U.S. Regulation of the International Securities and Derivatives Markets, § 8.01, 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 § 8.01 (11th and 12th Editions 2014-2017)
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The Securities Act does not provide an exemption for offers and sales of securities outside the United States. Section 5 of the Securities Act requires, in effect, that any offer or sale of a security made by U.S. "means or instruments of transportation or communication in interstate commerce or of the mails"—the so-called "jurisdictional means"—be registered with the SEC unless an exemption is available. [1]

Historically, the U.S. courts have generally applied the concept of jurisdictional means broadly, and in certain contexts a single telephone call into or from the United States may be enough to establish their use. [2] Moreover, even if the issuer and the underwriters do not use jurisdictional means but others do, and that use by others was reasonably foreseeable, courts may conclude that this contact with the United States is enough to make the registration provisions of the Securities Act applicable. [3] As a theoretical matter, a public offering outside the United States by a U.S. issuer may be subject to the registration requirements of the Securities Act since jurisdictional means would almost certainly be used, at least in a limited way. It is also theoretically possible that a public offering outside the United States by a foreign issuer may be subject to the registration requirements of the Securities Act if U.S. jurisdictional means are used in the offering; however, recent court decisions in the United States suggest that this is unlikely. [4]

The Securities Act also does not provide an exemption for a public offer or sale of a security by an issuer or underwriter or for a dealer in securities unless certain conditions are met. [5] Section 4(a)(3) of the Securities Act affords an

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exemption for offers and sales by U.S. and foreign securities dealers that are not "underwriters," unless the offers or sales occur prior to 40 days after the date the securities in question were first offered to the public or unless the securities are part of an "unsold allotment."

The term "underwriter" is defined in § 2(a)(11) of the Securities Act as "any person who has purchased from an issuer with a view to … the distribution of any security, or participates or has a direct or indirect participation in any such undertaking." The term "distribution" is not defined, and securities lawyers have been unable to conclude that offerings abroad are not distributions for this purpose. This uncertainty arises in part because the SEC, unlike other regulators, has made clear its belief that flowback of securities into the United States after a distribution abroad, even in a recognized international market, can be an indirect distribution in the United States and therefore subject to registration. Thus, members of an underwriting syndicate for an offering of securities outside the United States may be "underwriters" within the meaning of § 2(a)(11) of the Securities Act, especially if the securities are subsequently sold into the United States, and the exemption from the registration requirements afforded by § 4(a)(3) would not be available for offers and sales by such dealers. Moreover, the broad concept of a "direct or indirect participation" in a distribution raises the question whether dealers (other than syndicate members) that participate in the offering, for example, simply by purchasing and reselling the securities being offered, may, depending on their manner of compensation, be "underwriters" whose offers and sales must be registered. [6]

The term "unsold allotment" has been interpreted broadly and includes, at least as a theoretical matter, securities purchased directly or indirectly from an issuer in a chain of transactions between securities dealers not involving a sale to an end-investor. Thus, offers and sales by a dealer that purchased the securities from an underwriter, or from another dealer that purchased the securities from an underwriter, are not exempt from the registration requirements of the Securities Act by virtue of § 4(a)(3), whether or not the 40-day period has elapsed. In any event, offers and sales by dealers that purchased the securities in

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true secondary market transactions are not exempt until 40 days after the securities were first offered to the public. It is generally believed that the concept "offered to the public" for purposes of the 40-day limitation of § 4(a)(3) is not limited to offerings in the United States.

There is thus no express exemption in the Securities Act for offers and sales that are made outside the United States by an issuer, an underwriter or a dealer if there is any use of jurisdictional means in connection with the initial issue or subsequent resales.

[1] Release 4708

Although the registration requirements of the Securities Act apply by their terms whenever jurisdictional means are used to offer and sell securities, the SEC, after public pressure, interpreted their scope less broadly. The SEC first announced its view of the extraterritorial reach of the registration requirements of the Securities Act in 1964 when it published SEC Release No. 33-4708 ("Release 4708"). In that release, the SEC acknowledged that the securities laws were "primarily intended to protect American investors" and concluded that debt securities could be issued by U.S. companies without registration if "the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States" or in circumstances that would result in the securities "coming to rest" abroad. [7] This formulation was characteristic of the U.S. approach to regulation at the time—a desire to prohibit doing indirectly what could not be done directly—which led to imprecise general statements such as "coming to rest" that raised as many questions as they purported to answer.

On the basis of Release 4708, and no-action letters issued under it, U.S. securities lawyers developed detailed contractual provisions and related procedures designed to ensure that securities being offered abroad would not flow into the United States or wind up in the hands of U.S. persons as part of their distribution. For debt securities, these provisions typically included: (i) procedures to ensure that securities in definitive form were not available until 90 days after the distribution had been completed, and then only upon certification that the owner was not a U.S. person, (ii) agreements by the underwriters that they would not sell unsold allotments in the United States or to U.S. persons at any time, or other securities sold in the offering and acquired subsequently in the market until the 90-day period had passed, and (iii) agreements by the underwriters that they

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would deliver "confirmations" to other dealers imposing the same selling restrictions on them. [8] The concept of completion of the distribution was integral to these procedures, and the definition of "U.S. person" embraced U.S. nationals resident abroad.

[2] Problems That Emerged Under Release 4708

While the cooperative efforts of the SEC, the private bar and market participants provided a degree of certainty as to whether particular international offerings were required to be registered, certain difficulties emerged. First, as the international securities markets broadened and developed, issues arose that were not contemplated at the time of Release 4708. These included fundamental questions such as the application of the release (which had been addressed specifically to debt offerings by U.S. issuers) to international offerings by foreign issuers, including in particular international equity offerings. Indeed, for equity securities, lockup and certification procedures were not practicable, so the steps taken were limited to variants of (ii) and (iii) described above for debt securities. There were also technical questions— *e.g.*, the application of the registration requirements to "continuous" offerings, such as medium-term note programs in which discrete tranches of debt securities are issued from time to time with varying degrees of frequency, sometimes as often as daily. [9]

Second, the growing internationalization of the securities markets, and in particular the desire of U.S. institutional investors to acquire foreign securities as part of their diversified worldwide portfolios, focused attention on whether the registration requirements of the Securities Act should be subject to a more rigorous territorial limitation. For example, while Release 4708 stated that the registration requirements of the Securities Act were intended to protect U.S. nationals, it was not clear whether as a matter of law such persons were or should be entitled to the protections of the registration requirements when purchasing unregistered securities from abroad in markets outside the United States.

Finally, there was some uncertainty as to when securities offered and sold abroad could be resold in the United States pursuant to the exemptions from the registration requirements afforded by § 4(a)(1) or § 4(a)(3) of the Securities Act. The difficulty was that the registration requirements clearly apply to offers and sales that are part of a distribution, but the Securities Act is silent as to when a distribution is over. While the procedures developed under Release 4708 were reasonably designed to ensure that the securities being offered "came to rest"

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abroad, and thus were adequate to ensure that offers and sales made in accordance with them did not have to be registered, neither the SEC nor the private bar was able to say precisely when securities offered abroad could trade back into the United States under § 4(a)(1) or § 4(a)(3), since there was no definitive answer to the question of whether any particular seller was still participating in a distribution. It also was unclear as a matter of law whether each distribution participant was required to avoid resales until all distributors had sold their allotments or only until it had sold its allotment.

Other exemptions from registration suggested a cautious approach in the absence of official guidance— *e.g.*, the exemption provided by § 3(a)(11) for intrastate offerings if, among other things, there are no resales outside the state in question for a period of nine months, or the exemption provided by Rule 144 under the Securities Act, which at that time restricted resales of privately placed securities for three years. Securities lawyers generally advised that 90 days after completion of the distribution should be allowed before debt securities and equity securities offered abroad with respect to which there was no active U.S. market could be considered to be freely tradable into the United States under § 4(a)(1) or § 4(a)(3). [10] However, the staff of the SEC indicated informally its belief that up to nine months or a year should be allowed for equity and convertible debt of all U.S. issuers and for foreign issuers whose shares were actively traded in the United States.

Footnotes

1 The term "interstate commerce" extends to commerce between the United States and other countries. § 2(a)(7) of the Securities Act.

2 There is limited jurisprudence regarding the application of the registration requirements to offerings outside the United States. The cases so broadly interpreting the concept of jurisdictional means have generally involved efforts by issuers and underwriters to qualify for the intrastate offering exemption of § 3(a)(11) of the Securities Act, often in rather dubious circumstances. It is doubtful that the doctrines articulated in those cases would be applied in full to international offerings by foreign issuers, where considerations of comity would be weighty. Moreover, even if a court were to conclude that jurisdictional means had been used, it would still be possible to find a lack of subject matter jurisdiction. *See infra* Note 4.

3 *See, e.g.*, *United States v. Wolfson*, 405 F.2d 779, 783–84 (2d Cir. 1968) (discussing reasonably foreseen use of the mails).

4 A non-U.S. person who purchased securities outside the United States would have a right to rescission if the registration requirements were violated. In light of recent U.S. court decisions, it is, however, doubtful whether U.S. courts would adopt this position, and unlikely that they would do so in the case of an offering by

a foreign issuer. *See* § 11.10[3] for a discussion of the extraterritorial reach of the U.S. securities laws and the recent court decisions in the United States following the Supreme Court's decision in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010).

5 *See* §§ 4(a)(1) and 4(a)(3) of the Securities Act. There are exemptions from Securities Act registration based on types of offerings, such as for certain offerings of one security for another issued by the same company (*see* § 3(a)(9) of the Securities Act) or for offerings of securities that receive court approval following a fairness hearing (*see* § 3(a)(10) of the Securities Act). These exemptions can apply to offerings of securities outside the United States. *See* § 10.06[2], Note 114 and accompanying text; § 9.05[3][b], Note 149 and accompanying text. In addition, there are exemptions for certain types of securities, such as those issued or guaranteed by U.S. banks or U.S. branches or agencies of foreign banks (*see* § 3(a)(2) of the Securities Act and § 3.05[2]), that are also available for offerings of securities outside the United States.

6 The definition of "underwriter" in § 2(a)(11) of the Securities Act states explicitly that the term "shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission."

7 29 Fed. Reg. 9828 (July 22, 1964). This release dealt only with the registration requirements of § 5 of the Securities Act and not with the scope of the antifraud provisions of the securities laws. The same is true of Regulation S under the Securities Act, the successor to Release 4708, discussed later in this chapter.

8 For a discussion of the practices developed on the basis of Release 4708, *see* Alan L. Beller & Gail S. Berney, *Eurobonds*, 19 REV. SEC. COMM. REG., No. 4 (1986).

9 *See* § 10.02[2].

10 Over time, some members of the securities bar became relatively comfortable with a 40-day seasoning period in certain circumstances, since 40 days is the period specified in § 4(a)(3)(A) of the Securities Act.

U.S. Regulation of the International Securities and Derivatives Markets, § 8.02, SAFE HARBOR PROVISIONS OF REGULATION S

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 § 8.02 (11th and 12th Editions 2014-2017)
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In response to the difficulties and uncertainties discussed in § 8.01 above, in 1990 the SEC adopted Regulation S under the Securities Act—a comprehensive approach to the various issues relating to offerings of securities outside the United States that undid or superseded many of the concepts that had previously applied. [11] Regulation S consists of a general statement—which declares simply

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that the registration requirements apply only to offers and sales of securities made in the United States—and two safe harbors. A "safe harbor" under U.S. law is, generally speaking, a set of detailed procedures for ensuring that a general principle is observed. If the detailed procedures are followed, any doubts about how the general principle will be applied can be eliminated.

The general statement does not often serve as a basis for planning offerings outside the United States. Because the consequences of violating the registration requirements are so severe, issuers and underwriters often wish to receive the legal opinion of U.S. counsel that registration is not required. [12] While the territorial principle was a helpful and sensible advance in defining the scope of the registration requirement, in view of the difficulties of applying that principle to transactions that are by definition international in character, U.S. counsel is likely to be reluctant to provide opinions with respect to transactions not covered by one of the safe harbors.

The safe harbors are for (i) offers and sales by issuers, other participants in a distribution and their affiliates, and (ii) resales by others, such as investors that acquire securities in a U.S. private placement (including in a transaction exempt from the registration requirements under Rule 144A). [13]

In 1998, the SEC adopted amendments to Regulation S intended to prevent certain abusive practices by U.S. issuers that developed in connection with equity offerings purportedly made pursuant to the Regulation's safe harbors. [14] The release stated that the amendments to Regulation S were designed to prevent “abuses in connection with sales of domestic equity securities [which] have been common … especially schemes involving the securities of thinly capitalized or ‘microcap’ companies.” [15] These schemes were viewed by the SEC as having been a "guise for distributing securities into the U.S. markets without the protections of § 5 of the Securities Act." [16]

[1] Issuer and Distributors

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In order to fall within the first safe harbor, an offer or sale by an issuer, by distributors—underwriters, dealers and others who participate pursuant to a contractual arrangement in a distribution—or by their affiliates or anyone acting on their behalf, must meet two basic conditions: (i) the securities must be sold in an "offshore transaction" and (ii) there can be no "directed selling efforts" in the United States by the issuer or any distributor (or any of their affiliates).

[a] Offshore Transaction

An offer or sale is an "offshore transaction" if the offer is made outside the United States and either (i) the buyer (who may be a U.S. person) is (or is reasonably believed by the seller to be) outside the United States when the buy order is originated or (ii) the transaction is executed on the physical trading floor of a foreign securities exchange. [17] For purposes of alternative (i) of the definition of

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"offshore transaction," the general rule is that the buyer itself, rather than its agent, must be outside the United States. However, if the buyer is a corporation, partnership or investment company, it is enough that an authorized person employed by it or, in the case of an investment company, by its investment adviser, places the buy order while outside the United States. [18] Offers and sales in the United States to certain U.S. fiduciaries acting for foreign investors, [19] or to certain international organizations, are also considered offshore transactions. [20]

[b] Directed Selling Efforts

"Directed selling efforts" are any activities undertaken for the purpose, or that reasonably could be expected to have the effect, of conditioning the U.S. market for the securities being offered. [21] They include mailing printed material to U.S. investors, conducting promotional seminars in the United States or placing advertisements in publications with a general circulation in the United

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States. [22] The distribution or publication in the United States of information, opinions or recommendations concerning the issuer or any class of its securities—including research reports sent out by a participant in the distribution (or any of its affiliates)—could also constitute directed selling efforts, depending on the circumstances. [23] However, marketing efforts in connection with a registered U.S. public offering, or with a transaction that is exempt from the registration requirements of the Securities Act, such as a U.S. private placement (including general solicitation and general advertising in Rule 506(c) and Rule 144A offerings), [24]

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generally will not be treated as directed selling efforts for a simultaneous offering outside the United States. [25]

The prohibition on directed selling efforts is not intended to interfere with routine corporate communications, news stories or other *bona fide* journalistic activities. Thus, the dissemination by an issuer of routine corporate communications of the kind normally published by companies, such as press releases regarding financial results or the occurrence of material events, will not be deemed to be directed selling efforts. [26] In addition, access by journalists to press conferences and general meetings with company spokesmen, and to notices released to the press, need not be limited, even when the foreign offering is being discussed and the journalists work for publications with a general circulation in the United States, so long as: the press conference or meeting is held, and the notice is released, outside the United States; the information to be disseminated is made available to the foreign and U.S. press generally; and the press conference or release is not intended to induce purchases of securities by persons in the United States. [27]

The requirement that the information be made generally available to the press created uncertainty with respect to the common practice in Europe of granting one-on-one interviews to a limited number of financial publications— *The Financial Times* in particular—in connection with or in anticipation of an offering. If the publication had a general circulation in the United States or, as in the case of *The Financial Times*, a U.S. edition that may also run the interview, one-on-one interviews were discouraged by securities lawyers in the absence of definitive SEC guidance on the question. Uncertainty, some of it unwarranted, also arose as to the ability of the U.S. press to attend general presentations.

Partly in response to these uncertainties, the SEC adopted Rule 135e under the Securities Act, which provides a "safe harbor" to enable members of the press, including the U.S. press and publications with a general circulation in the United States to participate in offshore press activities conducted by or on behalf of non-U.S. issuers. [28] Rule 135e reaffirms the SEC's previous guidance regarding the ability of journalists to obtain access to issuers outside the United States; it allows one-on-one interviews, including "exclusive" interviews, to be granted to U.S. journalists; and it permits the U.S. journalists to participate in meetings with the issuer or specially arranged visits to the issuer, so long as the issuer either holds a general press conference to which both the U.S. and foreign journalists are given access before or after those interviews or meetings or gives foreign journalists the opportunity to conduct similar interviews or to participate in similar meetings. [29]

In general, Regulation S is not intended to interfere with any lawful and customary activities, selling or otherwise, that are conducted outside the United States. [30] Advertising campaigns for an offering outside the United States, including on television and radio, as occurred regularly in European privatizations, are therefore consistent with Regulation S. [31] Care should still be taken as to the information disseminated through such activities about the issuer and the securities being offered, particularly in relation to the consistency of such information with the offering document. [32]

Finally, while dissemination in the United States of a broker-dealer's quotations for a security being offered and sold outside the United States could be deemed directed selling efforts, the dissemination of a foreign broker-dealer's quotations by third-party systems (*e.g.*, a system operated by a foreign marketplace or by a private vendor that disseminates such quotations primarily

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in foreign countries) will not be deemed directed selling efforts, provided that (i) securities transactions cannot be executed between foreign broker-dealers and persons in the United States through the system and (ii) the issuer, distributors, their respective affiliates, persons acting on behalf of any of the foregoing, foreign broker-dealers and other participants in the system do not initiate contacts with U.S. persons or persons within the United States beyond those contacts permitted under Rule 15a-6 under the Exchange Act. [33]

The prohibition on directed selling efforts in the United States applies to each participant in the distribution during any "distribution compliance period" under Regulation S [34] and for so long as such participant is offering an unsold allotment. Because the prohibition on directed selling efforts can extend past the closing date, a number of questions have arisen as to when "tombstone" advertisements [35] can be published in a publication having a general circulation in the United States and when research reports can be circulated in the United States.

Tombstone advertisements in a publication with a general circulation in the United States will not be viewed as directed selling efforts, no matter when publication occurs, so long as less than 20% of the publication's aggregate circulation (including U.S. and foreign editions if they are substantially the same) is in the United States and the advertisement contains an appropriate legend and only the limited information specified by Regulation S. [36] If those requirements are not met, a participant in the distribution should not publish a tombstone advertisement in a publication with a general circulation in the United States until any distribution compliance period under Regulation S has expired and the person publishing the tombstone has disposed of its allotment.

Similarly, research reports may be circulated in the United States at any time if they meet the requirements of Rules 138 and 139 under the Securities Act. [37] If they do not meet those requirements, a participant in the distribution should not circulate research reports in the United States until the expiration of

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any distribution compliance period under Regulation S and the disposition of its allotment. [38]

[c] Additional Requirements

The offshore transaction and directed selling efforts requirements apply to any offering made in a manner that is intended to fall within a safe harbor of Regulation S under the Securities Act. However, in order to qualify for the safe harbor for issuers, distributors, their affiliates and persons acting on their behalf, certain additional requirements may need to be met as well. These requirements vary depending principally on the status of the issuer. [39] In general, the safe harbor provisions are least restrictive when it is least likely that securities offered abroad will flow into the U.S. market (Category 1) and most restrictive when adequate information about the issuer is not publicly available in the United States and existing or potential U.S. market interest is sufficient to suggest that offerings of the issuer's securities outside the United States may not come to rest abroad (Category 3). When adequate information about the issuer is publicly available in the United States (Category 2), the concerns about securities flowing into the U.S. market are reduced, and the restrictions fall between these two extremes. As a result of the amendments to Regulation S adopted in 1998, equity offerings by all U.S. issuers are subject to additional restrictions because of the SEC's concerns about flowback, regardless of availability of information.

The following table provides an overview of offerings that fall under each category: [40]

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TABLE 8-1

Category 1	*Category 2* [41]	*Category 3*
• Equity securities of a foreign issuer, [42] if there is no “substantial U.S. market interest” [43] in that class of equity. • Debt securities of a foreign issuer, if there is no “substantial U.S. market interest” in the issuer's total debt securities. • Any “overseas directed offering.” [44] • Securities backed by the full faith and credit of a foreign government.	• Equity securities of a foreign issuer that is a reporting issuer, [45] if there is “substantial U.S. market interest” in that class of equity. • Debt securities of a foreign issuer, if there is “substantial U.S. market interest” in the issuer's total debt securities. • Debt securities of a U.S. issuer [46] that is a reporting issuer.	• Equity securities of a foreign issuer that is not a reporting issuer, if there is “substantial U.S. market interest” in that class of equity securities. • Equity securities of any U.S. issuer. • Debt securities of a U.S. issuer that is not a reporting issuer.

41 Market practice has developed to apply additional restrictions to two types of offerings of equity securities of reporting foreign issuers that fit within Category 2: certain offerings of equity securities where substantially all of the trading takes place in the United States, whether in ADR form or otherwise; and offerings of ADRs, irrespective of the trading level of the underlying securities in the United States. Some market participants refer to such offerings as “Category 2 ½” offerings. For a further discussion of “Category 2 ½,” *see infra* § 8.02[1][c][ii].

42 Defined in as a “foreign government” or “foreign private issuer” (each as defined in Rule 405 under the Securities Act).

43 For a discussion of “substantial U.S. market interest,” *see* § 8.02[1][c][i].

44 *See* Note 56 and accompanying text.

45 The definition of “reporting issuer” excludes investment companies registered or required to register under the Investment Company Act of 1940. For a discussion of the meaning of “reporting issuer” under Regulation S, *see* Note 57.

46 The technical term used in Regulation S is “domestic issuer,” which means any issuer other than a “foreign government” or “foreign private issuer” (each as defined in Rule 405 under the Securities Act).

The following table provides an overview of the restrictions that apply to offerings that fall under each category:

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TABLE 8-2

Category 1	*Category 2* [47]	*Category 3 Debt*	*Category 3 Equity*

• Offshore transaction. • No directed selling efforts.	• Offshore transaction. • No directed selling efforts. • Offering restrictions. • 40-day distribution compliance period. • Notice to distributors.	• Offshore transaction. • No directed selling efforts. • Offering restrictions. • 40-day distribution compliance period. • Notice to distributors. • Temporary global note.	• Offshore transaction. • No directed selling efforts. • Offering restrictions. • 6-month to 1-year distribution compliance period. • Notice to distributors. • Investor certification of non-U.S. person status • Purchaser agreement on resales and hedging. • Transfer refusal procedures. • Legend (for domestic issuers only).

47 The following restrictions are typically imposed in a "Category 2 ½ " offering:

- offshore transaction;
- no directed selling efforts;
- offering restrictions;
- 40-day distribution compliance period;
- notice to distributors;
- investor certification of non-U.S. person status;
- purchaser agreement on resales and hedging; and
- transfer refusal procedures.

For a further discussion of "Category 2 ½," *see infra* § 8.02[1][c][ii].

[i] *Category 1 Offerings*

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Category 1 offerings include all offerings of securities of a foreign government (or of a governmental body that would be eligible to file Securities Act registration statements on Schedule B), [48] and offerings of a foreign private issuer if there is no "substantial U.S. market interest" in the type of security being offered. As a practical matter, particularly in the case of equity securities, there will be a "substantial U.S. market interest" for very few foreign issuers. Even foreign companies that have offered their shares to the public and obtained a listing on a securities exchange in the United States are, in most cases, unlikely to find that there is a substantial U.S. market interest in their equity securities. [49]

There is no substantial U.S. market interest in a foreign company's *debt* securities if the issuer reasonably believes that when the offering began: (i) its debt securities were held of record by fewer than 300 U.S. persons, *or* (ii) less than $1 billion in aggregate principal amount of its debt securities was held of record by U.S. persons, *or* (iii) less than 20% in aggregate principal amount of its debt securities was held of record by U.S. persons. [50] Commercial paper that

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is exempt from registration pursuant to § 3(a)(3) of the Securities Act need not be counted when applying these tests. [51]

It is important to note that, in the case of debt securities that are guaranteed by the parent of the issuer, the definition of substantial U.S. market interest applies only to the debt securities of the parent company. [52] If, however, the debt securities are guaranteed by an entity other than the parent of the issuer, for example, by a foreign bank, the definition applies to the debt securities of both companies considered separately, and if there is a substantial U.S. market interest for the debt securities of either of them, the offering of the bonds must be treated as falling into Category 2. If a foreign bank has guaranteed a large number of debt securities in bearer form or has its own debt securities outstanding in a pattern that suggests Category 2 treatment is appropriate, the simplest and most prudent course would be to treat an offering of debt securities guaranteed by that bank as falling into Category 2. [53]

There is no substantial U.S. market interest in a foreign company's equity securities if the issuer reasonably believes that in its most recent fiscal year (i) the securities exchanges and inter-dealer quotation systems [54] in the United States did not constitute the single largest market for the class of equity securities being offered *and* (ii) either (a) less than 20% of all recorded trading in that class of securities took place on securities exchanges and inter-dealer quotation systems in the United States or (b) at least 55% of such recorded trading took place on securities markets of a single foreign country. [55]

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Category 1 also includes any "overseas directed offering"— *i.e.*, an offering by a foreign issuer that is directed to the residents of a single foreign country in accordance with local laws and practices, or any offering of straight debt securities by a U.S. issuer that is made in the same manner, but only if the securities of the U.S. issuer are denominated in a foreign currency. [56]

No requirements beyond those relating to offshore transactions and directed selling efforts are required for Category 1 offerings. Some market participants treat offerings of securities of foreign issuers as falling into Category 2 as a matter of course. Where it is possible to determine clearly that an offering falls into Category 1, it does not seem necessary to demand compliance with the additional requirements of Category 2.

[ii] *Category 2 Offerings*

Category 2 offerings consist of all debt offerings of foreign issuers that do not fall into Category 1, all non-Category 1 equity offerings of foreign issuers that are subject to (and in compliance with) the periodic reporting requirements of the Exchange Act [57] and all debt offerings (other than overseas directed offerings) of U.S. issuers subject to and in compliance with the periodic reporting requirements of the Exchange Act.

For Category 2 offerings, certain steps are required beyond satisfying the offshore transaction and directed selling efforts requirements. These may be described as the "distribution compliance period," "offering restrictions" and "notice" requirements.

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Under the "distribution compliance period" requirement, [58] distributors generally may not offer or sell securities sold in the offering to or for the account or benefit of U.S. persons until 40 days after the later of (a) the date the securities are first offered to the public and (b) the closing date for the offering. [59] Unsold allotments may not be sold to or for the account or benefit of U.S. persons at any time. With a number of exceptions, "U.S. person" is defined to include individuals resident in the United States and corporations and other entities organized there. [60] It does not include U.S. nationals resident abroad. [61]

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Except in the case of continuous offerings, which are discussed in Chapter 10, the "distribution compliance period" under Regulation S is not tied to the completion of the distribution of the securities in question (as it was pursuant to Release 4708). This allows distributors to sell securities other than allotment securities free of the restrictions of Regulation S (i) at any time, in the case of securities that were not sold in the offering, or (ii) once the 40-day distribution compliance period has elapsed, in the case of securities sold in the offering and repurchased in the market, even when allotments remain unsold either by them or by other participants in the distribution. [62] It is, however, important to recall in this regard that 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). Accordingly, except in clear cases, it may be difficult as a practical matter to distinguish allotment securities from other securities for the purpose of taking advantage of this provision of Regulation S.

The issuer and the distributors must also comply with the requirement that "offering restrictions" be adopted. [63] The underwriters and selling group members must agree in writing that they will make offers and sales of the securities during the distribution compliance period only in accordance with Regulation S or pursuant to an exemption from the registration requirements of the Securities Act. [64] Moreover, any offering materials or documents used in connection with the offer or sale of the securities during the "distribution compliance period"

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must include statements to the effect that the securities have not been registered under the Securities Act and may not be sold in the United States or to U.S. persons (other than distributors) unless the securities are registered under the Securities Act or an exemption from the registration requirements is available. [65] In particular, these statements must appear in the prospectus or offering circular and in summary form in any advertisement relating to the offering. [66]

Regulation S also requires each distributor that sells securities to a distributor, U.S. or foreign securities dealer or other person receiving remuneration in connection with the sale during the distribution compliance period (or allotment securities at any time) to deliver a confirmation or other "notice" stating that the purchaser is subject to the same restrictions on offers and sales as a distributor. However, the purchaser receiving the notice need not observe the offering restrictions requirements or deliver a similar notice to others unless the purchaser is a dealer or person receiving selling concessions, fees or other remuneration in respect of the securities offered or sold. [67]

In addition, in light of the concerns expressed by the SEC in the 1998 Release with respect to equity issuances by foreign issuers under Regulation S, [68] market practice has developed to apply additional restrictions to two types of

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Regulation S offerings of securities of foreign issuers that are reporting companies under the Exchange Act: certain offerings of equity securities where substantially all of the trading takes place in the United States, whether in American depositary receipt ("ADR") form or otherwise; and offerings of ADRs, irrespective of the trading level of the underlying securities in the United States. Such offerings are referred to by some market participants as "Category 2 ½" offerings, in reference to the fact that although the offerings technically meet the requirements of Category 2, the trading profile of the securities would suggest that some of the policy considerations underlying the additional restrictions contained in Category 3 are relevant to such securities as well.

For these offerings, modified Category 3 procedures are considered appropriate to limit the flowback of such securities into the United States for some period of time, thereby rebutting the suggestion that the securities are merely being parked overseas on a temporary basis in order to avoid the registration requirements of the Securities Act. These procedures are generally structured to include transfer restrictions that apply for 40 days, rather than six months, as would be the case in a Category 3 offering. [69] In addition, other procedures that might be implemented include requiring each investor to certify that it has not engaged in hedging activities with regard to the securities in anticipation of the offering or during the distribution compliance period and, if the issuer has a registered ADR facility (and underlying shares are being offered rather than ADRs), that it will not deposit the offered securities into the registered ADR facility during the distribution compliance period. A registered ADR facility may also be closed to new deposits during the distribution compliance period to police the transfer restrictions; alternatively, new depositors into the facility may be required during the distribution compliance period to certify that the securities they are depositing were acquired by them before the offering. It may also be necessary to have the securities represented by some form of nonfungible security during the distribution compliance period, or held through some form of custodial facility to allow policing of the transfer restrictions. This would be most likely when ADRs are being offered or when common shares are being offered and it is not possible to close the ADR program to new deposits or there is no ADR program and the securities being offered trade in the same form as the securities traded in the United States. When bonds convertible into these types of securities are offered, precluding conversion for 40 days from issuance would be a prudent means of policing the transfer restrictions with respect to the underlying securities. Category 2 offerings of convertible bonds, in particular, have also raised difficult questions regarding the availability of an exemption from SEC registration requirements in connection with hedging activities (for example, a purchase of the convertible bond and then a sale of the underlying security on

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a U.S. exchange) by distributors on behalf of investors and by investors acting for themselves.

[iii] *Category 3 Offerings*

Category 3 offerings consist of (i) equity offerings of foreign issuers not subject to the periodic reporting requirements of the Exchange Act if there is a "substantial U.S. market interest" for the class of securities being offered; (ii) equity offerings of all U.S. issuers; and (iii) debt offerings of U.S. issuers not subject to the periodic reporting requirements of the Exchange Act. [70] Very few offerings of foreign issuers will fall into this category. [71]

There are more elaborate procedural requirements for Category 3 offerings. For both debt and equity offerings, the "distribution compliance period," "offering restriction" and "notice" requirements apply. [72] In addition, in the case of debt offerings, when issued the securities must be represented by a temporary global security that cannot be exchanged for securities in definitive form until the expiration of the 40-day distribution compliance period and then only upon certification of beneficial ownership of the securities by either (i) a non-U.S. person or (ii) a U.S. person who purchased the securities in a transaction that did not require registration under the Securities Act. [73]

In the case of equity offerings, the distribution compliance period is extended to six months [74] (one year if the issuer is a nonreporting issuer), and the following additional conditions apply during the distribution compliance period: [75]

- the purchaser of the securities must certify that it is not a U.S. person and is not acquiring the securities for the account or benefit of any U.S. person, or

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  is a U.S. person who is purchasing securities in a transaction that does not require registration under the Securities Act;
- the purchaser of the securities must agree to resell such securities only in accordance with the provisions of Regulation S, pursuant to registration under the Securities Act or pursuant to an available exemption from registration, and must agree not to engage in hedging transactions with regard to such securities unless in compliance with the Securities Act;
- the securities of a U.S. issuer must contain a legend to the effect that transfer is prohibited except in accordance with the provisions of Regulation S, pursuant to registration under the Securities Act or pursuant to an available exemption from registration, and that hedging transactions involving those

securities may not be conducted unless in compliance with the Securities Act; and

- the issuer is required, either by contract or a provision in its bylaws, articles, charter or comparable document, to refuse to register any transfer of the securities not made in accordance with the provisions of Regulation S, pursuant to registration under the Securities Act or pursuant to an available exemption from registration; provided, however, that if the securities are in bearer form or foreign law prevents the issuer of the securities from refusing to register securities transfers, other reasonable procedures (such as legends) are implemented to prevent any transfer of the securities not made in accordance with the provisions of Regulation S.

Moreover, the "offering restrictions" requirement is expanded in equity offerings by U.S. issuers to include an agreement by all distributors not to engage in hedging transactions with regard to the securities during the distribution compliance period unless in compliance with the Securities Act and a requirement that all offering materials and documents state that hedging transactions involving these securities may not be conducted unless in compliance with the Securities Act. [76]

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The Category 3 restrictions, as applied to U.S. companies, have led to significant difficulties. In 1999 and 2000, three exchanges, initially the European Association of Securities Dealers Automated Quotation N.V./S.A. ("EASDAQ") [77] and, subsequently, the Australian Stock Exchange and the OM Stockholm Exchange, wrote to the staff saying that smaller, privately held, nonreporting, growth-oriented U.S. companies wished to list their shares on their respective exchanges in connection with offerings made in reliance on the safe harbor provisions of Regulation S without simultaneous registration under the Securities Act. However, because of the manner in which securities listed on these exchanges were traded and settled, it was not possible for the offerings to comply strictly with some of the requirements of Regulation S. In particular, the certification, agreement, monitoring and stop-transfer requirements of Rule 903(b)(3)(iii)(B)(1), (2) and (4) under the Securities Act could not be implemented due to the book-entry trading systems they operated, and the notice requirements contained in Rules 903(b)(3)(iv) and 904(b)(1)(ii) could not be met by exchange members or participants because their computer systems were not configured in a way that would allow them to comply. [78]

Noting that (i) U.S. firms are not permitted to participate in the markets in question, either as brokers or as market-makers, and (ii) no trading screens would be placed in the United States, the SEC staff issued a series of no-action letters in 1999 and 2000 [79] permitting reliance by nonreporting U.S. issuers on certain alternative procedures for initial public offerings under Regulation S that are made in conjunction with listings on these markets.

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However, it is no longer clear that these no-actions letters can be relied upon. [80] More recently, some European exchanges have considered seeking similar no-action positions, but no relief has been granted. It would be advisable to seek and obtain clearance, formal or informal, before proceeding, rather than relying on the procedures developed specifically for these three exchanges. Even if these procedures are available, some non-U.S. exchanges may be unwilling to impose on their members restrictions regarding transactions with or for the account of U.S. persons.

There have been a number of Category 3 offerings in recent years by U.S. issuers, many of them seeking a listing on alternative markets, such as the Alternative Investments Market of the London Stock Exchange ("AIM"). In 2014 and 2015, the London Stock Exchange issued a series of notices in connection with the enactment of the EU Regulation on Central Securities Depositories. The regulation introduced the requirement for electronic settlement of securities on European trading venues, including securities issued under Category 3. As a result, the UK central securities depository ("CREST") developed procedures to allow the electronic settlement of securities issued under Category 3, which were published by CREST in May 2015. Effective September 1, 2015, the London Stock Exchange adopted amendments to its rules on electronic settlement of

Category 3 securities in line with the EU regulation and CREST's procedures. These amendments removed the exclusion of "Regulation S, Category 3" securities from the rule that requires securities to be recorded in electronic form, and updated the London Stock Exchange's guidance to establish revised procedures for the electronic settlement of these securities while meeting the restrictions imposed under Category 3. [81] Although the SEC staff has not approved these procedures, we understand they have been used in a number of offerings.

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A second difficulty in complying with Category 3 restrictions for offshore U.S. equity offerings relates to the application of the Category 3 restrictions to convertible bond offerings by U.S. companies. This difficulty and the SEC staff's solution to it are discussed in § 10.06[4].

A third difficulty has arisen out of the relationship between Regulation S and Rule 802 under the Securities Act in the context of exchange offers by U.S. companies for the shares of foreign acquisition targets. Rule 802, described in detail in § 9.05[9][c], permits an exchange offer by a U.S. company for shares of a foreign target on the basis of an exemption from the registration requirements of the Securities Act so long as less than 10% of the target's publicly held shares (calculated in the manner specified in the rule) are held of record by U.S. holders. The exemption is not conditioned on compliance with any resale restrictions, such as those contained in Category 3 of Regulation S. Thus, shares of U.S. companies that are sold offshore to foreign target shareholders in transactions that are exempt from registration under Rule 802 may flow back immediately into the U.S. market, subject to the availability of the general exemptions afforded by §§ 4(a)(1) and 4(a)(3) of the Securities Act. This result has been accepted by the SEC, at least where there are some shares in the target that are held by U.S. holders. The SEC staff does not agree, however, that Rule 802 is available when there are no U.S. shareholders in the target. [82] In these circumstances, U.S. companies seeking to avoid registration must rely on the exemption afforded by Regulation S, and the resale restrictions of Category 3 will apply.

The onerous restrictions imposed by Category 3 significantly reduce the value of shares in U.S. companies as acquisition currency. Accordingly, where Rule 802 is not available, U.S. acquirors of foreign companies will likely seek to register their exchange offers with the SEC. However, the applicable registration statement could require the inclusion of financial information about the target, reconciled to U.S. generally accepted accounting principles ("GAAP"), and this may not be readily available. [83] Moreover, the registration process can be time-consuming and costly. In these circumstances, *i.e.*, when Rule 802 is not available because the target has no U.S. shareholders, consideration should be given to approaching the SEC staff in order to seek a relaxation of the Category 3 requirements. Arguments in favor of such a relaxation are that: (i) U.S. issuers report regularly under the Exchange Act, (ii) information about the acquisition will be reported in the ordinary course on Form 8-K, so the market will be appropriately informed, (iii) it is unlikely that the shares will be valued at a discount,

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thus rendering Category 3 restrictions largely superfluous because the incentive for immediate resale to lock in a discount will not be present and (iv) the rigorous application of Category 3 restrictions would place U.S. companies at a disadvantage in relation to competing foreign bidders to which Category 3 restrictions generally do not apply.

[d] Use of the Internet in Regulation S Offerings

As in the case of public and private offerings in the United States, issuers regularly use the Internet in connection with Regulation S offerings, and offering-related materials are often posted on the websites of issuers or other distribution participants. In 1998, the SEC outlined certain procedures that can be used to solicit non-U.S. purchasers over the Internet to ensure compliance with the relevant Regulation S restrictions. [84] First, the website should contain a prominent "meaningful" disclaimer making it clear that the offer is directed only to countries other than the United States. In the case of Category 2 and 3 offerings, the disclaimer should also make clear that the offer is not open to U.S. persons. Second, steps should be implemented that are reasonably designed to guard against engaging in actual sales in the United States or, where applicable, to U.S. persons. [85]

Third, it should be confirmed that there are no indirect indications—such as payment drawn on a U.S. bank—that purchasers are in the United States or, in a Category 2 or Category 3 offering, U.S. persons. Fourth, measures should be taken to ensure that the content of the solicitation does not appear to be targeted to persons in the United States or, where applicable, to U.S. persons. [86]

Issuers also often limit online access to offering materials by imposing an access filter that requires a user to provide residence information confirming that it has a non-U.S. address and, where applicable, that it is a non-U.S. person, before it can access offering material on the issuer's website. The SEC's 1998 outline of the steps that should be taken to guard against sales to U.S. persons did not require such an access filter for a Regulation S offering, but it did say an access filter should be used if there was a concurrent exempt placement in the United States. Also, in the context of SEC-registered offerings, the SEC stated

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that an access filter is necessary [87] in order to rely on Rule 135e for Internet dissemination of press materials:

> Securities Act Rule 135e … permits a foreign private issuer and other offering participants to provide journalists with access to offshore press activities that discuss a present or proposed offering of securities. Rule 135e requires that press-related materials be released only outside the United States and that press conferences be held outside the United States. As a result, we believe that dissemination through the Internet by the issuer or other person covered by Rule 135e of these materials or press conferences will not comply with Rule 135e *unless procedures are implemented to assure that only permitted recipients under the rules are able to access the information.* [88]

Based on informal communications with the SEC staff, we understand that the requirement of access filters for reliance on Rule 135e in an SEC-registered offering, discussed in the April 2000 release, was not intended to apply more generally to require them as a condition to posting offering-related materials on the Internet in any Regulation S offering. We do not believe access filters are required in order to post offering-related materials on the Internet in a Regulation S offering, as long as the other circumstances of the offering do not suggest that the posting could be conditioning the U.S. market. In particular, there should be no sales to U.S. persons and no disclosures suggesting a U.S. marketing focus. The issuer's past practices in posting similar materials, and any applicable local regulatory obligations to do so, would also support the view that the posting is not conditioning the U.S. market.

Where a Regulation S offering is being made in conjunction with a private placement in the United States, access filters have routinely been imposed because of the language in the 1998 release. Now that the prohibition on general solicitation and general advertising has been eliminated for private placements in reliance on Rule 506(c) or Rule 144A, practitioners may question whether access filters are still required in such offerings. For other private placements, for

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example under § 4(a)(2), additional protective measures may be necessary. [89] These matters are described in greater detail in § 7.04.

[e] Impact of U.S. Sales

With two exceptions, the availability of the safe harbor is determined separately for the issuer and each distributor, so that a failure by one of them to comply will not affect the availability of the safe harbor for the others. [90] Directed selling efforts in the United States by the issuer or any distributor will cause the safe harbor to be lost for all of them, and the failure by the issuer or any distributor to adopt offering restrictions in connection with Category 2 and Category 3 offerings will also result in a loss of the safe harbor for all. [91]

Offshore transactions made in compliance with Regulation S will not be integrated with U.S. offerings that are registered under the Securities Act or are exempt from the registration requirements, for example, in accordance with Rule 144A under the Securities Act. [92] Accordingly, offerings outside the United States under Regulation S may be made in conjunction with registered public offerings or exempt offers and sales, including private placements, in the United States. [93]

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Like Release 4708, Regulation S does not say when securities offered outside the United States may be sold into the United States under § 4(a)(1) or § 4(a)(3) of the Securities Act. It is, however, generally understood, and the SEC staff appears to have confirmed, that securities other than unsold allotments [94] and equity securities of U.S. issuers [95] may be sold into the United States immediately, subject in the case of sales by dealers to the 40-day requirement under § 4(a)(3), and subject in the case of sales by distributors and their affiliates in Category 2 and Category 3 offerings to the expiration of the applicable distribution compliance period.

However, the SEC has cautioned that Regulation S does not provide an exemption for resales into the United States by purchasers of securities placed offshore under Regulation S. [96] As a result, "persons who would be considered underwriters under § 2(a)(11) of the Securities Act are not permitted to make unregistered public resales of these securities in the United States in reliance on the § 4(a)(1) exemption from registration." [97] The determination whether a person is an underwriter, particularly in the case of an entity that is not a securities professional, is often based on an analysis of the facts and circumstances involved.

Investors who are not securities dealers and who do not receive a selling concession or similar discount are generally thought to be free to sell securities into the United States at any time under § 4(a)(1) of the Securities Act, subject to any applicable contractual limitations. The same should be true of non-U.S. shareholders, including affiliates, of a non-U.S. target who receive shares in an exchange offer conducted pursuant to Regulation S or Rule 802 under the Securities Act as part of a business combination, so long as the recipients of the shares are not affiliates of the acquiror. [98]

[2] Resales

The second safe harbor of Regulation S under the Securities Act is for resales of securities outside the United States by persons other than the issuer, a

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distributor, any of their affiliates (except any officer or director who is an affiliate solely by virtue of holding such position) or any person acting on their behalf. Under this safe harbor, securities that are initially offered abroad, or in the United States in a private placement (including in a transaction exempt from the registration requirements under Rule 144A), can be resold immediately abroad so long as the "offshore transaction" requirement is met and there are no directed selling efforts in the United States in connection with the resale. [99] In the case of resales by dealers, officers and directors of the issuer, and certain other persons, additional conditions must be met in certain circumstances. [100]

For purposes of the resale safe harbor, the "offshore transaction" requirement is met if the offer is made outside the United States and either (i) the buyer (who may be a U.S. person) is (or is reasonably believed by the seller to be) outside the United States when the buy order is originated [101] *or* (ii) the transaction is executed on a foreign securities exchange or market designated by the SEC (a "designated offshore securities market" [102]). In contrast with the requirement of

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the safe harbor for offers and sales by distributors, there is no need for the sale to take place on a physical trading floor. [103]

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The 1998 amendments to Regulation S added Rule 905 under the Securities Act (and made conforming changes to Rule 144 under the Securities Act) to classify as "restricted securities" within the meaning of Rule 144 equity securities of U.S. issuers that are offered and sold under Regulation S. Thus, equity securities of U.S. issuers originally sold pursuant to Regulation S may be resold, after the expiration of a six-month holding period (or a one-year holding period for a nonreporting issuer), to a U.S. person by a nonaffiliate of the issuer in reliance on the safe harbor provided by Rule 144. [104]

Rule 905 also dealt with abuses of Regulation S where the offshore purchaser used a promissory note to pay all or a portion of the purchase price of equity securities of U.S. issuers and then repaid the promissory note only with the proceeds from the sale of the securities into the United States upon the expiration of the Regulation S distribution compliance period. As the SEC recognized, under such an arrangement, "in economic substance, the issuer is raising funds from the U.S. public markets." [105] The SEC's classification of domestic equity securities as Rule 144 "restricted securities" eliminates this problem by applying the Rule 144 requirement that its restricted period will not begin in the case of domestic equity securities purchased with promissory notes unless and until the promissory note (i) provides for full recourse against the purchaser of the securities, (ii) is secured by sufficient collateral other than the securities purchased and (iii) shall have been discharged by payment in full prior to the sale of the securities. [106]

Rule 905 also provides that the offshore resale under Regulation S of restricted securities that are equity securities of a U.S. issuer will not "wash off" the restricted status of those securities and allow them to be resold freely into the United States by the purchaser. Rather, the securities remain "restricted securities" under Rule 144 until the expiration of the applicable holding period under that rule no matter how many times the securities are resold outside the United States. [107] However, the SEC also noted that it was taking a targeted approach to

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addressing the abuses prompting the 1998 amendments to Regulation S and declined to extend Rule 905 to the securities of foreign private issuers. [108] Accordingly, once resold outside the United States, securities other than equity securities of domestic issuers are unrestricted and generally can be freely resold, including into the United States, subject in the case of sales by dealers to the 40-day requirement under § 4(a)(3) and, in the case of sales by dealers and persons receiving selling concessions, fees or other remuneration in respect of the securities offered in Category 2 and Category 3 offerings, to the expiration of the applicable distribution compliance period. [109]

The resale safe harbor, even as tightened up by Rule 905, was a significant expansion of the position taken by the SEC in no-action letters issued under Release 4708. [110] In those letters, issued in connection with the French privatizations, the SEC staff permitted immediate "regular way" resales on the Paris Bourse of equity securities that were privately placed in the United States in circumstances where there was no U.S. public market for the issuer's securities (other than commercial paper) at the time of the U.S. placement. Based on subsequent statements by SEC staff members, securities lawyers generally believed that this approach to resales should be limited to exchanges where participation by U.S. investors was no greater than on the Paris Bourse. In particular, given the extent of U.S. participation in transactions on the London Stock Exchange, the approach derived from these no-action letters was not thought to be available for resales on that exchange. Resales on other European exchanges were considered by U.S. counsel on a case-by-case basis.

Regulation S extended this approach to debt securities and to all resales outside the United States that satisfy the requirements of the resale safe harbor, without regard to whether there is a U.S. market for the securities in question. One significant effect of this safe harbor is that U.S. investors can resell immediately outside the United States foreign equity securities that they acquired in private placements in the United States (including placements on the basis of Rule 144A). [111] The resale safe harbor thus significantly increased the attractiveness of privately placed securities of foreign issuers because the liquidity of such securities was no longer impaired—resales may be made immediately outside the

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United States into the principal trading market for the securities. [112] Securities lawyers may still look to the doctrines contained in the no-action letters obtained in connection with the French privatizations [113] when considering whether resales on a securities exchange that is not a designated offshore securities market nonetheless have the benefit of an exemption from the registration requirements of the Securities Act.

Footnotes

11 The regulation was first proposed for comment in June 1988, a revised version was proposed for comment in July 1989 and a further revised version was adopted in April 1990. For a discussion of the regulation as originally proposed, *see* Leslie N. Silverman & Daniel A. Braverman, *Registration Requirements for Securities Offered Abroad*, 21 REV. SEC. COMM. REG., No. 22 (Dec. 21, 1988). The SEC received 89 comment letters on Regulation S as originally proposed, and these are outlined in the SEC's Outline of Commentators' Remarks dated April 21, 1989. The following discussion of the regulation draws on Adam Fleisher & Peter Castellon, *Regulation S Selling and Transfer Restrictions: A Basic User's Guide*, *available at* http://www.cgsh.com/cgsh/Regulation-S-Selling-and-Transfer-Restrictions.pdf (July 18, 2012).

12 Issuers and underwriters that violate the registration requirements of the Securities Act are subject to enforcement actions brought by the SEC and investors' right to rescission or damages. *See* § 11.02.

13 For a discussion of U.S. private placements, *see* Chapter 7.

14 *See* SEC Release No. 33-7505 (Feb. 17, 1998).

15 63 Fed. Reg. 9632 (Feb. 25, 1998).

16 63 Fed. Reg. 9632 (Feb. 25, 1998). Many of the abuses were first highlighted by the SEC in a 1995 interpretive release discussing certain "problematic practices" involving the purported offering under Regulation S of equity securities of U.S. issuers and requesting comment as to whether Regulation S should be amended to curb such perceived abuses. SEC Release No. 33-7190 (June 27, 1995). In 1997, the SEC issued a second release that proposed certain amendments to Regulation S and responded to comments received on the 1995 interpretive release, recommending among other things that equity securities of U.S. issuers, as well as equity securities of non-U.S. issuers if more than 50% of the trading volume for those securities takes place in the United States, be classified as "restricted securities" within the meaning of Rule 144 under the Securities Act. The SEC proposed treating such securities of non-U.S. issuers in the same way as equity securities of U.S. issuers despite substantial criticism from commenters on the prior release that the 50% test would be too broad. SEC Release No. 33-7392 (Feb. 20, 1997).

Although the SEC adopted most of the amendments proposed in its 1997 release in 1998, in order to "avoid undue interference with offshore offering practices of foreign companies," the amendments adopted did not apply to equity securities of foreign issuers. SEC Release No. 33-7505 (Feb. 17, 1998). The SEC nonetheless expressed continuing concern about the potential for abusive practices in offerings of equity securities by foreign issuers: "Although the abusive practices under Regulation S have not been evident in offerings by foreign issuers, the [SEC] was concerned that abusive practices might develop in the future since the economic incentives for indirect distributions and resales into the United States are the same for equity offerings by both domestic companies and foreign companies where the principal market for their securities is the U.S." SEC Release No. 33-7505 (Feb. 17, 1998), 63 Fed. Reg. 9632, 9633 (Feb. 25, 1998). The 1998 adopting release points out many of the considerations voiced by commenters that influenced the SEC's decision not to apply the amendments to foreign issuers, but the SEC left open the possibility of changing its position should abusive practices develop in the context of offshore equity offerings by foreign issuers. *See infra* Note 68. The SEC has also brought a number of enforcement actions against entities and individuals believed to be abusing the Regulation S safe harbor. *See, e.g.*, *Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009); *In re Carley*, SEC Admin. Proc. File No. 33-8480 (Sept. 1, 2004); *In re Robert G. Weeks*, SEC Admin. Proc. File No. 3-9952 (Feb. 4, 2002); *SEC v. Cohen*, SEC Litigation Release No. 16583 (June 5, 2000); *SEC v. Softpoint, Inc.*, 958 F. Supp. 846 (S.D.N.Y. 1997), *aff'd without op.*, 159 F.3d 1348 (2d Cir. 1998); *United States v. Sung*, SEC Litigation Release No. 14500 (May 15, 1995).

17 Over the years since this reference was included in Regulation S, most foreign securities exchanges moved away from using a physical trading floor. Electronic systems have replaced the trading floor in many of these markets. Dealer-to-dealer systems involve transactions that cannot easily be analogized to those occurring on a physical trading floor, insofar as they involve transactions with known counterparties. Electronic "black-box" trading systems, however, maintain the anonymity of the buyers and sellers. So long as the buyer remains anonymous, we believe the seller should be able to form a reasonable belief that the buyer is not in the United States, provided the seller does not otherwise believe (due to, for example, independent knowledge of the identities of persons acting as buyers) that such persons are in the United States.

18 55 Fed. Reg. 18,306, 18,310 n.39 (May 2, 1990). Although neither Regulation S nor the adopting release deals expressly with offshore transactions involving U.S. pension funds, an offer or sale to a fiduciary outside the United States acting with discretion for the fund should qualify as an offshore transaction. There remains some uncertainty, however, as to the appropriate treatment of certain offshore accounts of U.S. pension funds under the "U.S. person" definition. *See infra* Note 61.

19 This codifies the no-action position taken by the SEC staff in *Baer Securities Corp.* (avail. Oct. 12, 1979). Although the rule speaks of U.S. fiduciaries who act on a discretionary basis for foreign investors, the principle applies all the more to U.S. fiduciaries who act for them on a nondiscretionary basis. The TEFRA antibearer bond rules, however, generally prohibit offers and sales in the United States of unseasoned debt securities in bearer form, even when the buyer is a fiduciary for a foreign investor. *See* § 8.04.

20 Sales in the United States pursuant to certain employee benefit plans, permitted by Rule 903(b)(1)(iv) of Regulation S, are also considered offshore transactions. *See Cleary, Gottlieb, Steen & Hamilton* (avail. July 24, 1990).

21 Rule 902(c)(3)(vi) under the Securities Act provides that the publication by an issuer of a notice announcing a foreign offering will not constitute "directed selling efforts" if the notice complies with Rules 135 or 135c under the Securities Act. Rule 135 covers notices issued in the context of a U.S. public offering prior to the filing of a registration statement. The notice may only contain certain specified information, including the name of the issuer, the title, amount and basic terms of the securities, the anticipated timing of the offering and a brief statement of the manner and purpose of the offering, but not including a description of the issuer's business or the names of the underwriters. Rule 135c applies to notices with a similar content issued in the context of an offering that is exempt from registration under Regulation S (or otherwise, for example under one of the private placement exemptions), but only if the issuer is subject to the periodic reporting requirements of the Exchange Act or exempt from those requirements pursuant to Rule 12g3-2(b) thereunder and certain other conditions are met. *See also* §§ 7.02[4] and 7.06 for a discussion of publicity considerations in exempt offerings involving both sales outside the United States under Regulation S and in the United States as private placements.

22 SEC Release No. 33-6863 (Apr. 24, 1990). In general, a publication has a "general circulation" in the United States if it "is printed primarily for distribution in the United States, or has had, during the preceding twelve months, an average circulation in the United States of 15,000 or more copies per issue." Rule 902(c)(2) under the Securities Act. The U.S. editions of *The Financial Times* and *The Economist*, and perhaps the U.S. editions of other foreign newspapers and magazines as well, will fall within the definition of a publication with a "general circulation" in the United States. The non-U.S. editions of such newspapers and magazines, however, are not affected. For a discussion of Regulation S offerings utilizing the Internet, *see* § 8.02[1][d].

23 Research reports could be viewed as directed selling efforts, or as inconsistent with an offshore transaction, which would make the Regulation S exemption unavailable. It is common for counsel to prepare one or more memoranda when work on the transaction begins, describing the restrictions in detail. These memoranda serve multiple purposes: they alert offering participants to the existence of restrictions; they

establish a written record of attention to the restrictions, which can be useful in the event a lapse occurs; and they are sometimes used (particularly where the offering is a debut offering in the home market) to implement an understanding among the participating financial institutions about guidelines for research reports.

The distribution of pre-deal research outside the United States in an offering by a foreign private issuer does not usually present the same concerns. In the typical Regulation S -only equity offering, or a typical Regulation S and Rule 144A equity offering in connection with a debut offering in the home market, the principal trading market for its equity is, or is expected to be, outside the United States. In connection with such an offering, the Global Research Settlement and FINRA rules would not prohibit a foreign underwriter (even one affiliated with an SEC-registered broker-dealer and FINRA member) from preparing and distributing pre-deal research to persons outside the United States in a manner that does not involve U.S. jurisdictional means or the participation of any SEC-registered broker-dealer (or analysts associated with that broker-dealer). If the principal trading market is, or is expected to be, in the United States, however, caution is appropriate due to heightened concern in the United States and other jurisdictions about conflicts of interest.

For a further discussion of research reports, *see* text accompanying *infra* Note 37; §§ 3.02[3][e], 7.02[4], Notes 142–143.

24 SEC Release No. 33-9415 (July 10, 2013). While restrictions on general solicitation and general advertising were recently lifted for certain types of private placements, the prohibition on directed selling efforts in a Regulation S -only offering— *i.e.*, where there is no contemporaneous registered or exempt U.S. offering that permits general solicitation and general advertising (*e.g.*, pursuant to Rule 144A)—remains unchanged. *See* SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 138.04 (Nov. 13, 2013). For a discussion of when general solicitation and general advertising are permissible in a private placement, *see* Chapter 7.

25 *See* 55 Fed. Reg. 18306, 18320 (May 2, 1990); 78 Fed. Reg. 44,771, 44,786 (July 24, 2013). This is consistent with the SEC's view that "offshore transactions" made in compliance with Regulation S will not be integrated with registered domestic offerings or domestic offerings that satisfy the requirements for an exemption from registration under the Securities Act, even if undertaken contemporaneously. *See infra* text accompanying Notes 90–91. Ironically, more care may have to be taken when there is no concurrent offering in the United States, since efforts in the United States to generate secondary market interest in securities being distributed abroad could constitute directed selling efforts, and it would be difficult to establish that such efforts were directly associated with exempt offers and sales.

While it should also be the case that selling efforts in the United States following the public filing of a registration statement would not constitute "directed selling efforts" if the registration statement were subsequently withdrawn and the public offering abandoned in favor of a private placement or no U.S. offering at all, the SEC staff could take the view that the determination depends on the facts and circumstances, including the extent to which the transaction was marketed prior to withdrawal and the amount of time between withdrawal and the offshore offering. A prudent approach would be to permit at least 30 days between withdrawal of a registration statement and the commencement of an offering under Regulation S. It may be possible, however, to shorten the time between withdrawal of the registration statement and launch of a Regulation S offering if no marketing had been conducted in the United States and a considerable time had passed since filing of the registration statement, or if there had been marketing efforts but a considerable amount of time had passed since they were conducted. *See* the discussion of Rule 155 under the Securities Act in § 7.02[6].

26 SEC Release No. 33-6863 (Apr. 24, 1990).

27 Preliminary Note 7 to Regulation S under the Securities Act; SEC Release No. 33-6863 (Apr. 24, 1990). Rule 902(c)(3)(vii) also requires that the conditions of Rule 135e be satisfied. For a discussion of Rule 135e, *see* text accompanying *infra* Notes 28–29; §§ 3.02[3][c] and 7.02[4].

28 SEC Release No. 33-7470 (Oct. 10, 1997). The SEC also adopted a safe harbor from the tender offer rules

for certain offshore press activities. Rule 14d-1(e).

29 *See* §§ 3.02[3][c] and 7.02[4].

30 Preliminary Note 7 to Regulation S under the Securities Act and SEC Release No. 33-6863 (Apr. 24, 1990).

31 Although publications with U.S. editions—such as *The Financial Times*—as a matter of policy will not agree to restrict news or editorial coverage to certain editions, they will agree to restrictions on where advertisements appear. Accordingly, an issuer can ensure that advertisements relating to an offering do not appear in the United States.

32 *See* § 3.02[3][c].

33 SEC Release No. 33-6863 (Apr. 24, 1990). Similarly, the provision of international offering circulars through an online database will not be deemed to be directed selling efforts so long as the online provider, itself a nondistributor, implements certain measures, including the placement of an initial cautionary screen containing a legend stating, among other things, that the documents on the site relate to securities that have not been registered under the Securities Act, and the use of subscription agreements restricting users from distributing documents obtained from the database outside their respective organizations. *See Europrospectus.com Ltd.* (avail. Apr. 28, 2004); *Perfect Information* (avail. Dec. 22, 2000).

34 *See* § 8.02[1][c][ii].

35 As used in this context, a "tombstone" advertisement is a brief announcement of the completion of a transaction. Offering advertisements under Rule 134 are also sometimes referred to as "tombstone" advertisements. *See* § 3.02[3][d].

36 Rule 902(c)(3)(iii) under the Securities Act.

37 SEC Release No. 33-6863 (Apr. 24, 1990); SEC Release No. 33-7606 (Nov. 3, 1998), *as amended* by SEC Release No. 33-7606A (Nov. 13, 1998), SEC Release No. 33-8591 (July 19, 2005). For a further discussion of research reports, and a detailed consideration of Rules 138 and 139, *see* §§ 3.02[3][e], 7.02[4], Notes 142–143.

38 Section 4(a)(3) of the Securities Act also restricts the circulation of research reports in the United States. *See* § 8.03 and text accompanying Note 115.

39 In the case of securities guaranteed by the parent of the issuer, the category of the offering is determined by reference to the status of the parent guarantor rather than that of the issuer. *See* text accompanying Note 52. In addition, certain nonparticipating preferred stock and asset-backed securities are treated as debt for purposes of determining the appropriate category. Rules 902(a)(1) and 902(a)(2) under the Securities Act.

The SEC staff has also indicated that the category of offering under Regulation S is determined at the time the issuer makes a securities offering in reliance on Regulation S. If changes occur in the issuer's circumstances after it makes the offering that would permit the issuer to qualify for a different category of the safe harbor in the future, the SEC staff has clarified that there would be no change in the distribution compliance period applicable to any outstanding securities issued in reliance on Regulation S. SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 277.01 (Jan. 26, 2009).

40 The following tables are based closely on Adam Fleisher & Peter Castellon, *Regulation S Selling and Transfer Restrictions: A Basic User's Guide*, *available at* https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/regulation-s-selling-transfer-restrictions-a-basic-users-guide.pdf (July 18, 2012).

48 For a discussion of the eligibility requirements of Schedule B, *see* § 3.05[1].

49 An important exception to this general rule is that certain emerging market issuers have relatively extensive U.S. shareholder bases. This situation has arisen in a number of cases because the issuer's home market infrastructure is not sufficiently well-developed to accommodate sizable equity offerings or to provide for a stable and liquid aftermarket in such securities. For instance, a number of Latin American, Chinese and other emerging market issuers have more than half of their equity securities held in the United States. Most of these issuers are subject to the reporting requirements of the Exchange Act, which, since there is

substantial U.S. market interest in their equity securities, results in their being treated as Category 2 issuers for purposes of Regulation S. Certain other emerging market issuers, such as Russian companies that have offered equity securities in the United States under Rule 144A and separately established unrestricted ADR programs, may find that there is a substantial U.S. market interest in their shares in circumstances where they are not subject to the reporting requirements of the Exchange Act. As a result, they may be treated as Category 3 issuers for purposes of Regulation S.

50 Rule 902(j)(2) under the Securities Act. For purposes of Rule 902(j)(2), "held of record" has the same meaning as in Rule 12g5-1. *See* § 4.11[2][b], Note 653 and accompanying text for a discussion of Rule 12g5-1.

Although Regulation S refers to debt securities being "held of record," that term is defined to include debt securities that are held in bearer form. It is not clear how a "reasonable belief" should be formed with respect to bearer debt securities. In the absence of official guidance, a foreign issuer should consider the following:

- if the issuer has less than $1 billion of debt securities (excluding commercial paper) outstanding worldwide, there is *per se* no substantial U.S. market interest;
- if the issuer has more than $1 billion of debt securities (excluding commercial paper) outstanding worldwide, but (i) has not offered any securities in the United States (other than commercial paper), (ii) does not have debt or equity securities listed on a securities exchange in the United States or a sponsored ADR program and (iii) does not know of significant holdings of its debt securities by U.S. investors, it would be reasonable to conclude that there is no substantial U.S. market interest for its debt securities; and
- in other circumstances, the offering should be treated as falling into Category 2.
- *See* § 8.04 for a discussion of certain U.S. tax rules that apply to bearer securities.

51 Rule 902(j)(3) under the Securities Act.

52 In the case of debt securities that are guaranteed by subsidiaries of the issuer, the SEC staff has informally advised us that a subsidiary guarantor may rely on the status of its issuer parent under Regulation S as long as the subsidiary guarantor meets the requirements of Rule 3-10 of Regulation S-X, *i.e.*, the subsidiary guarantor is wholly owned by the issuer parent and the subsidiary fully and unconditionally guarantees the issuer parent's securities.

53 Substantial U.S. market interest in the debt securities of a foreign bank or any other entity that guarantees debt securities must be measured by reference to all securities that are issued or guaranteed by the bank or other entity. Letters of credit should be treated as guarantees under Regulation S, and it would be prudent to treat support or "keep well" agreements in the same way. Since the procedures for Category 2 are relatively easy to apply, being prudent does not entail incurring any substantial additional cost.

54 These include the "pink sheets." *See* § 3.01, Note 32.

55 Rule 902(j)(1) under the Securities Act. In determining the category of a particular offering, distributors are entitled to rely on a representation by the issuer that it reasonably believes that there is no substantial U.S. market interest for the kind of security being offered. Where a foreign or U.S. market does not record all trading in a security, only the trading that is otherwise known to the issuer, or can be reasonably measured or approximated, need be considered. Where a substantial market for the issuer's equity securities does not record trading volume, the issuer may reasonably believe that there is not substantial U.S. market interest in that class of securities where less than 20% of the class is held of record by persons for whom a U.S. address appears on the records of the issuer, its transfer agent, voting trustee, depositary or person performing similar functions. SEC Release No. 33-6863 (Apr. 24, 1990).

56 The requirement that the offering be directed to the residents of a single foreign country is not inconsistent with making a U.S. private placement at the same time. The principle that an offering under Regulation S is not to be "integrated" with a contemporaneous registered or exempt U.S. offering applies to overseas-directed offerings just as it does to other foreign offerings. *See infra* text accompanying Notes 92–93.

57 For a discussion of these requirements, *see* Chapter 5. In order to be a Regulation S "reporting issuer," an issuer must file all required Exchange Act reports in the twelve months (or such shorter period as the issuer was required to file reports) before the offer or sale of securities is made in reliance on Regulation S. An issuer that has not filed a report required to be filed under the Exchange Act in the 12 months or such shorter period as the issuer was required to file reports (before the offer or sale) would fail to satisfy the definition of a "reporting issuer" for purposes of Rule 902(i) until the delinquent report in question has been filed.

58 These requirements are set out in Rule 903(b)(2) under the Securities Act. For a discussion of how the distribution compliance period is determined in continuous offerings, *see* § 10.02.

59 *See* Rule 903(b)(2)(ii) under the Securities Act. In the event an issuance of debt securities is re-opened at a later date, market practice is to use temporary global notes to represent, and assign temporary security identifiers (*i.e.*, Committee on Uniform Security Identification Procedures ("CUSIP") and International Securities Identification Number ("ISIN") numbers) to, the securities issued in the re-opening until the distribution compliance period has ended. The securities issued in the re-opening then become fungible with, and assume the CUSIP and ISIN numbers of, the securities issued in the initial offering and the temporary global notes are exchanged for interests in the permanent global notes bearing those numbers.

60 Rule 902(k)(1) under the Securities Act. The definition also includes any nondiscretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person; any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated or (if an individual) resident in the United States; and any partnership or corporation incorporated under the laws of any foreign jurisdiction and formed by a U.S. person principally for the purpose of investing in securities not registered under the Securities Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501(a) under the Securities Act, *see* § 7.02[2], Note 35) that are not natural persons, estates or trusts.

Rule 902(k) under the Securities Act specifically excludes the following additional entities from the definition of a U.S. person: certain U.S. fiduciaries acting for non-U.S. investors; any estate of which the professional fiduciary acting as executor or administrator is a U.S. person if the estate also has a non-U.S. executor or administrator who has sole or shared investment discretion and the estate is governed by foreign law; any employee benefit plan established and administered in accordance with the laws of a country other than the United States; and certain foreign branches and agencies of U.S. banks and insurance companies. Rule 902(k)(2) under the Securities Act. Notwithstanding the exclusion of certain U.S.-based entities from the definition of U.S. person, issuers and distributors should nevertheless consider liability issues that could arise from the use of U.S. jurisdictional means in connection with the offer or sale of securities.

61 Rule 902(k) under the Securities Act. As noted earlier, it is not clear whether offshore accounts of U.S. pension funds should be viewed as U.S. persons. *See supra* Note 18. It is clear from the terms of Regulation S itself that a discretionary account (other than an estate or trust) held by a dealer or other fiduciary organized in the United States is a U.S. person (unless held for the account of a non-U.S. person as described below) and that a nondiscretionary account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person is also a U.S. person. Conversely, it is also clear that a discretionary account (other than an estate or trust) held by a dealer or other fiduciary organized outside the United States (a "foreign fiduciary") is not a U.S. person. According to the adopting release for Regulation S, "where a non-U.S. person makes investment decisions for the account of a U.S. person, that account is not treated as a U.S. person." SEC Release No. 33-6863 (Apr. 24, 1990), 55 Fed. Reg. 18,306, 18,316 (May 2, 1990). Moreover, a foreign fiduciary is not itself a U.S. person. Therefore, an offer or sale to a foreign fiduciary for the discretionary account of a U.S. pension fund would appear not to breach the "distribution compliance period" requirement of Regulation S, which prohibits offers and sales to, or for the account or benefit of, U.S. persons.

This, however, may not be the case. The relevant portion of the definition of U.S. person referred to above does not apply to accounts of "estates" or "trusts," and U.S. pension funds are generally organized as trusts. Under Regulation S, trusts having a U.S. trustee are considered to be U.S. persons unless "a trustee who is not a U.S. person has sole or shared investment discretion with respect to the trust assets, *and no beneficiary of the trust … is a U.S. person.*" Rule 902(k)(2)(iii) under the Securities Act (emphasis added). It would thus appear that a discretionary account of a U.S. pension fund held by a foreign fiduciary would be a U.S. person because the trustee of the fund can be expected to be a U.S. person and the "beneficiaries" of the fund— *i.e.*, the employees—will also generally be U.S. persons. Although it is unlikely that the SEC had U.S. pension funds in mind when it crafted the rule with respect to trusts, unless the position is clarified, it would be prudent for distributors not to offer or sell securities to offshore accounts of U.S. pension funds in Category 2 or Category 3 offerings or to fiduciaries acting for such accounts.

62 A distributor holding an unsold allotment of securities in a segregated identifiable account may sell other securities of the same class as if it were not a distributor, so long as such other securities are not borrowed from and will not be replaced by securities that are part of the unsold allotment. SEC Release No. 33-6863 (Apr. 24, 1990).

63 Rule 903(b)(2)(i) under the Securities Act.

64 Rule 902(g)(1)(i) under the Securities Act.

65 Rule 902(g)(2) under the Securities Act. This requirement does not apply to press releases that are not advertisements. For a discussion of legends required for press releases that are advertisements, *see* § 7.02[4]. For offers and sales of equity securities of U.S. issuers, the offering materials or documents must also state that hedging transactions involving those securities may not be conducted unless in compliance with the Securities Act. *See* § 8.02[1][c][iii], Note 75 and accompanying text.

66 Rules 902(g)(2)(i), 902(g)(2)(ii) and 902(g)(2)(iii) under the Securities Act.

67 SEC Release No. 33-6863 (Apr. 24, 1990). For a description of the requirements imposed by Regulation S on resales by a dealer or person receiving selling concessions, fees or other remuneration, *see* Note 100. In addition, dealers are subject to the requirements imposed by § 4(a)(3) of the Securities Act. For a discussion of § 4(a)(3), *see* § 8.03.

68 As noted in *supra* Note 16, the 1998 amendments, as originally proposed, would have moved out of Category 2 and into Category 3 all offerings of equity securities of foreign issuers with principal markets in the United States. The SEC had proposed that the "principal market" for a foreign issuer's securities would be in the United States if "more than 50 percent of all trading in such class of securities took place in, on or through the facilities of securities exchanges and inter-dealer quotation systems in the United States in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation." *See* SEC Release No. 33-7392 (Feb. 20, 1997), 62 Fed. Reg. 9258, 9264 (Feb. 28, 1997). Many of those commenting on the original proposals had strongly opposed applying the amendments to foreign issuers, arguing that the imposition of Category 3 restrictions would impede both public offerings and trading in those securities in offshore public markets. After considering these comments, the SEC decided that additional restrictions on equity securities of foreign issuers with principal markets in the United States were unwarranted at the time in the absence of a showing that offerings of these securities had in fact abused Regulation S. The SEC noted in the release adopting the 1998 amendments, however, that it "will monitor practices in this area, and will revisit the issue if abuses occur." SEC Release No. 33-7505 (Feb. 17, 1998), 63 Fed. Reg. 9632, 9633 (Feb. 25, 1998).

69 *See* § 8.02[1][c][iii].

70 Equity offerings by U.S. reporting issuers were added to Category 3 as a result of the 1998 amendments to Regulation S.

71 *See supra* Note 49 for a discussion of possible exceptions to the general rule. In addition, a nonreporting foreign subsidiary of a U.S. company may be treated as a U.S. issuer falling within Category 3 if the majority of its executive officers or directors are U.S. citizens, more than half of its assets are in the United States, or its business is administered principally from the United States. *See* the definition of "foreign issuer" in Rule 902(e) of Regulation S under the Securities Act. *See also supra* text at Note 68 for a discussion of market practice for certain offerings of securities of foreign issuers that are subject to the reporting requirements of the Exchange Act, especially where substantially all of their securities trade in the United States.

72 Rule 903(b)(3) under the Securities Act.

73 Rule 903(b)(3)(ii)(B) under the Securities Act. A similar procedure and certification are required in the case of offerings of bearer debt securities as a result of U.S. tax rules. *See* § 8.04.

74 The distribution compliance period was shortened from one year to match the shortened holding period for restricted securities of reporting companies in the amendments to Rule 144. *See* SEC Release No. 33-8869 (Dec. 6, 2007).

75 Rule 903(b)(3)(iii) under the Securities Act.

76 The limitation on hedging derives from the SEC's concern, highlighted in its 1995 interpretive release on "problematic practices" under Regulation S, that hedging during the distribution compliance period could serve to shift the economic benefits and risks back to the United States or to U.S. persons, and thus breach the distribution compliance period requirement in substance if not in form. *See* SEC Release No. 33-7190 (June 27, 1995). The SEC also expressed concern in that release about the issuance of nonrecourse promissory notes for all or almost all of the purchase price, where the expectation of repayment stems from the resale of the equity securities into the U.S. market, or the issuance of recourse notes where the entity providing the notes is unknown to the seller of the securities or has no, or minimal, assets and where, again, the expectation of repayment stems from the resale of the equity securities in the U.S. market. The 1998 amendments to Regulation S did not prohibit the use of promissory notes as consideration for a purchase under Regulation S, as had been proposed originally, but rather dealt with this problem through Rule 905 under the Securities Act, which applies to the resale under Regulation S of equity securities of U.S. issuers. *See* § 8.02[2].

The limitation applies to short selling and other hedging transactions such as option writing, equity swaps or other types of derivative transactions, where the counterparties to the hedging transaction transfer the benefits and burdens of ownership back to the U.S. market during the distribution compliance period in a transaction that does not benefit from an exemption from the registration requirements of the Securities Act, such as Rule 144A. For a discussion of hedging in the context of private placements, *see* § 7.04[2][a].

77 EASDAQ was subsequently acquired by Nasdaq and operated under the name "Nasdaq Europe." However, in 2003 the market ceased operations.

78 EASDAQ and the OM Stockholm Exchange stated that there was no field in which the required language could be placed and that the programming changes that would be required to create such a field would be expensive and time-consuming. Letter from Dirk P. Tirez, General Counsel, European Association of Securities Dealers Automated Quotation N.V./S.A., to Paul M. Dudek, Chief, SEC, Office of International Corporate Finance (July 22, 1999); Letter from Ulf Lindgren, Chief Legal Counsel, OM Stockholm Exchange SE, to Paul M. Dudek, Chief, SEC, Office of International Corporate Finance (Sept. 27, 2000).

79 *OM Stockholm Exchange* (avail. Oct. 11, 2000); *Australian Stock Exchange Limited* (avail. Jan. 7, 2000); *European Association of Securities Dealers Automated Quotation N.V./S.A*. (avail. July 27, 1999).

80 In 2011, the staff granted no-action relief from certain requirements of Category 3 to a domestic reporting issuer which allowed it to obtain a secondary listing of depositary receipts representing its common stock on the Stock Exchange of Hong Kong ("SEHK"). In granting relief, the staff noted that U.S. entities may not participate on SEHK; no SEHK trading terminals may be placed in the United States and that alternative restrictions and procedures would be implemented. The alternative restrictions and procedures implemented were similar to those adopted by the three exchanges discussed in Notes 77 to 79. In addition to those procedures, persons depositing shares in the Hong Kong depositary are required to certify either that they are not, and are not acting on behalf of, a U.S. person or an affiliate of the issuer and will receive the depositary receipts outside the United States; or that they are not, and are not acting on behalf of, a distributor or an affiliate of a distributor or the issuer, are depositing the shares in connection with a sale of depositary receipts under Rule 904 and will not be issued any depositary receipts. *Coach, Inc. & J.P. Morgan Chase Bank N.A.* (avail. Nov. 28, 2011).

81 *See* Guidance to Rule 1550 of the Rules of the London Stock Exchange (Mar. 21, 2016), and the Whitebook published by Euroclear UK & Ireland on May 11, 2015 relating to its proposed "Euroclear UK & Ireland:

Regulation S Category 3 Settlement Service." Physical settlement is no longer available for Category 3 Securities trading on the London Stock Exchange.

82 *See* SEC, Division of Corporation Finance, Manual of Publicly Available Telephone Interpretations, Third Supplement, Section II, Cross-Border Release, Part C, Question 1 (July 2001) (stating that the exemptions are intended to create an incentive to include U.S. securityholders in a particular offering, not to provide an exemption for offerings made only to foreign securityholders).

83 *See* § 9.05[9][c] (discussing information to be provided for an SEC-registered exchange offer).

84 SEC Release No. 33-7516 (Mar. 23, 1998). Compare this approach with the procedures set forth in the *Europrospectus.com and Perfect Information* no-action letters, *supra* Note 33, where the entity making offering documents available over the Internet was not distributing securities.

85 The SEC staff has informally noted to us that in the context of a Regulation S -only offering, such steps need not be more extensive than procedures generally implemented to ensure compliance with the requirement under Regulation S that purchasers be outside the United States.

86 For example, providing disclosure on the U.S. tax consequences of investing in the securities, or naming U.S. broker-dealer affiliates of the underwriters, would suggest that the material is targeted to the United States or to U.S. persons.

87 Certain information can be disseminated through the Internet without the use of an access filter prior to the filing of a registration statement with the SEC under Rule 135 and following the filing of a registration statement under Rule 134. For a discussion of Rules 134 and 135, *see* § 3.02[3].

88 SEC Release No. 33-7856 (Apr. 28, 2000), 65 Fed. Reg. 25,843, 25,850 n.68 (May 4, 2000) (emphasis added). For a discussion of Rule 135e under the Securities Act, *see* §§ 3.02[4][c] and 7.04.

89 Rule 135c allows reporting issuers and issuers that are exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act to disseminate certain public announcements of unregistered offerings through the Internet without use of an access filer. For a discussion of Rule 135c, *see* § 7.04.

90 SEC Release No. 33-6863 (Apr. 24, 1990).

91 SEC Release No. 33-6863 (Apr. 24, 1990).

92 55 Fed. Reg. 18,306, 18,320 (May 2, 1990); 78 Fed. Reg. 44,771, 44,786 (July 24, 2013).

93 When an offering outside the United States is made in conjunction with a public offering in the United States, a question arises as to how much of the global offering should be registered. For a foreign issuer, it is customary to register the U.S. tranche as well as about 10% to 15% of the offering overseas to cover transfers between underwriting syndicates and trading of the securities into the United States (although consideration should be given to registering a higher percentage if the primary trading market for the foreign issuer's securities is or is expected to be the United States). For a U.S. issuer, it will, as a practical matter, be necessary to register the entire global offering because of Rule 905 under the Securities Act, in the case of equity securities, and because of the likelihood of flowback into the United States, in the case of debt securities. For a further discussion of these issues, *see* § 3.02[3][a]. If an appropriate amount of securities is registered to cover the "flowback" into the United States of the securities offered and sold abroad, the prohibition against directed selling efforts and, in Category 2 and Category 3 offerings, the "distribution compliance period," "offering restrictions," "notice" and other requirements are inapplicable because resales into the United States and to U.S. persons have, in fact, been registered. In connection with such resales, any broker or dealer, whether U.S. or foreign, must comply with Rules 173 and 174 under the Securities Act. *See* § 3.02[1][e], Notes 92 and 94 and accompanying text (discussing when sales by dealers, whether or not acting as underwriters, need to be made on the basis of a prospectus on file with the SEC). With respect to offers and sales made outside the United States pursuant to Regulation S, whether a final offering document will be required to be delivered to investors will depend on local laws and will not be required under U.S. law.

94 *See infra* Note 114.

95 Equity securities of U.S. issuers that are offered and sold under Regulation S are classified as "restricted

securities" within the meaning of Rule 144 under the Securities Act and are subject to additional restrictions on resale. *See* Rule 905 under the Securities Act and *infra* Notes 104–109 and accompanying text.

96 SEC Release No. 33-7392 (Feb. 20, 1997), 62 Fed. Reg. 9258, 9263 (Feb. 28, 1997), stating that "purchasers must determine whether an exemption for resales into the United States is available."

97 SEC Release No. 33-7392 (Feb. 20, 1997), 62 Fed. Reg. 9258, 9263 n.41 (Feb. 28, 1997). Sections 2(a)(11) and 4(a)(1) of the Securities Act are discussed in § 7.02.

98 *See* §§ 9.05[7][c] and 9.05[8].

99 The SEC has cautioned that "[a]ny arrangement to return the restricted securities to U.S. markets may indicate, as suggested by SEC Release No. 33-7190 (June 27, 1995), an evasive scheme to avoid registration, which would invalidate any safe harbor claim." SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Interpretation 528.02 (Jan. 26, 2009).

100 For resales by dealers and persons receiving selling concessions, fees or other remuneration in respect of the securities offered or sold prior to the expiration of the applicable distribution compliance period, Rule 904(b)(1) under the Securities Act requires that the seller must not know that the buyer of the securities is a U.S. person and, if the seller knows that the buyer of the securities is a dealer or person receiving a selling concession, that the seller must send the buyer a confirmation setting out the applicable transfer restrictions. For resales by an officer or director of the issuer who is an affiliate of the issuer solely as a result of being an officer or director, Rule 904(b)(2) under the Securities Act requires that no selling concession, fee or other remuneration be paid in connection with the resale other than a customary broker's commission as would be received by a person executing the sale as an agent.

101 If the buyer is a corporation, partnership or investment company, it is enough that an authorized person employed by it or, in the case of an investment company, by its investment adviser, places the buy order while outside the United States. 55 Fed. Reg. 18,306, 18,310 n.39 (May 2, 1990).

102 Designated offshore securities markets now include the Eurobond market as regulated by the International Securities Market Association, the Australian Stock Exchange Limited, the Bahamas International Securities Exchange (*see The Bahamas International Securities Exchange* (avail. Oct. 20, 2011)), the Barcelona Stock Exchange (*see Barcelona Stock Exchange, Bilbao Stock Exchange, Madrid Stock Exchange and Valencia Stock Exchange* (avail. Mar. 11, 2003) (the "Spanish Stock Exchange Letter")), the Berlin Stock Exchange (*see Berlin Stock Exchange* (avail. Sept. 26, 2000)), the Bermuda Stock Exchange, the Bilbao Stock Exchange (*see* Spanish Stock Exchange Letter), the Bursa Malaysia Securities Berhad and for the limited purpose of permitting the secondary market trading of certain bonds, Bursa Malaysia Bonds Sdn Bhd (*see Bursa Malaysia Securities Berhad and Bursa Malaysia Bonds Sdn Bhd* (avail. Sept. 10, 2010)), the Canadian National Stock Exchange and Pure Trading (*see CNSX Markets Inc*. (avail. Feb. 24, 2010)), the Canadian Venture Exchange Inc. (*see Canadian Venture Exchange* (avail. Mar. 17, 2000) and *Alberta Stock Exchange* (avail. Mar. 9, 1993)), the Cairo and Alexandria Stock Exchanges (*see Cairo and Alexandria Stock Exchanges* (avail. Apr. 16, 2003)), the Channel Island Stock Exchange (*see Channel Island Stock Exchange (CASE)* (avail. Sept. 6, 2002)), the Copenhagen Stock Exchange (now NASDAQ OMX Copenhagen A/S) including First North (*see First North and NASDAW OMX Stockholm AB, NASDAQ OMX Copenhagen A/S and NASDAQ OMX Helsinki Ltd.* (avail. Apr. 24, 2014) (the "First North Letter")), the Eurolist Market and the Alternext Market as operated by Euronext Paris (*see Eurolist and the Alternext Market* (avail. Mar. 16, 2007)), Euronext Amsterdam (*see Euronext Amsterdam* (avail. Apr. 7, 2006)), Euronext Brussels (*see Euronext Brussels* (avail. Nov. 10, 2004)), the Frankfurt Stock Exchange, the OM Helsinki Stock Exchange (now NASDAQ OMX Helsinki Ltd.) including First North (*see* First North Letter), the Stock Exchange of Hong Kong Limited (including the Growth Enterprises Market, *see The Stock Exchange of Hong Kong Limited* (avail. June 27, 2000)), the Hellenic Exchanges—Athens Stock Exchange, SA (*see Hellenic Exchanges & Athens Stock Exchange, SA* (avail. July 15, 2016)), the Irish Stock Exchange, the Istanbul Stock Exchange, the Johannesburg Stock Exchange, the Korea Stock Exchange (*see Korea Stock Exchange* (avail. Sept. 11, 2000)), the Bolsa de Valores de Lima (*see Bolsa de Valores de Lima* (avail. May 14, 1998)), the London Stock Exchange (including SEAQ International, *see First*

Boston Corp. (avail. June 14, 1990) and AIM, *see London Stock Exchange* (avail. Aug. 18, 1998)), the Bourse de Luxembourg, the Madrid Stock Exchange (*see* Spanish Stock Exchange Letter), the Malta Stock Exchange plc (*see The Malta Stock Exchange plc* (avail. July 9, 2013)), the Mexico Stock Exchange, the Borsa Valori di Milano, the Montreal Stock Exchange, the OM Oslo Stock Exchange (including Merkur Market) (*see Oslo Børs—Merkur Market* (avail. Apr. 13, 2016)), the Panama Stock Exchange (*see Panama Stock Exchange* (avail. June 21, 2006)), the Prague Stock Exchange (*see Prague Stock Exchange* (avail. May 28, 2004)), the Stock Exchange of Singapore Ltd., the OM Stockholm Stock Exchange (now NASDAQ OMX Stockholm AB), including First North (*see* First North Letter), the SWX Swiss Exchange (*see SWX Swiss Exchange* (avail. July 3, 2002)), the Taiwan Stock Exchange (*see Taiwan Stock Exchange Corp.* (avail. Dec. 14, 2004)), the Tel Aviv Stock Exchange Ltd. (*see Tel Aviv Stock Exchange Ltd.* (avail. May 12, 1999)), the Tokyo Stock Exchange (including the Tokyo Stock Exchange's Market of High Growth and Emerging Stocks ("Mothers") (*see Tokyo Stock Exchange Inc.* (avail. Aug. 20, 2004))), the Toronto Stock Exchange, the Valencia Stock Exchange (*see* Spanish Stock Exchange Letter), the Vienna Stock Exchange (*see Wiener Börse* (avail. Dec. 14, 2004)) and the Warsaw Stock Exchange. The SEC originally designated certain of these exchanges pursuant to no-action letters, and subsequently codified those designations when it amended Regulation S in 1998. SEC Release No. 33-7505 (Feb. 17, 1998). The SEC may designate other foreign securities exchanges if requested to do so.

103 We have considered whether trades made using the International Order Book of the London Stock Exchange constitute "trades on" a designated offshore securities market. Based on discussions with the SEC, we are of the view that they do, whether or not the securities in question have been admitted to the Official List of the U.K. Listing Authority. The International Order Book is the central trading mechanism for the most liquid depositary receipts representing shares of non-U.K. companies, including both depositary receipts that have been admitted to the Official List and those that have not been so admitted. We rely on two theories in reaching our conclusion. First, the International Order Book could be considered simply a part of the London Stock Exchange, based on the no-action letters issued with respect to the AIM and SEAQ International, which confirm (rather than designate) each to be a designated offshore securities market because it is part of the London Stock Exchange, and the close working relationship and ongoing information exchanges between the International Order Book and the London Stock Exchange. Second, language contained in the release adopting Regulation S supports the view that trades in the International Order Book should constitute trades on a designated offshore securities market because they are reported to the London Stock Exchange. The release states that transactions executed "in, on or through the facilities of a designated offshore securities market" include all transactions reported to that market, and that trades executed between sessions, reported to the exchange and included in exchange trading volume, will be deemed to occur on that market. *See* SEC Release No. 33-6863 (Apr. 24, 1990).

104 For a discussion of Rule 144 and its amendments, *see* § 7.04[2].

105 SEC Release No. 33-7505 (Feb. 17, 1998), 63 Fed. Reg. 9632, 9637 (Feb. 25, 1998).

106 Rule 144(d)(2) under the Securities Act.

107 Since resales of equity securities of U.S. issuers under Regulation S do not "wash off" the Rule 144 restricted status, standard Rule 144 procedures (including legending) should be applied during the applicable restricted period. These procedures, however, may be incompatible with the trading practices of many offshore markets, particularly those that accommodate only uncertificated securities and those with rules prohibiting the listing of legended securities. *See supra* Notes 77–81 and accompanying text. *See also* § 7.04[2] for a discussion of Rule 144 and the amendments that significantly shortened the Rule 144 holding period for nonaffiliate holders of restricted securities.

108 *See* SEC Release No. 33-7505 (Feb. 17, 1998).

109 *See supra* Note 100 for a discussion of the restrictions application to dealers and persons receiving selling concessions, fees or other remuneration in respect of the securities offered or sold.

110 *See, e.g.*, *College Retirement Equity Fund* (avail. Feb. 18, 1987).

111 For a discussion of the restrictions on resale in the United States of privately placed securities, including

securities sold under Rule 144A, *see* Chapter 7.

112 When securities are offered and sold outside the United States under Regulation S and in the United States on a private placement basis (under Rule 144A or otherwise), there are in effect two classes of securities until the restrictions applicable to the privately placed securities end upon resale outside the United States or the expiration of the applicable Rule 144 holding period for unrestricted resale by nonaffiliates. This distinction can result in lack of fungibility of the two classes of securities. This lack of fungibility may not, however, prove to be particularly problematic where there is little or no U.S. trading in those securities, which is often the case in the context of equity securities where the only or principal trading market for the securities is outside the United States.

113 *See* text accompanying *supra* Note 108.

U.S. Regulation of the International Securities and Derivatives Markets, § 8.03, SECURITIES ACT § 4(a)(3)

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 § 8.03 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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Regulation S is only part of the regulatory scheme that applies to offerings of securities outside the United States. In order to appreciate its implications fully, Regulation S must be taken in context, which includes § 4(a)(3) of the Securities Act, discussed below, and the antibearer bond rules of the Internal Revenue Code, which are discussed in § 8.04.

Section 4(a)(3) of the Securities Act exempts from the registration provisions of the Securities Act offers and sales of securities by U.S. and foreign securities dealers, subject to compliance with certain requirements. In the context of a Regulation S offering, these requirements have the effect of prohibiting all U.S. and foreign securities dealers (whether or not they are participants in the distribution) from offering or selling in the United States unsold allotments at any time, [114] and other securities sold in the offering until 40 days after the commencement of the offering. [115] Thus, even in the case of a Category 1 offering, to

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which the "distribution compliance period" does not apply, dealers are subject to the requirements of § 4(a)(3) of the Securities Act. [116]

In addition, because a research report with respect to a company's shares may be viewed as an offer of those shares, § 4(a)(3) may prevent the distribution of research reports in the United States during the 40-day period by both participants and nonparticipants in the offering. Broker-dealers that are not participating in the offering generally ignore this risk. Broker-dealers that are participating in the offering generally refrain from distributing research reports in the United States during the 40-day period, except perhaps in circumstances where they have sold their allotments and there was a significant preexisting trading market for the shares; in these circumstances, the report could be said to relate to the outstanding shares trading in the market, and not to the shares being distributed. In addition, the broker-dealer must take care to deliver only the preexisting shares, rather than the shares sold in the offering, at least during the 40-day period, to satisfy any orders that may have been stimulated by the research report. It should also be permissible for a broker-dealer participating in the offering to distribute in the United States research reports where Rule 138 or Rule 139 is available. [117]

Even where Rule 138 and Rule 139 are unavailable, underwriters can still distribute research reports outside the United States notwithstanding the unavailability of the § 4(a)(3) exemption, as long as they take measures to prevent the reports from being delivered in the United States. These measures include limiting the persons and locations to which reports are addressed, including legends on the reports themselves, providing separate warnings to recipients against redissemination, and monitoring how and to whom the reports are distributed. [118]

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When there is already an active market for the issuer's securities outside the United States, these limited-distribution research practices are rarely relied on, because they are often inconsistent with the way ongoing research is distributed; but in such cases the Rule 138 and Rule 139 safe harbors are often available.

Footnotes

114 The SEC staff has indicated that an underwriter may resell an unsold allotment of securities from a public offering, provided that six months have elapsed since the closing of the last sale under the relevant

registration statement and the underwriter complies with the volume and manner of sale restrictions of Rule 144 under the Securities Act (although the resale would not technically be under Rule 144 and no Form 144 need be filed). SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 128.02 (Jan. 26, 2009). We believe the same analysis should apply to allotment securities from offshore transactions conducted pursuant to Regulation S.

115 The restrictions of § 4(a)(3) of the Securities Act will not have the effect of precluding U.S. sales when the "flowback" into the United States of securities originally offered and sold abroad has been registered with the SEC, in connection with a concurrent U.S. public offering or otherwise. *See supra* Note 93. Nor will the restrictions of § 4(a)(3) preclude Rule 144A resales (if available) or other private placements into the United States.

116 It is important to remember that for purposes of § 4(a)(3), unsold allotments include any securities purchased directly from an issuer, or indirectly in a chain of transactions between securities dealers that has not been interrupted by a sale to an end-investor. This raises the practical question, referred to earlier, of how to distinguish allotment securities from others. *See* Note 62 and accompanying text.

117 *See* Rule 138 and Rule 139 under the Securities Act. For a further discussion of the distribution of research reports, *see* §§ 3.02[3][e] and 7.02.

118 Banks acting as initial purchasers or placement agents may also broadly disseminate research reports in the United States in connection with a Rule 144A or Rule 506(c) placement and not jeopardize the private placement exemption or the Regulation S exemption, even where Rules 138 and 139 are unavailable. However, if the private placement is part of an initial public offering outside the United States where by definition there is no pre-existing market for the issuer's shares, the unavailability of the § 4(a)(3) exemption for the 40 days following that offering would make a broad U.S. distribution of research problematic. This limitation on the broad U.S. distribution of research in international IPOs has little impact as a practical matter, because banks generally restrict the distribution of research in the United States in those offerings in any event for the reasons discussed in § 3.03[3][e]. Banks may distribute research reports to accredited investors in the United States in connection with a Rule 506(b) or § 4(a)(2) private placement, although if the offering is a distribution for purposes of Regulation M, this would not be permitted during the Regulation M restricted period. By contrast, Rule 101 of Regulation M provides an exemption for offerings to qualified institutional buyers in transactions exempt from registration under § 4(a)(2) of the Securities Act, Rule 144A or pursuant to Regulation D, and an exemption for research satisfying the conditions of Rules 138 or 139.

U.S. Regulation of the International Securities and Derivatives Markets, § 8.04, INTERNAL REVENUE CODE ANTIBEARER BOND RULES

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 § 8.04 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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The antibearer bond rules (generally referred to as Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA")) of the U.S. Internal Revenue Code of 1986, as amended (the "Internal Revenue Code" or "I.R.C."), impose additional regulatory restrictions on offerings of debt securities that are treated as *bearer-form* [119] debt obligations for U.S. tax purposes. [120]

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Section 502 of the Hiring Incentives to Restore Employment Act, [121] which was enacted on March 18, 2010 (the "HIRE Act"), imposes significant restrictions on U.S. issuers' ability to issue debt securities in bearer form. Those restrictions generally apply only to debt securities issued after March 18, 2012.

Section 8.04[1] below describes the application of the TEFRA restrictions to debt securities issued after March 18, 2012. Section 8.04[2] then describes the application of the TEFRA restrictions to debt securities issued on or before March 18, 2012.

[1] Application of TEFRA Restrictions to Issuances After March 18, 2012

The TEFRA restrictions, as amended by the HIRE Act for debt securities issued after March 18, 2012, [122] impose certain sanctions on issuers and holders of debt obligations in bearer form. [123] These sanctions are designed to restrict access by U.S. investors to debt obligations in bearer form and therefore apply to obligations issued by both U.S. and foreign issuers. [124] As a result of the amendments made by the HIRE Act, the sanctions apply even if all of the investors are located outside the United States, subject to the limited exception discussed below.

[a] Issuer Consequences

Under the TEFRA restrictions, U.S. issuers that issue debt in bearer form after March 18, 2012 will be denied deductions for interest paid on the debt. [125] The interest also will not qualify for the "portfolio interest" exemption from U.S.

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withholding tax, although other withholding tax exemptions, such as those applicable under an income tax treaty, will continue to apply. [126] In addition, both U.S. and non-U.S. issuers may be subject to a substantial excise tax. [127]

The excise tax is the only TEFRA-related penalty that typically is imposed on a non-U.S. issuer that issues bearer-form debt obligations. [128] The excise tax rules provide, however, that a debt security will not be subject to the excise tax if (i) it is issued under "arrangements reasonably designed to ensure" that it will be issued only to non-U.S. persons, (ii) interest on the obligation is payable only outside the United States and its possessions and (iii) the face of the obligation contains a notice that any holder who is a U.S. person will be subject to limitations under the U.S. income tax laws (collectively, the "foreign-targeted" requirements). [129] Accordingly, the HIRE Act generally does not eliminate non-U.S. issuers' ability to issue debt in bearer form. Although the HIRE Act does not specify the requirements necessary to satisfy the "arrangements reasonably designed" standard, the IRS has announced that it intends to issue rules "identical to" the TEFRA "C" and "D" regulations that apply to debt issued on or before March 18, 2012 and which are discussed in detail in § 8.04[2]. [130] Regulations have not yet been issued.

[b] Holder Consequences

A holder of a debt obligation that is issued in bearer form will not be allowed to deduct losses incurred with respect to the obligation [131] and will be required to treat gain on the sale of the obligation as ordinary income (and not capital gain). [132] However, these consequences do not apply to debt obligations meeting certain exceptions in the applicable Treasury Regulations, [133] or if the

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issuer was subject to the excise tax in connection with the issuance of the debt obligation. [134]

In addition to the restrictions on offerings of debt obligations in bearer form discussed here, it should be noted that obligations issued directly (or through affiliated entities) by the U.S. government, government-owned agencies and government-sponsored enterprises and obligations backed by any such securities (where more than 50% of the income or collateral supporting the obligations consists of interest on or principal of such U.S. government securities) have been required to be issued in registered form for many years. [135]

Debt obligations that (i) are issued by a natural person, (ii) are not of a type offered to the public or (iii) have a maturity of not more than one year are not "registration-required" obligations and may be issued in bearer form without incurring U.S. tax sanctions. [136] However, U.S. issuers (but not foreign issuers) of commercial paper must comply with the U.S. tax law restrictions to ensure that their obligations are not subject to U.S. information reporting requirements and backup withholding tax and, in the case of obligations with maturities of more than 183 days, that interest on such obligations is "portfolio interest" that is exempt from U.S. withholding tax. [137]

U.S. issuers of debt obligations in registered form must receive a statement—which generally must be signed by the beneficial owner of the obligation under penalties of perjury—to the effect that the beneficial owner is not a U.S. person in order for interest on the obligations to qualify as "portfolio interest" that is exempt from U.S. withholding tax. [138] Although short-term commercial paper generally is not subject to this requirement, [139] documentation of a holder's non-U.S. status generally is required in order to establish an exemption from U.S. information reporting requirements and backup withholding tax. It is impractical, however, to obtain certification of non-U.S. beneficial ownership from purchasers of short-term commercial paper. Accordingly, the applicable Treasury Regulations provide that, solely for purposes of establishing an exemption from information reporting requirements and backup withholding tax, original issue discount obligations having a maturity of 183 days or less will not be subject to a certification requirement, provided the commercial paper is issued in accordance with certain specified requirements, including compliance with the

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"foreign-targeting" rules. [140] Certification is required for commercial paper issued by a U.S. issuer with a maturity of more than 183 days.

[c] Application of Post-March 18, 2012 Rules to Non-U.S. Issuers

In some foreign markets, debt securities may be offered and sold in bearer form to satisfy local custom or market preferences and, in a small and decreasing minority of cases, to comply with local law. Non-U.S. issuers may continue to use the foreign-targeting procedures described in § 8.02[1][c] above to issue bearer-form debt securities without being subject to issuer sanctions. Alternatively, in most bond offerings by a non-U.S. company, [141] it is possible to avoid the application of the TEFRA restrictions by structuring the offering in a manner that causes the bonds to qualify as registered-form obligations for U.S. tax purposes, [142] while nevertheless allowing the bonds to be denominated as bearer obligations, in which case they generally are treated as such for purposes of local market preferences or customs. For instance, as discussed above, bonds that are represented by a bearer-form global note nonetheless will be considered registered-form securities for U.S. tax purposes so long as the global note is held throughout its term by a depositary and physical securities in bearer form are made available to investors only in certain limited circumstances. [143] The difference between the market's view of what constitutes a bearer instrument (which depends principally on the designation of the instrument as a bearer bond) and the technical U.S. tax definition (which depends on the manner in which an interest in the instrument may be transferred) makes it possible to structure offerings

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that are considered in bearer form from a non-U.S. perspective but nevertheless qualify as registered-form obligations for TEFRA purposes.

In substantial global bond offerings by non-U.S. issuers, depositary banks frequently enter into book-entry registration agreements with the issuer, pursuant to which they agree to hold the global note in a manner that causes the bonds to qualify as registered-form obligations for U.S. tax purposes. [144] These measures are routinely adopted in global bond offerings in which significant U.S. demand is anticipated from the outset. [145] The fact that book-entry agreements currently are an optional addition to, rather than a standard feature of, global bond documentation in the context of offerings by non-U.S. companies has restricted their use in contexts not involving a clear U.S. nexus. Even if a global bond offering is not thought to be of interest to U.S. investors, however, the use of book-entry arrangements can produce significant benefits and minimize exposure to costs or risks. Such arrangements normally will have no substantial non-U.S. consequences. [146]

[2] Application of TEFRA Restrictions to Issuances on or Before March 18, 2012

This section discusses the TEFRA rules that apply to debt securities issued on or before March 18, 2012. A principal difference in these rules as compared to the rules for debt securities issued after March 18, 2012 is that they provided U.S. issuers with a general exemption from U.S. tax sanctions for bearer-form debt securities that met the following three general requirements, which were intended to establish that the issuance was targeted at foreign investors [147]:

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- issuers and dealers must offer and sell bearer obligations pursuant to arrangements that are reasonably designed to ensure that the obligation will be sold (or resold in connection with the original issue) only to non-U.S. persons (the "arrangements reasonably designed" requirement);
- interest on bearer obligations must be payable only outside the United States and its possessions; and
- a statement must appear on the face of bearer obligations, including any bearer coupons, to the effect that any U.S. person who holds the obligation will be subject to limitations under the U.S. tax laws. [148]

[a] "Arrangements Reasonably Designed"

Treasury Regulations under the Internal Revenue Code provide procedures for offering debt obligations in bearer form in compliance with the "arrangements reasonably designed" requirement. [149] For obligations issued on or before September 7, 1990, the regulations were linked to the U.S. securities laws and provided that the obligations satisfied the requirement if they were not required to be registered under the Securities Act because they were intended for distribution to non-U.S. persons. [150]

The IRS ceased to rely on the securities laws in May 1990 when it adopted Treasury Regulation § 1.163-5(c)(2)(i)(D) (which is generally referred to as "TEFRA D" or the "D Rules"). [151] Under the D Rules, obligations issued after September 7, 1990 are subject to independent U.S. tax law requirements that go beyond those imposed by the U.S. securities laws. These requirements impose restrictions on offers and sales of bearer-form debt obligations and on delivery

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of such obligations in definitive form and require certification of non-U.S. beneficial ownership.

The D Rules were adopted by the IRS in response to the adoption of Regulation S under the Securities Act by the SEC. Regulation S by and large embodies a territorial approach to the application of U.S. rules: many offers and sales of securities may be made without registration under the Securities Act to persons outside the United States regardless of their nationality. The antibearer bond provisions of the I.R.C., however, continue to restrict offers and sales of bearer debt securities to U.S. persons wherever they may be. As a result, additional U.S. tax law restrictions on offers and sales of bearer debt securities were deemed necessary. In addition, the IRS continued to require certification of non-U.S. beneficial ownership by purchasers of bearer debt securities.

[i] *The D Rules*

The D Rules restrict offers and sales of bearer-form debt obligations in connection with their original issuance, require obligations sold during the applicable "restricted period" to be delivered only outside the United States and require certification of non-U.S. beneficial ownership.

The D Rules provide that an issuer (or, subject to the safe harbor rule discussed below, a distributor) of bearer-form debt obligations may not offer or sell such obligations to a U.S. person or to a person within the United States during an applicable "restricted period." [152] The restricted period for an obligation commences on the earlier of the closing date and the first date on which the obligation is offered to persons other than distributors and ends 40 days following the closing date. [153] However, the offering and sale limitations imposed during the restricted period will apply to the unsold allotment of a distributor until the distributor actually sells the securities. [154]

A "distributor" with respect to any obligation is: (i) any person who offers or sells the obligation during the restricted period pursuant to a written contract with the issuer, (ii) any person who offers or sells the obligation during the restricted period pursuant to a written contract with a person described in (i), or (iii) any person who acquires the obligation from an affiliate for purposes of offering or selling the obligation during the restricted period, if that affiliate is the issuer or a distributor described in (i) or (ii). [155]

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The D Rules contain an important safe harbor for offers and sales by distributors. Under the safe harbor, if the distributor (i) agrees to comply with the offering and sale restrictions of the D Rules and (ii) has in effect procedures reasonably designed to ensure that its employees or agents who are directly engaged in selling the obligation are aware that the obligation cannot be offered or sold during the restricted period to a U.S. person or to a person within the United States, the distributor will be deemed to satisfy the D Rules' restrictions on offers and sales. [156] Thus, an issuer will not be subject to U.S. tax sanctions as a result of an inadvertent sale of a bearer-form debt obligation to a U.S. person by a distributor that has satisfied the requirements of the safe harbor.

The D Rules do not elaborate on the type of procedures that will be considered reasonable for purposes of the safe harbor provision. However, many market participants have established policies to ensure that their sales employees are aware of applicable sales restrictions, to identify securities that are subject to such restrictions and to document their procedures regarding compliance with the restrictions. The measures appropriate for a particular market participant will depend on its circumstances. Issuers generally require dealers to represent to the issuer that they have reasonable procedures in effect with respect to the offering.

Notwithstanding the general restrictions, the D Rules permit issuers and distributors to sell bearer-form debt obligations during the restricted period to: (i) distributors purchasing for resale, (ii) foreign branches of U.S. financial institutions [157] purchasing for their own account or for resale, (iii) U.S. persons purchasing through foreign branches of U.S. financial institutions and holding the obligation through U.S. financial institutions, (iv) international organizations and (v) foreign central banks. [158] However, securities generally may not be *offered* for sale to U.S. persons (other than those listed in (i) and (ii) above). [159] In light of this restriction, the practical significance of the rule permitting U.S. persons to acquire securities through foreign branches of U.S. financial institutions may be limited.

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As described above, the D Rules generally prohibit an offer to a person who is within the United States. Consequently, while Regulation S preserves the securities law exemption for offers and sales in the United States to U.S. professional fiduciaries acting on a discretionary basis for non-U.S. persons, the D Rules do not permit offers of bearer-form debt obligations to a U.S. office of such a fiduciary.

In addition to restricting offers and sales, the D Rules prohibit delivery of a definitive obligation in bearer form in the United States at any time in connection with a sale of the obligation made during the restricted period. [160] The D Rules also provide that in order to take delivery of an obligation in definitive bearer form (or to receive a payment of interest prior to delivery in definitive form), a holder or a financial institution acting on the holder's behalf must provide certification to the issuer stating that:

- the obligation is owned by a person that is not a U.S. person;
- the obligation is owned by a foreign branch of a U.S. financial institution, or by a U.S. person that acquired the obligation through a foreign branch of a U.S. financial institution and holds the obligation through a U.S. financial institution, and such financial institution has agreed to comply with the information reporting requirements and other rules for bearer-form debt obligations held by or through financial institutions; or
- the obligation is owned by a financial institution (U.S. or foreign) for purposes of resale during the restricted period and has not been acquired for purposes of resale directly or indirectly to a U.S. person or to a person in the United States. [161]

A limited exception to this certification requirement is available for obligations issued in a qualifying offering intended principally for sale in the local markets of a single foreign country. [162] This rule was intended to permit U.S. issuers to obtain access to markets where local law or practice makes it impossible

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to obtain certification. However, the exception is available only for countries specifically designated by the IRS as jurisdictions in which certification is not permissible. [163] To date, the IRS has designated Germany and Switzerland as local markets that qualify for this special rule. [164]

An obligation targeted for sale in a country designated by the IRS must satisfy additional requirements relating to the terms of the obligation and the manner in which it is distributed. Under these requirements, principal and interest on the obligation must be denominated only in the currency of a single foreign country [165] and must be payable only within that country. In addition, the obligation must be offered and sold in accordance with customary local practices and documentation, the issuance of the obligation must be subject to guidelines or restrictions imposed by the country's governmental, banking or securities authorities, and the obligation may not be listed or be the subject of an application for listing on an exchange located outside the country. Finally, the distributors of the obligation must covenant to use reasonable efforts to sell the obligation within the country and more than 80% of the issue must be offered and sold to nondistributors by distributors maintaining an office located in the foreign country. [166]

The following table outlines the certifications and distribution compliance period that apply to standard underwritten offerings of debt and equity securities under the TEFRA D Rules. "Category" refers to the category of transaction under Regulation S. "S" means Regulation S ; "D" means the D Rules. Except where noted, the distribution compliance period lasts for 40 days and, under the TEFRA D Rules, any certification regarding non-U.S. status will generally be given at the end of such period. [167]

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TABLE 8-3

	U.S. Issuer				*Foreign Issuer*				
	Debt			*Equity*	*Debt*		*Equity*		
Category	1	2	3	3	1	2	1	2	3
Certification	D*	D*	S/D*	S**	D*	D*			S**
Distribution Compliance/Restricted Period	D	S/D	S/D	S**	D	S/D		S	S**

* There is no certification requirement for an offering that qualifies for the local offering exemption of TEFRA D. Generally, these will be overseas-directed offerings in respect of countries specifically designated by the IRS that fall within Category 1 of Regulation S. Thus far, the IRS has designated only Germany and Switzerland. [169]

** The distribution compliance period is for six months (one year if the issuer is a nonreporting issuer) and special rules apply.

[ii] *The C Rules*

Treasury Regulation § 1.163-5(c)(2)(i)(C) ("TEFRA C" or the "C Rules") provides alternative procedures that non-U.S. issuers may use to satisfy the "arrangements reasonably designed" requirement. [170] Under the C Rules, the requirement will be met if a debt obligation is issued only outside the United States and the issuer does not significantly engage in interstate commerce with respect to the issuance of the obligation, either directly or through an agent, an underwriter or a member of the selling group. The C Rules define "interstate commerce" as trade or commerce in obligations or any transportation or communication relating thereto between a foreign country and the United States. [171]

An issuer that uses the means of interstate commerce in connection with the issuance of an obligation will, in most cases, be significantly engaged in

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interstate commerce with respect to the issuance. [172] The C Rules provide by way of illustration that an issuer will be significantly engaged in interstate commerce if:

- there are negotiations or communications regarding the sale of the obligation between the issuer or an underwriter or member of the selling group and the purchaser while either of them is in the United States;
- the U.S. office of an underwriter or the issuer is involved in the offer or sale of the obligation, either directly with the prospective purchaser or through the issuer in a foreign country;
- the obligation is delivered in the United States; or
- the obligation is advertised in the United States. [173]

The C Rules impose fewer procedural restrictions than the D Rules on the issuance by a foreign issuer of bearer debt obligations. In particular, the C Rules do not require certification of non-U.S. beneficial ownership on delivery of definitive bearer obligations, and debt obligations issued under the C Rules need not bear the TEFRA legend (discussed below). However, the requirement that payments of interest on bearer debt obligations be made outside the United States does apply. [174]

The comparative disadvantage of the C Rules is that, unlike the D Rules, they do not provide safe harbor protection against a distributor's inadvertent noncompliance with the selling restrictions applicable to an issue. The broadly worded requirements of the C Rules—that an issuer "not significantly engage in interstate commerce with respect to the issuance … either directly or through its agent, an underwriter, or a member of the selling group" [175]—have also been of concern to issuers. The regulations indicate that any communication between an underwriter and a prospective purchaser with respect to a sale while either of

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them is located in the United States can constitute engaging in interstate commerce for this purpose. [176] Many issuers have concluded that the benefit of safe harbor protection under the D Rules, in view of the broad market acceptance of the procedures required by these rules, outweighs the procedural advantages available under the C Rules.

Whether the C Rules should be used for an offering of bearer debt obligations of a foreign issuer should be determined on a case-by-case basis in light of the relevant facts and circumstances. Certain offerings, however, are more obvious candidates for the C Rules than others. For example, it may be sufficient to use the C Rules if the debt obligations are privately placed outside the United States with a limited number of foreign investors purchasing for their own account or in the case of non-U.S. dollar-denominated debt obligations that are issued only in local markets. On the other hand, the C Rules may be less suitable for a public offering of debt obligations in the Euromarket, especially in the case of U.S. dollar-denominated obligations. The C Rules should not be used if there is a concurrent placement of debt obligations in the United States under Rule 144A or otherwise.

[b] Interest Payable Outside the United States

The requirement (applicable whether the C or D Rules are followed) that interest be payable only outside the United States and its possessions will be met if payments of interest can be made only upon presentation of a coupon (or upon making of a demand for payment) outside the United States and its possessions. [177] In addition, if the issuer is a U.S. issuer or a foreign issuer with significant U.S. connections, [178] payments generally may not be made by transfer of funds to the payee in the United States or mailed to an address in the United States. The regulations permit other issuers to make payments on bearer-form debt obligations in this manner, but (perhaps to avoid confusion) bond documentation typically uses payment terms appropriate for U.S. issuers.

[c] Legend Requirement

The following statement in English (referred to as the "TEFRA legend") must appear on the face of each bearer-form debt obligation and coupon:

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Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in §§ 165(j) and 1287(a) of the Internal Revenue Code. [179]

Footnotes

119 A debt obligation will be treated as a bearer obligation for U.S. tax purposes if it is not considered registered for such purposes. A debt obligation will be registered for U.S. tax purposes if it either (i) is registered with the issuer or its agent, and the transfer of the debt obligation may be effected only by surrender of the old obligation and either the reissuance of the old obligation to the new holder or the issuance of a new obligation to the new holder, or (ii) may be transferred only through a book-entry system maintained by the issuer or its agent. Treas. Reg. § 5f.103-1(c).

For debt obligations issued after March 18, 2012, an obligation also will be treated as being in registered form if it is held through a "dematerialized book entry system" or any other book-entry system specified by the Secretary of the Treasury. Although the Internal Revenue Code does not define "dematerialized book entry system," Notice 2012-20 (2012-13 I.R.B. 574 (Mar. 7, 2012)) provides that Treasury and the Internal Revenue Service intend to issue regulations that will provide that an obligation will be treated as in registered form if it is held through (i) a dematerialized book-entry system in which beneficial interests are transferable only through a book-entry system maintained by a clearing organization (or by its agent); or (ii) a clearing system in which the obligation is effectively immobilized. For this purpose, an obligation is treated as "effectively immobilized" if: (i) it is represented by one or more global securities in physical form that are issued to and held by a clearing organization (or by a custodian or depositary acting as its agent) for the benefit of purchasers of interests in the obligation under arrangements that prohibit the transfer of the global securities except to a successor clearing organization subject to the same terms; and (ii) beneficial interests in the underlying obligation are transferable only through a book-entry system maintained by the clearing organization (or its agent). Notice 2012-20 further provides that an obligation is treated as transferable only through a book-entry system even if holders are permitted to obtain physical certificates in bearer form in the following limited circumstances: (i) the termination of the clearing organization's business without a successor, (ii) a default by the issuer or (iii) at the issuer's request upon a change in tax law that would be adverse to the issuer but for the issuance of physical securities in bearer form. The Treasury Department and IRS have yet to issue such regulations. However, the Department of the Treasury 2016–2017 Priority Guidance Plan (Aug. 15, 2016) now includes "[r]egulations relating to the definition of registered form under §§ 149(a) and 163(f)" (item 1 under "Financial Institutions and Products").

120 In some foreign markets, debt securities typically are offered and sold in bearer form. As discussed in more detail below, however, in many bond offerings the rules relating to immobilized obligations may make it possible to avoid the application of these TEFRA restrictions by structuring the offering in a manner that causes the bonds to qualify as registered-form obligations for U.S. tax purposes, while nevertheless denominating the bonds as bearer obligations, which generally is sufficient to satisfy local market preferences.

121 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

122 HIRE Act § 502(a), amending I.R.C. § 163(f)(2).

123 Debt obligations that are not "registration-required" obligations, as discussed below, may be issued in bearer form without incurring the sanctions. I.R.C. § 163(f)(2)(A).

124 *See* Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (JCS-38-82), Dec. 31, 1982, p. 190.

125 I.R.C. § 163(f)(1).

126 I.R.C. §§ 871(h)(2) and 881(c)(2). *See* Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress (JCS-2-11), Mar. 2011, p. 222.

127 I.R.C. § 4701. The amount of the excise tax is 1% of the principal amount of the obligation multiplied by the number of calendar years (or portions thereof) from the issue date to the maturity date of the obligation. As discussed below, the "arrangements reasonably designed" exception will continue to apply for purposes of the TEFRA excise tax. Thus, notwithstanding the sanctions described in the text, a U.S. or non-U.S. issuer that issues debt in bearer form after March 18, 2012 in compliance with the TEFRA D rules generally will not be subject to the excise tax.

128 I.R.C. § 4701.

129 I.R.C. § 4701(b)(1), as amended by HIRE Act § 502(e).

130 Notice 2012-20, § 6, 2012-13 I.R.B. 574 (Mar. 7, 2012).

131 I.R.C. § 165(j)(1).

132 I.R.C. § 1287(a).

133 Treas. Reg. §§ 1.165-12(c) (exceptions from loss deduction denial) and 1.1287-1(c) (exceptions from ordinary income treatment).

134 I.R.C. §§ 165(j)(1) and 1287(a).

135 § 163(f)(2)(A); Treas. Reg. § 1.163-5(c)(1); *see* Letter from Donald T. Regan, Secretary of the Treasury, to Robert Dole, Chairman of the Senate Committee on Finance (Sept. 7, 1984); *see also* 31 U.S.C. § 3121(g), as amended by HIRE Act § 502(d).

136 I.R.C. § 163(f)(2)(A).

137 Interest on obligations with maturities of 183 days or less generally is not subject to U.S. withholding tax. *See* I.R.C. § 871(g)(1)(B)(i).

138 I.R.C. §§ 871(h)(2)(B) and 881(c)(2)(B).

139 *See supra* Note 137.

140 Treas. Reg. § 1.6049-5T(b)(10)(i). The foreign-targeted requirements are discussed in the text accompanying Note 129 and in § 8.02[1][c]. The regulations also require that the obligation on its face include the following statement:

> By accepting this obligation, the holder represents and warrants that it is not a United States person (other than an exempt recipient described in section 6049(b)(4) of the Internal Revenue Code and regulations thereunder) and that it is not acting for or on behalf of a United States person (other than an exempt recipient described in section 6049(b)(4) of the Internal Revenue Code and the regulations thereunder).

141 The structure discussed in this paragraph may not suitable for offerings by U.S. companies, because, as discussed above, non-U.S. investors may be unwilling to provide the investor-specific U.S. tax certifications that are required to receive interest payments free of U.S. withholding tax on bonds that are treated as registered-form obligations for U.S. tax purposes.

142 Bonds that are considered to be in *registered form* for U.S. tax purposes are not subject to the TEFRA restrictions discussed above.

143 *See supra* Note 119. If the depositary agrees to maintain a book-entry system recording the ownership of the global note on the issuer's behalf, the notes also generally would be treated as in registered form. This structure, however, is unlikely to provide significant additional flexibility, given the "effectively immobilized" rule described *supra* in Note 119. Alternatively, it typically is possible to satisfy any local law or market preferences for physical securities by providing for the availability of registered-form (as opposed to bearer-form) physical securities in those circumstances.

144 Such arrangements should be designed such that the bonds are treated as "effectively immobilized" as described in Note 119.

145 A number of substantial non-U.S. issuers relied on a similar technique to facilitate the sale in the United States of instruments that were required to be denominated as bearer obligations for non-U.S. reasons, under the U.S. tax rules in effect prior to the HIRE Act. *See* IRS Private Letter Rulings 9343018 and 9343019 (both July 29, 1993), which deal with debt offerings by the World Bank and by a U.K. bank. New debt offerings using this technique generally should be designed in accordance with Notice 2012-20, as discussed in Note 119, rather than in accordance with these older Private Letter Rulings.

146 There may continue to be circumstances in which the arrangements do not make sense in the context of a particular offering, but that is likely to be the case in only a very small proportion of international bond offerings. Following the adoption of standardized documentation, the only such likely circumstances are where the documentation of an existing facility immutably requires that physical bearer-form securities be made available, or where the offering is targeted to one of the few remaining markets where local market practice requires that definitive bearer securities be made available in definitive bearer form, in circumstances other than those specified by Notice 2012-20.

147 As discussed in § 8.02[1], *supra*, non-U.S. issuers may continue to rely on the procedures described in this section in connection with the issuance of debt securities in bearer form.

148 Pre-HIRE Act I.R.C. § 163(f)(2)(B). As discussed in § 8.04[1], the rules for debt securities issued after March 18, 2012 provide that the otherwise applicable excise tax will not apply to bearer-form debt securities

that are issued according to procedures that meet requirements substantially identical to these three requirements.

149 Treas. Reg. § 1.163-5(c)(2)(i). The IRS has announced that it intends to issue regulations providing that rules "identical to" the rules in these regulations will apply to debt securities issued after March 18, 2012 for purposes of establishing an exemption from the otherwise applicable excise tax. Notice 2012-20, § 6. The IRS has not yet issued these regulations. *See supra* Note 130 and accompanying text.

150 Treas. Reg. § 1.163-5(c)(2)(i)(A). The regulations adopted the U.S. securities law definition of "U.S. person" and provided that an opinion of counsel could be relied on in determining that obligations were not "registration-required" because they were intended for distribution to non-U.S. persons. The obligations also had to be offered for sale and delivered in connection with their original issuance only outside the United States and its possessions. Treas. Reg. § 1.163-5(c)(2)(i)(B) prescribed rules for satisfying the "arrangements reasonably designed" requirement in cases where the obligations were registered under the Securities Act and in certain other cases.

151 T.D. 8300, 55 Fed. Reg. 91, 19622 (May 10, 1990).

152 Treas. Reg. § 1.163-5(c)(2)(i)(D)(1).

153 Treas. Reg. § 1.163-5(c)(2)(i)(D)(7).

154 Treas. Reg. § 1.163-5(c)(2)(i)(D)(7). The securities must be sold to someone who is neither related to the distributor nor another member of the selling group.

155 Treas. Reg. § 1.163-5(c)(2)(i)(D)(4). A confirmation or other notice of the transaction is not a written contract for purposes of this rule. Two corporations are affiliates for these purposes if one of them owns, directly or indirectly, stock possessing 50% or more of the voting power and value of the stock of the other or if a third corporation owns, directly or indirectly, stock possessing 50% or more of the voting power and value of the stock of each corporation.

156 Treas. Reg. § 1.163-5(c)(2)(i)(D)(1)(ii)(B).

157 For this purpose, "financial institutions" include banks, broker-dealers, insurance companies, finance companies, mutual funds, pension plans and investment advisers. Treas. Reg. § 1.165-12(c)(1)(iv).

The exemption for securities purchased by or through a foreign branch of a U.S. financial institution requires the financial institution to certify that it will comply with the information reporting requirements and other rules for bearer-form debt obligations held by or through financial institutions. This certification can be made on a blanket basis and renewed every three years.

158 Treas. Reg. § 1.163-5(c)(2)(i)(D)(1)(iii)(B), (C) and (c)(2)(i)(D)(5).

159 Treas. Reg. § 1.163-5(c)(2)(i)(D)(1)(iii)(C) refers to the "sale" of an obligation, while Treas. Reg. § 1.163-5(c)(2)(i)(D)(1)(iii)(B) refers to "an offer or sale" of an obligation.

160 Treas. Reg. § 1.163-5(c)(2)(i)(D)(2).

161 Treas. Reg. § 1.163-5(c)(2)(i)(D)(3). A temporary global security generally is not a definitive obligation for this purpose. If definitive obligations are not made available for delivery within a reasonable period of time after the end of the restricted period, the issuer will be deemed to have failed to satisfy the certification requirement. A "permanent" global security exchangeable for definitive obligations would be viewed as a definitive obligation for these purposes. However, U.S. issuers generally took steps to ensure that obligations in definitive bearer form could be withdrawn from such a "permanent" global security in order to avoid exposure to arguments that the obligations should be considered to be in registered form (which would trigger additional tax certification requirements as a prerequisite to obtaining the portfolio interest exemption from U.S. withholding tax).

162 Treas. Reg. § 1.163-5(c)(2)(i)(D)(3)(iii).

163 Treas. Reg. § 1.163-5(c)(2)(i)(D)(3)(iii)(F).

164 Notice 90-55, 1990-2 C.B. 344.

165 Although the IRS has not ruled on the question, it would appear that Germany's adoption of the euro may

have eliminated the ability of German-targeted issues to rely on this exemption.

166 Treas. Reg. § 1.163-5(c)(2)(i)(D)(3)(iii).

167 For a discussion of the certifications required under Regulation S, *see* § 8.02[1][c][ii] and [iii].

169 Issues targeted to Germany may no longer be eligible for this special rule. *See supra* Note 165 and accompanying text.

170 The C Rules are not available with respect to obligations guaranteed by, convertible into a debt or equity interest in, or substantially identical to an obligation issued by, a U.S. person that owns 10% or more of the combined voting power of the issuer. Treas. Reg. § 1.163-5(c)(2)(ii).

171 Treas. Reg. § 1.163-5(c)(2)(iii).

172 *See, e.g.*, Treas. Reg. § 1.163-5(c)(2)(iii). Examples 3 and 4 make clear that a single telex originating in the United States and that is related to the issuance of the bearer instrument is sufficient to be "significantly engaged in interstate commerce" with respect to the issuance of the obligation.

However, the means of interstate commerce may be used without violation of the C Rules in connection with certain activities that are merely of a "preparatory or auxiliary character" and that do not involve communication between a prospective purchaser and the issuer or an underwriter while either of them is in the United States. The C Rules provide examples of such activities. *See* Treas. Reg. § 1.163-5(c)(2)(iii)(A).

173 Treas. Reg. § 1.163-5(c)(2)(iii)(B).

174 *See* § 8.04[2][a].

175 Treas. Reg. § 1.163-5(c)(2)(i)(C).

176 *See supra* Note 172.

177 Treas. Reg. § 1.163-5(c)(2)(v).

178 Such issuers include non-U.S. issuers that are "controlled foreign corporations" or that have significant income effectively connected with the conduct of a U.S. trade or business. Treas. Reg. § 1.163-5(c)(2)(v)(A).

179 Treas. Reg. § 1.163-5(c)(1)(ii)(B). Temporary global notes and obligations issued under the C Rules need not contain this legend.