwriters, unless any such non-U.S. broker-dealer is acting as a "conduit" for a FINRA member or determines to adhere voluntarily to the principles set forth in the rules. However, both FINRA rules do apply to a FINRA member (or a non-FINRA member acting as a "conduit" for a FINRA member) participating in an IPO of equity securities conducted outside the United States pursuant to Regulation S. [607]

[3] Maintaining a Fixed-Price Offering

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FINRA Rule 5141 is intended to ensure that securities in a U.S. public offering (including those comprising part of a global offering) are sold at the specified (or "fixed") public offering price, without granting direct or indirect discounts, selling concessions or other allowances except to members of the selling syndicate or selling group (including foreign broker-dealer members of the syndicate or group). [608] The rule replaced a number of NASD rules and related interpretations commonly referred to as the "Papilsky Rules." [609] Notably, while the Papilsky Rules required that any FINRA member granting a selling concession, discount or other allowance in a U.S.

public offering to a foreign broker-dealer obtain a written agreement that such foreign broker-dealer would comply with the same pricing requirements and related matters as applied to FINRA members when they distributed securities, FINRA Rule 5141 contains no such requirement. [610] However, the standard form of Master Agreement Among Underwriters requires a foreign broker-dealer to comply with FINRA Rule 5141 as though it were a member of FINRA to the extent it acts as a "conduit" for, or receives any selling commissions, discounts, allowances or other compensation from, or is otherwise being directed with respect to allocations or disposition by, a FINRA member. Additionally, unlike NASD Rule 2750, which prevented NASD members from allocating securities in a fixed-price offering to related persons of the member, FINRA Rule 5141 explicitly permits sales of securities in a fixed-price offering to affiliates of a member of the selling syndicate or selling group provided that such sale is made at the fixed public offering price and not a "reduced price" (as defined in the rule) and otherwise complies with FINRA Rule 5130 where applicable. [611]

It is important to note that FINRA Rule 5141 does not require that securities offerings be conducted on a fixed-price basis, nor does it prohibit multiple-price offerings. Such multiple-price offerings, however, generally should not be structured in a manner that discriminates among classes of investors; they may,

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for example, provide for volume-related discounts applicable to all participating investors. The rule also allows a reduction in the public offering price of securities in an under-subscribed offering and allows placement of the remaining securities in such "sticky deal" in a FINRA member's investment account or the account of an affiliate. [612] By its express terms, FINRA Rule 5141 only applies until the offering is terminated or can no longer be sold at the stated public offering price. [613]

[4] “Fair and Reasonable” Compensation

Pursuant to FINRA Rule 5110 (the "Corporate Financing Rule"), FINRA members may not participate in a public offering if the underwriting compensation received or to be received in connection therewith is considered excessive. In addition, the underwriting arrangements and compensation for certain public offerings must be reviewed and approved by FINRA's Corporate Finance Department before sales can be made. [614] Although there are certain exemptions from the review requirement, [615] there is no exemption from the substantive terms

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of the Corporate Financing Rule in the context of a U.S. public offering. [616] In general, the Corporate Financing Rule is intended to ensure that the underwriting terms and arrangements in connection with a public offering in which a FINRA member participates are "fair and reasonable." [617] Some of the more significant issues presented by the Corporate Financing Rule are set forth below.

[a] Overallotment Options

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The Corporate Financing Rule has a direct impact on the size of overallotment options that may be granted to the underwriters in connection with U.S. public offerings conducted on a firm commitment basis. FINRA Rule 5110(f)(2)(J) prohibits the receipt of an overallotment option of more than 15% of the securities being offered (the "firm securities"), without taking into account the securities offered pursuant to the overallotment option. [618] Thus, while the underwriting syndicate can overallot more than 15% of the firm securities being offered, it can only receive an option from the issuer or selling securityholders to purchase up to an aggregate of 15% of the firm securities. If the syndicate overallotted more than 15%, it would be "naked" short the balance and would need to satisfy this excess short position through other means such as open-market purchases. [619]

In the past, there had been some question whether the 15% limitation applied on an aggregate or syndicate-by-syndicate basis in a global offering. In response, FINRA staff provided guidance that permits FINRA members participating in a global offering to be allocated overallotment option securities of up to an aggregate of 15% of the securities registered with the SEC in the global offering, so long as FINRA members are subject to a firm commitment underwriting agreement and regardless of the number of securities eventually sold by such members (including securities offered by such members outside the United States).

[b] Limits on Compensation

The Corporate Financing Rule places certain limitations on the total amount of underwriting compensation that underwriters and certain "related persons" may receive in connection with a public offering. [620] The rule also prohibits participation in the offering if the underwriting compensation received or to

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be received in connection with the offering is considered "unfair or unreasonable." [621]

Underwriting compensation consists not only of cash compensation in the form of the underwriting discount, but also any other "item of value" received by the underwriting group from any source within the period beginning 180 days prior to the filing date of the registration statement with FINRA and ending on the day the offering commences (the "compensation review period"), unless such item falls within a specific exemption. [622] In addition, items of value received within 90 days after the commencement of the offering are subject to FINRA review to determine whether they should be deemed "underwriting compensation" in connection with the offering. [623]

Items of value include, among other things, underwriting commissions and discounts, expense reimbursements (including reimbursement of fees and expenses of underwriters' counsel), [624] finder's fees and financial and consulting and advisory fees. Securities of the issuer, even if not acquired from the issuer or if received in connection with another offering or for providing other services,

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are also items of value. Cash compensation received for acting as a private placement agent, providing a loan or credit facility or for providing services in connection with a merger or acquisition are not considered items of value. [625]

In addition to the exclusion of specified items from the category of items of value, the Corporate Financing Rule contains five exceptions that are intended to distinguish items of value received as consideration for underwriting services from those received as consideration for other financial services, such as venture capital services. [626] The transactions covered by the five categories include acquisitions of securities:

- in private placements or as compensation for a loan or credit facility by certain entities that routinely make investments in, or provide loans or credit facilities to, other companies, and meet a "capital under management" test or that are banking or insurance companies;
- in issuers that have significant institutional investor involvement in their corporate governance before the required filing date of the public offering;
- in private placements that have significant institutional investor participation;
- made to prevent dilution of an investor's position, including as a result of preemptive right exercises, stock splits or *pro rata* rights offerings or the conversion of securities not deemed to be underwriting compensation; and
- made to prevent dilution before the effective date of a public offering where the purchaser has a prior investment history. [627]

Regardless of whether securities received by a member of an underwriting group are deemed underwriting compensation, if such securities are unregistered and received within the 180-day period prior to the filing date of the registration statement with FINRA, the Corporate Financing Rule imposes a lock-up on their sale (actual or through derivatives transactions) for 180 days following the commencement of the offering. Unregistered equity securities received after the filing are also subject to the lock-up, but only if they are deemed underwriting compensation in connection with the offering. [628] The imposition of a lock-up reflects FINRA's concern that "underwriters holding significant amounts of unregistered equity could dilute or manipulate the market for an issuer's equity securities immediately following the public offering, especially in the case of thinly traded issuers." [629]

Footnotes

574 FINRA was created in July 2007 through combination of the National Association of Securities Dealers ("NASD") and the member regulation operations of the NYSE. The current FINRA rulebook includes (i) FINRA rules and legacy NASD rules applicable to all member firms, unless more limited application is specified in such rule, and (ii) legacy NYSE rules applicable only to FINRA members that are also members of the NYSE. Helpful rule conversion charts can be found on FINRA's website: www.finra.org.

575 *See* FINRA Rules, Rules 5121, 5110(b)(1) and 5110(b)(7), FINRA MANUAL.

576 Control is presumed at 10% or more beneficial ownership of common or preferred equity, 10% or more interest in a partnership's profits or losses or the power to direct the management or policies of the relevant entity. Under this definition of control, ownership of nonvoting securities could fall within the definition if the ownership is substantial enough to influence management. Additionally, the criteria for control under FINRA Rule 5121 is not limited to securities beneficially owned by a participating FINRA member but also includes any such securities the FINRA member has the right to acquire within 60 days of its participation in the public offering. *See* FINRA Rules, Rule 5121(f)(6), FINRA MANUAL.

577 *See* FINRA Rules, Rule 5121(a), FINRA MANUAL.

578 FINRA Rule 5122 applies similar investor protections to certain private offerings made by a FINRA member or an entity that controls, is controlled by or is under common control with a FINRA member (as "control" is defined in the rule). Investors must receive written disclosure of the intended use of proceeds, the amount of offering expenses and the amount of compensation to be paid to the FINRA member in connection with the private offering, and such disclosure must be filed with FINRA on or before the date it is distributed to investors. FINRA Rule 5122 also places a 15% cap on the amount of offering proceeds the participating FINRA member can receive for costs, discounts, commissions or other sales incentives. Many types of private offerings are exempt from the requirements and limitations of FINRA Rule 5122, including offerings made under Rule 144A or Regulation S, offerings of investment-grade rated debt or preferred securities, as well as sales to employees and affiliates of the issuer, qualified purchasers under the Investment Company Act and qualified institutional buyers as defined in Rule 144A. Notably, however, FINRA Rule 5122 does apply to private offerings by FINRA members made in reliance on § 4(a)(2) of the Securities Act or Regulation D thereunder.

FINRA Rule 5123 generally requires FINRA members and associated persons to file with FINRA any private placement memorandum or term sheet used in connection with certain private offerings no later than 15 days after the document is provided to investors. Such disclosure must include a description of the anticipated use of offering proceeds and the amount and type of offering expenses and offering compensation. Because of its numerous exemptions—which include most offerings to institutional investors (including offerings made pursuant to Rule 144A) and offerings pursuant to Regulation S, as well as offerings of nonconvertible debt or preferred securities by issuers that meet the eligibility criteria for use of Form S-3 and F-3 for primary offerings—from a practical perspective the rule mainly applies to private placements by smaller issuers of securities to individual investors. *See* FINRA Rules, Rule 5123, FINRA MANUAL.

579 *See* FINRA Rule 5130, FINRA MANUAL.

580 *See* FINRA Rules, Notice to Members No. 03-79 (Dec. 2003); SEC Release No. 34-48701 (Oct. 24, 2003);

NASD Conduct Rules, IM-2110-1, FINRA MANUAL.

581 The term "equity security" is defined in FINRA Rule 5130 by reference to § 3(a)(11) of the Exchange Act.

Although FINRA Rule 5130 applies to IPOs of equity securities, as noted below, it exempts from its scope offerings of securities (whether in the form of ordinary shares or ADRs registered on Form F-6 under the Securities Act) that have a preexisting market outside the United States.

582 For this purpose, the term "associated person of a member" includes natural persons registered under FINRA rules, sole proprietors, partners, officers, directors and branch managers of a FINRA member or other natural persons occupying a similar status or performing similar functions, and natural persons engaged in the investment banking or securities business who are directly or indirectly controlling or controlled by a FINRA member. *See* FINRA By-Laws of the Corporation, Article I, Paragraph (rr), FINRA MANUAL.

583 "Beneficial interest" is broadly defined in FINRA Rule 5130(i)(1) to mean "any economic interest, such as the right to share in gains or losses," but does not include fees received by an entity for acting in a fiduciary capacity or managing or operating a collective investment account.

584 *See* FINRA Rules, Rule 5130(a), FINRA MANUAL.

585 *See* FINRA Rules, Rule 5130(i)(10), FINRA MANUAL.

586 The Securities Industry and Financial Markets Association has developed a standard form of representation letter that may be sent to prospective investors for this purpose and for purposes of obtaining representations under FINRA Rule 5131. In addition, certain third-party providers, such as Dealogic, offer a service whereby they will collect and maintain representation letters from prospective investors on behalf of FINRA member clients. *See* FINRA Interpretive Letter to Tom Fleming of Dealogic (Feb. 17, 2004).

587 FINRA Rules, Rule 5130(b), FINRA MANUAL. In single syndicate transactions that include both U.S. and non-U.S. underwriters, and in dual syndicate transactions in which there may be transfers of allocated securities between the U.S. and non-U.S. syndicates, there may be some question as to whether the non-U.S. underwriters are acting as "conduits" for the U.S. underwriters and thus would need to comply with the restrictions of FINRA Rule 5130 in connection with sales made to non-U.S. persons. In general, however, we are of the view that where a non-U.S. broker-dealer is selling securities to non-U.S. investors for which it bears the underwriting risk (where those non-U.S. investors have not been selected by a FINRA member), the non-U.S. broker-dealer should not need to comply with FINRA Rule 5130. On the other hand, if a FINRA member engages a non-U.S. broker-dealer to sell securities in the offering to non-U.S. investors for which the FINRA member bears the underwriting risk or with respect to which the FINRA member grants a selling concession, discount or other allowance to the non-U.S. broker-dealer, the non-U.S. broker-dealer may be viewed as a "conduit" for the FINRA member and should take steps to reasonably ensure that the non-U.S. offerees are not "restricted persons" under the rule. One such step required by standard U.S. master agreements among underwriters ("MAAUs") is for the FINRA member to ensure that any non-U.S. broker-dealer complies with FINRA Rule 5130 as if such non-U.S. broker-dealer were a member of FINRA.

Additionally, under the prior Interpretation, certain firms established barriers designed to prevent transfers of securities between the U.S. and non-U.S. syndicates (or between U.S. and non-U.S. underwriters in a single syndicate structure) in order to establish that non-U.S. underwriters would not receive selling compensation from the U.S. underwriters and thus that such non-U.S. underwriters were not subject to the Interpretation's prohibitions. Although FINRA Rule 5130 does not mandate such procedure, it might nonetheless continue to be useful as a means of establishing that the non-U.S. underwriters were not acting as "conduits" for the U.S. underwriters, particularly in U.S.-led offerings.

588 Although private placements are exempted from the rule, FINRA Rule 5130 does apply to IPOs of equity securities conducted outside the United States pursuant to Regulation S if the sales are made by a FINRA member or an entity (including, *e.g.*, a foreign broker-dealer or bank) acting as a "conduit" for a FINRA member. *See supra* Note 581.

589 FINRA Rules, Rule 5130(i)(9), FINRA MANUAL.

590 *See* FINRA Notice to Members No. 03-79 (Dec. 2003).

591 *See* FINRA Rules, Rule 5130(c)(6), FINRA MANUAL. Non-U.S. investment companies are eligible for this exemption only if (i) they are listed on a foreign exchange for sale to the public or authorized for sale to the public by a non-U.S. regulatory authority and (ii) no person owning more than 5% of its shares is a restricted person. A number of non-U.S. investment company trade associations submitted comment letters in connection with original NASD Rule 2790 objecting to the way in which this exemption was crafted. These letters contend that the exemption effectively precludes non-U.S. investment companies from participating in IPOs subject to the rule because non-U.S. funds frequently do not know who their ultimate beneficial owners are. (The same problem also precludes non-U.S. funds from relying on the exemption described above allowing sales to accounts in which the beneficial interests of restricted persons do not exceed 10% in the aggregate.) This remains an issue for non-U.S. investment companies as the exemptions did not substantively change when NASD Rule 2790 was redesignated as FINRA Rule 5130.

592 FINRA Rules, Rule 5130(c), FINRA MANUAL.

593 *See* FINRA Rules, Rule 5130(d)-(g), FINRA MANUAL.

594 In August 2002, the NASD first proposed rulemaking to prohibit certain allocation abuses. *See* NASD Notice to Members No. 02-55 (Aug. 2002). Then, in May 2003, the NASD and NYSE issued a joint task force report containing proposals for additional rulemaking regarding IPO allocation practices. *See* NYSE/NASD IPO Advisory Committee Report and Recommendations of a committee convened by the New York Stock Exchange, Inc. and the NASD at the request of the SEC (May 2003). The report articulated four general themes from which its recommendations were derived: (i) promoting transparency and avoiding aftermarket distortions, (ii) eliminating abusive allocation practices, (iii) improving access to information regarding IPOs, and (iv) encouraging underwriters to maintain high standards of conduct and promote education related to IPOs. Following the report, in November 2003, the NASD supplemented its existing rule proposal to reflect several of the report's recommendations, and in February 2004, the NYSE submitted its own rule proposal with respect to IPO allocations that largely mirrored the NASD proposed rule. *See* NASD Notice to Members No. 03-72 (Nov. 2003); SEC Release No. 34-50896 (Dec. 20, 2004).

The issue of abusive allocations of IPO shares was also addressed in connection with the April 2003 Global Research Settlement among the SEC, NYSE, NASD and various other securities regulators, on the one hand, and several of the largest investment banks, on the other. *See* § 14.07[5][b] for a discussion of the Global Research Settlement. In conjunction with the Global Research Settlement, the settling firms entered into a voluntary initiative pursuant to which they each agreed to implement policies and procedures reasonably designed to prevent the allocation of securities in "hot" IPOs (*i.e.*, those IPOs where the securities begin trading at a premium in the secondary market) to executive officers and directors of U.S. public companies and non-U.S. public companies with a principal equity trading market in the United States. *See* Press Release, SEC, Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings to Corporate Executives and Directors (Apr. 28, 2003).

In addition, the SEC deemed it appropriate in April 2005 (especially following settlements regarding hot IPO allocations with certain investment banks earlier in the year) to issue an interpretive release reminding investment banks that attempts to induce aftermarket bids or purchases during a Regulation M restricted period violate the regulation (and indeed always have violated Regulation M). The release focuses, in particular, on the application of Regulation M to the book-building process, emphasizing the impermissibility of arrangements such as tie-ins (*i.e.*, agreements to purchase shares in the aftermarket in exchange for receiving an allocation), laddering (*i.e.*, allocating IPO shares based on a commitment to purchase shares at specified prices in the aftermarket) and certain other forms of soliciting aftermarket bids or purchases. SEC Release No. 33-8565 (Apr. 7, 2005). In addition to describing a number of examples of impermissible conduct during the restricted period, the release notes that certain conduct occurring after the restricted period, though not itself violative of Regulation M, could be evidence of an attempt at impermissible inducement. Citing several enforcement cases, the release specifically mentions: (i) carrying out follow-up solicitations for immediate aftermarket orders with customers who earlier indicated aftermarket interest; and (ii) tracking or monitoring customer purchases to determine if customers have purchased in accordance with their earlier indications of aftermarket interest (although the release recognizes that there may be legitimate reasons to monitor customer activity).

595 *See* FINRA Regulatory Notice 10-60 (Nov. 2010); SEC Release No. 34-63016 (Sept. 29, 2010).

596 FINRA Rules, Rule 5131 adopts the same definitions of "new issue" and "beneficial interest" found in FINRA Rule 5130. *See supra* Notes 579 and 583 and accompanying text.

597 *See* FINRA Rules, Rule 5131(a), FINRA MANUAL.

598 *See* FINRA Rules, Rule 5131(b)(1)(A)–(C), FINRA MANUAL.

599 *See* FINRA Rules, Rule 5131(b)(2), FINRA MANUAL; *supra* Notes 586–588 and accompanying text.

600 *See* FINRA Rules, Rule 5131(b)(2), FINRA MANUAL.

601 *See* FINRA Rules, Rule 5131, Supplemental Material.01, FINRA MANUAL. In making an IPO allocation in compliance with FINRA Rule 5131, FINRA members may rely on written representations provided by the beneficial owner of an account within the prior 12 months, provided such FINRA member does not believe, or have reason to believe, such representations are inaccurate. FINRA Rules, Rule 5131, Supplemental Material.02, FINRA MANUAL.

Additionally, effective February 3, 2014, FINRA adopted new supplemental guidance for FINRA Rule 5131, making it easier for certain "fund of funds" or similarly structured entities to receive IPO allocations. Under Supplemental Material.02(b), FINRA members are permitted to allocate IPO shares to an account that has provided a written representation that

- it does not look through to the beneficial owners of any "unaffiliated private fund" (as defined below) that has invested in the account (except for beneficial owners that are control persons of the investment adviser to such unaffiliated private fund); and
- any "unaffiliated private fund" that has invested in the account (a) is managed by an investment adviser; (b) has assets greater than $50 million; (c) owns less than 25% of the account receiving the IPO shares and no single investor in the "unaffiliated private fund" has an economic interest of 25% or greater; and (d) was not formed for the specific purpose of investing in the account to receive the IPO shares. *See* FINRA Rules, Rule 5131, Supplemental Material.02(b), FINRA MANUAL.

An "unaffiliated private fund" is defined as a private fund (as defined in the Investment Advisers Act) whose investment adviser does not have a "control person" in common with the investment adviser of the account to receive the IPO shares. A "control person" means a person with direct or indirect control over the investment adviser, as the term control is defined in Form ADV.

602 FINRA members are also obligated to promptly record and maintain information regarding any penalties assessed by such member on a representative in connection with a penalty bid. *See* FINRA Rules, Rule 5131(c)(2), FINRA MANUAL.

603 *See* FINRA Rule 5131(d)(4), FINRA MANUAL.

604 *See* FINRA Rule 5131(d)(1), FINRA MANUAL.

605 *See* FINRA Rules, Rule 5131(d)(2), FINRA MANUAL. As a practical matter, most IPO underwriting agreements now will include (i) an agreement by the book-running lead manager to notify the issuer of an impending lock-up waiver at least three business days prior to the effective date of the waiver and (ii) an agreement by the issuer to make public announcement of the waiver through a major news service at least two business days prior to the effective date of the waiver. Placing the obligation of public announcement on the issuer is permitted by Supplemental Material.03 to FINRA Rule 5131. To facilitate compliance with FINRA Rule 5131, forms of a lock-up waiver letter and an issuer press release announcing a waiver are often included as exhibits to IPO underwriting agreements.

606 *See* FINRA Rules, Rule 5131(d)(3), FINRA MANUAL.

607 *See supra* Notes 581 and 587.

608 FINRA Rules, Rule 5141, FINRA MANUAL. The rule does not apply to "at-the-market" offerings or to global

securities offerings where the U.S. portion is conducted on a private placement basis.

609 FINRA Rule 5141 replaced NASD Rules 2730, 2740 and 2750, as well as NASD IM-2730, IM-2740 and IM-2750. *See* FINRA Regulatory Notice No. 10-47, Note 5 (Oct. 2010).

610 Indeed, the SEC release proposing FINRA Rule 5141 specifically acknowledged that "[u]nderwriting terms in foreign jurisdictions vary considerably, as do applicable regulatory requirements" and that "[t]he relationships between foreign nonmembers and their customers are beyond the scope of the proposed rule change." Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc., Notice of Filing of Proposed Rule Change To Adopt FINRA Rule 5141 (Sale of Securities in a Fixed Price Offering) in the Consolidated FINRA Rulebook, SEC Release No. 34-62299 (June 16, 2010), 75 Fed. Reg. 35,105, 35,108 & n.31 (June 21, 2010).

611 FINRA Rules, Rule 5141(a) and Supplemental Material.01, FINRA MANUAL.

612 *See* SEC Release No. 34-62299 (June 16, 2010).

613 Securities that immediately trade in the secondary market at or above their public offering price are presumed to have been salable at the fixed public offering price, and, therefore, to have not been eligible for price reduction. *See* FINRA Rules, Rule 5141(a), FINRA MANUAL.

614 *See* FINRA Rules, Rule 5110(c)(1), FINRA MANUAL. Generally, in its reviews of public offerings subject to the provisions of FINRA Rule 5110 and/or the conflict of interest provisions of FINRA Rule 5121, FINRA examines copies of the relevant registration statement and offering document, the underwriting agreement and the engagement letter, if any, among other information, all of which must be filed with FINRA. FINRA staff has issued an interpretive letter pursuant to which it has concluded that free writing prospectuses prepared by any party are excluded from these filing requirements. FINRA Interpretive Letter to Eileen Ryan of the Securities Industry Association and Sarah Starkweather of The Bond Market Association (Aug. 1, 2006).

615 One notable exemption from the review requirements is for securities both (i) registered on Forms S-3 or F-3 pursuant to the standards for those forms in effect prior to October 21, 1992 and (ii) offered pursuant to Rule 415 under the Securities Act (the "Seasoned Issuer Exemption"). FINRA Rules, Rule 5110(b)(7)(C)(i), FINRA MANUAL. There have been significant changes in the eligibility standards for those forms since 1992, so an offering on one of those forms today may not, in fact, fit within this exemption. For example, prior to October 21, 1992, Form F-3 had a 36-month reporting history requirement and a public float requirement of $150 million (or $300 million for F-3 issuers). The reporting history requirement has since been reduced to 12 months for corporate issuers, and the public float test has been reduced to $75 million. *See* § 3.04[6]. Offerings of nonconvertible, investment-grade debt or preferred securities are also exempt from the FINRA review process. FINRA Rules, Rule 5110(b)(7)(B), FINRA MANUAL, unless participation of a QIU is required due to a FINRA "conflict of interest," *see supra* text accompanying Note 577 .

While there is no blanket FINRA filing exemption for WKSI shelf registration statements, in September 2013, FINRA implemented an immediate clearance process through which WKSI and certain other shelf filings can be automatically and immediately issued 24-hours a day, seven days a week. To be eligible for immediate clearance, (i) the submitter must represent that any additional information required to complete the FINRA filing will be submitted within three business days and (2) the FINRA filing fee must have been paid prior to the shelf having been filed with FINRA and wire transfer details must be provided. Prospectus supplements relating to offerings off a WKSI shelf generally will not need to be filed with FINRA for the three-year life of the WKSI shelf. No filing of a WKSI shelf is required if a general filing exemption under FINRA Rule 5110(c) is satisfied , unless participation of a QIU is required due to a FINRA "conflict of interest." *See supra* text accompanying Note 577. A same-day clearance process is also available for registered primary offerings conducted under Rule 415 under the Securities Act, subject to certain conditions. For shelf offerings that must be reviewed, there is generally "Life of Shelf" clearance, pursuant to which a FINRA member would be granted clearance for any offering based on the same shelf registration statement after the initial filing of the shelf documents with FINRA and receipt of a FINRA no-objections opinion covering that FINRA member (assuming certain other requirements are met).

Along with the shelf immediate clearance process, in September 2013, FINRA introduced two additional, streamlined clearance processes for nonshelf registration statements: limited review and expedited review. For the majority of IPOs, limited review generally is available and, because of its simplified filing process, is preferable for timely deal clearance. Because full review remains the default when submitting a transaction for review in FINRA's Public Offering System, counsel to the underwriters must select an alternative review process and make certain representations to FINRA regarding the terms of the underwriting compensation arrangements, including that all relevant documentation will be submitted to FINRA no later than five business days prior to the member's participation in the offering. FINRA staff then will consider counsel's request for an expedited or limited review in light of several factors, including the complexity of the underwriting arrangements and the timing of the transaction. For further information on the FINRA review options, please *see* FINRA's Public Offering Review Programs Guide, http://www.finra.org/sites/default/files/p353162.pdf (May 2016).

616 *See* FINRA Rules, Rules 5110(b)(7) and 5110(b)(8), FINRA MANUAL.

617 Certain underwriting arrangements have been determined by FINRA to be *per se* unreasonable and specifically forbidden by FINRA Rule 5110(f)(2). Such prohibited arrangements include the underwriter's receipt of a nonaccountable expense allowance in an amount greater than 3% of the offering proceeds and any right of first refusal ("ROFR") with a duration of more than three years or that provides more than one opportunity to waive the refusal right for a fee. As of May 2014, FINRA no longer considers certain agreements to pay an underwriter a termination fee or grant a ROFR in a terminated transaction *per se* unreasonable. Such agreements are permissible, provided that (i) the agreement specifies that the issuer has a right of "termination for cause" that eliminates its obligation to pay the termination fee or grant the ROFR; (ii) the fees to be paid under the agreement are not excessive, but reasonable and customary; and (iii) the agreement is void two years from the date of termination.

618 *See* FINRA Rules, Rule 5110(f)(2)(J), FINRA MANUAL.

619 *See* § 3.02[9][d] for a discussion of syndicate short sales.

620 Parties subject to the Corporate Financing Rule include all FINRA members participating in the public offering (whether in an underwriting or other capacity), affiliates (including non-U.S. affiliates) of the participating FINRA members, associated persons of the participating FINRA members (and their immediate family members), financial consultants and advisers, finders and underwriters' counsel. *See* FINRA Rules, Rules 5110(a)(4) and 5110(a)(6), FINRA MANUAL. These parties are collectively referred to herein as the "underwriting group."

Underwriters occasionally enter into agreements under which they agree to compensate out of their own pockets a finder or consultant in connection with an offering. In these circumstances, even though the aggregate amount of compensation paid by the issuer to the underwriting group is unaffected, the fee paid to the finder or consultant by the underwriters may be viewed as "underwriting compensation" by FINRA since it is technically an "item of value" received by an entity falling within the scope of the underwriting group. FINRA has indicated that it should be informed of such arrangements so that it can make a determination as to whether the payment should be viewed as "underwriting compensation" and disclosed in the prospectus as such. Note that both the Corporate Financing Rule and SEC Regulation S-K require disclosure in the prospectus of all items considered by FINRA to constitute underwriting compensation. *See* FINRA Rules, Rule 5110(c)(2)(C), FINRA MANUAL; Item 508(e) of Regulation S-K. *See also supra* Note 328 for a discussion of the treatment of overallotment options that are structured as "free options" as underwriters' compensation.

621 *See* FINRA Rules, Rule 5110(c)(1), FINRA MANUAL. FINRA Rule 5110(c)(2)(E) states that the amount of underwriting compensation considered "fair and reasonable" varies directly with the amount of risk assumed by the underwriting group and inversely with the aggregate amount of offering proceeds. In addition, although no stated maximum amount of underwriting compensation is set forth in the Corporate Financing Rule, historically, FINRA staff has informally indicated its view that such compensation should generally not exceed 8% or 9% of the offering proceeds. (Shelf offerings are no longer required to include a

representation in the disclosure document that the maximum underwriting compensation in connection with any offering under the shelf will not exceed 8%.) If the maximum compensation threshold is exceeded due to the receipt of items of value other than the underwriting discount itself (*see* discussion below regarding the broad definition of "items of value"), in certain circumstances, one or more FINRA members may need to be expelled from the underwriting group in order to bring the aggregate amount of underwriting compensation below the acceptable limit.

622 *See* FINRA Rules, Rule 5510(d)(1), FINRA MANUAL.

623 *See* FINRA Rules, Rule 5510(d)(2), FINRA MANUAL.

624 Because FINRA's Corporate Finance Department must be able to determine that the maximum amount of underwriting compensation to be paid by the issuer to the underwriting group in connection with a public offering is not "unfair and unreasonable," they often require expense reimbursement sections in underwriting or other deal-related agreements to include a cap on the overall amount to be reimbursed by the issuer. This capped amount, representing the maximum possible reimbursement to the underwriter group, is then factored into the overall underwriting compensation analysis.

625 FINRA Rules, Rule 5110(c)(3)(B)(ii), FINRA MANUAL. The rule also provides that nonconvertible and nonexchangeable debt securities and derivative instruments acquired or entered into during the compensation review period (*i.e.*, the period beginning 180 days prior to the filing of the registration statement with FINRA and ending 90 days after the commencement of the offering) are not considered items of value so long as they are at a "fair price" (as such term is defined in the rule) and acquired or entered into in the ordinary course of business in transactions unrelated to the public offering. *See* FINRA Rules, Rule 5110(c)(3)(B)(vi) and (vii), FINRA MANUAL. If such securities are acquired or derivatives entered into in connection with the public offering, they will be deemed items of value and will count as underwriting compensation, but if entered into at a fair price, will have zero compensation value for purposes of determining the overall compensation limit. *See* FINRA Rule 5110(e)(5), FINRA MANUAL.

626 *See* SEC Release No. 34-48989 (Dec. 23, 2003).

627 Qualification for each of the five excepted transaction categories requires satisfaction of further detailed requirements. *See* FINRA Rules, Rule 5110(d)(5), FINRA MANUAL.

628 In addition to exceptions to the lock-up covering certain transfers, such as transfers by operation of law or in connection with the reorganization of the issuer, the Corporate Financing Rule excepts from the lock-up requirements securities acquired subsequent to the issuer's IPO pursuant to a sale under Rule 144A under the Securities Act, as well as securities held by the underwriter or a related person that equal less than 1% of the total securities being offered in the IPO. *See* FINRA Rules, Rule 5110(g)(2), FINRA MANUAL. Acquisitions of securities to prevent dilution of an investor's position, including as a result of preemptive right exercises, stock splits or *pro rata* rights offerings or the conversion of securities not deemed to be underwriting compensation are also not subject to the lock-up requirement. *See* FINRA Rules, Rule 5110(g)(1), FINRA MANUAL.

629 *See* NASD Notice to Members No. 04-13 (Feb. 2004).