1-1-1990

SEC Proposed Regulation S: After Twenty-Five Years of Drifting, A New Safe Harbor for Foreign Offerings

Michael Redmond Gibbons

Follow this and additional works at: http://repository.law.miami.edu/umialr

Recommended Citation
Available at: http://repository.law.miami.edu/umialr/vol21/iss2/4

This Comment is brought to you for free and open access by Institutional Repository. It has been accepted for inclusion in University of Miami Inter-American Law Review by an authorized administrator of Institutional Repository. For more information, please contact library@law.miami.edu.
SEC PROPOSED REGULATION S: AFTER TWENTY-FIVE YEARS OF DRIFTING, A NEW SAFE HARBOR FOR FOREIGN OFFERINGS

I. INTRODUCTION: THE INTERNATIONALIZATION OF THE SECURITIES MARKETS

II. THE CURRENT REGIME: RELEASE NO. 4708
   A. Debt Securities Under Release No. 4708
   B. Equity Securities Under Release No. 4708
   C. Convertible Debt Securities Under Release No. 4708

III. THE STRUCTURE OF REGULATIONS
   A. The General Statement: Reliance on the Non-Safe Harbor Provision
   B. The Issuer Safe Harbor
      1. Rule 905(a): Safe Harbor for Qualifying Foreign Issuers
      2. Rule 905(b): Safe Harbor for All Reporting Issuers and Debt Securities of Foreign Issuers
      3. Rule 905(c): The Residual Safe Harbor Category
   C. The Resale Safe Harbor
      1. Rule 906(a): Resale Safe Harbor for Non-Dealers
      2. Rule 906(b): Resale Safe Harbor for Dealers

IV. PROPOSED CLARIFICATIONS AND CHANGES TO REGULATION S
   A. The U.S. Trustee and Non-U.S. Beneficiary Problem
   B. Comity and an Expanded Scope for Rule 905(a)
   C. Non-Dollar-Denominated Debt
   D. Resales After the End of the Restricted Period
I. INTRODUCTION: THE INTERNATIONALIZATION OF THE SECURITIES MARKETS

Securities, both debt and equity, are increasingly being offered for sale on a global basis.1 Issuers, in particular, want to raise capital in the least expensive manner available. Deregulation on major exchanges such as London and Tokyo, and technological advances in communication facilities and settlement systems have combined to provide issuers with a powerful incentive to raise capital outside their home market.2 Corporations are finding it increasingly difficult to ignore the fact that twenty or more basis points can be saved on capital raised in London, for example, as compared to New York.3

This trend toward globalization is not limited to issuers of securities. U.S. investors, particularly institutional investors, are attempting to diversify risk by acquiring a worldwide investment portfolio.4 Investors are no longer content to diversify their portfolio by purchasing securities of issuers listed on a single exchange, such as the New York Stock Exchange.

The revolutionary advances in the international markets are reflected in the growing number of international offerings and the increased volume of global trading. The international bond market, for example, grew at a compound annual rate of twenty-one percent from 1976 to 1986.5 Between 1980 and 1986, international bond issues6 increased from US$38.3 billion to US$225.4 billion.7

2. Id. at 12-13.
6. An “international bond” is a debt security that is issued outside the country of the borrower. Typically, they take the form of Eurobonds or foreign bonds. A “Eurobond” is a debt security issued through an international syndicate in a currency other than that of the country in which the bond is issued. A “foreign bond” is a debt security issued in a country other than that of the issuer, sold through a syndicate located primarily in the country of the distribution, and denominated in the currency of that country. See Offshore Offers and Sales, Securities Act Release No. 6779, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,242, at 89,127 n.36 (June 10, 1988).
U.S. issuers have been among the biggest borrowers in the international bond markets. In 1986, U.S. issuers raised US$43.7 billion through the sale of international bonds.

Issuers of equity securities have also benefited from the globalization of the securities markets. The recently established Euroequity market has shown outstanding growth. Euroequity offerings of common and preferred stock amounted to approximately US$17 billion in 1987 compared to only about US$200 million in 1983.

As investors throughout the world seek to diversify their portfolios by purchasing foreign securities, considerable amounts of capital are crossing national borders. Not surprisingly, government regulators are concerned about such cross-country investment. The growth of international trading markets, the significant increase in offshore offerings of securities, and the substantial participation by U.S. investors in foreign markets have presented the Securities and Exchange Commission (SEC) with a number of pressing regulatory issues. Linda Quinn, the Director of the Division of Corporation Finance, has stated that the internationalization of the financial markets is the biggest challenge facing the SEC today and in the near future.

The internationalization of the securities markets has raised the question of whether the registration requirements of Section five of the Securities Act of 1933 should be subject to a territorial limitation. A principal concern of companies raising capital abroad is the reach of Section five outside of the United States. On its

8. Id. at II-38.
9. See Offshore Offers and Sales, supra note 6, at 89,127 (citing OECD Financial Statistics Monthly (Mar. 1988)). In 1987, due to the October market crash and other economic factors, U.S. issuers saw their total borrowing on the international bond market drop to approximately US$21 billion. Id.
10. Euroequities include both common and preferred stocks distributed by a syndicate of international securities firms and banks to investors in markets outside the issuer's domestic market. See Offshore Offers and Sales, supra note 6, at 89,127 n.43.
12. See Offshore Offers and Sales, supra note 6, at 89,127 (citing U.S. Treasury Bulletin (Winter 1988)).
Section five's registration requirement is very broad. Historically, however, the SEC has not imposed burdensome registration procedures on overseas offerings which only have incidental contacts with the United States.

In July 1964, the SEC attempted to clarify the extraterritorial reach of Section five by issuing Release No. 4708. This release represents the current state of the law. The release states that the SEC will not take enforcement action against U.S. corporations for the distribution abroad of unregistered securities to foreign nationals. Under the release, U.S. corporations can use the means of interstate commerce as long as the distribution is effected in such a way that the unregistered securities come to rest abroad.

For nearly twenty-five years, the SEC maintained its original release on the extraterritorial reach of the Section five registration requirements. Attorneys and others in the securities industry, however, called for a new release that would take into account the significant changes effected by the globalization of securities markets.

Finally, in June 1988, the SEC released proposed rules for comment that called for a territorial approach in the application of the registration requirements. In proposed Regulation S, the SEC recognized the primacy of the laws in which a market is located. On July 11, 1989, after receiving numerous comments on its original proposal, the SEC released a revised Regulation S ("Regulation S"), which is even less restrictive of issuers and investors than its 1988 predecessor.

16. See H. Bloomenthal, supra note 11, § 4.15[2], at 4-112. Section five of the Securities Act is literally applicable to any sale of securities in which the mails or means of transportation or communication in "interstate commerce" are used, directly or indirectly. "Interstate commerce" includes, for this purpose, "commerce in securities . . . between any foreign country and any state" of the United States. 15 U.S.C. §776(7)(1988).


18. Offshore Offers and Sales, supra note 6, at 89,124.


20. Offshore Offers and Sales, supra note 6.

21. Id. at 89,128. The true extent to which Regulation S recognizes the force of local market laws is discussed below. In fact, Regulation S is less sensitive to principles of comity than its use of the "territoriality" concept would suggest.

This comment first offers a brief description of the current practice under Release No. 4708, followed by a structural outline of Regulation S. Additionally, a comparison is made between the proposed practice under Regulation S and the current regime under Release No. 4708. Finally, some changes to Regulation S are suggested which reflect its express purposes.

II. THE CURRENT REGIME: RELEASE NO. 4708

In July 1964, the SEC was faced with pressure to allow U.S. companies to raise capital effectively overseas. In response, the SEC issued a release which reflected the fact that U.S. securities laws are primarily intended to protect American investors. Release No. 4708 set out general standards intended to define the reach of the registration requirements of section five of the Securities Act. The release concluded by stating that debt securities may be offered and sold overseas by U.S. issuers without registration in the United States, 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.” Ultimately, this registration exemption for U.S. issuers’ securities sold overseas proved to be too general. The release failed to provide the certainty of result demanded by corporations and their counsel engaged in structuring public offerings.

Soon after the publication of Release No. 4708, securities lawyers developed procedures and drafted contractual provisions to ensure that those securities constituting part of a foreign offering would be precluded from distribution in the United States or to U.S. nationals. Thus, such securities would be exempt from registration under Release No. 4708. Over time, through the process of soliciting no-action letters from SEC staff regarding the scope of Release No. 4708, a complex set of SEC approved procedures has evolved. The procedures used by securities lawyers vary depending upon the nature of the security being offered. Equity securities, for example, have more restrictions associated with them, as equity

25. See Beller & Berney, supra note 23, at 42.
26. Id.
27. See Offshore Offers and Sales, supra note 6, at 89,124.
is considered more of a retail security in the United States. Conversely, since debt securities are presumed more attractive to institutional investors, it is presumed that there is reduced need for protective measures.

A. Debt Securities Under Release No. 4708

The SEC staff has granted numerous no-action letters with respect to non-convertible debt issues. Such issues typically employ the following restrictions to ensure that the securities come to rest abroad:

a) The issuer places provisions in its agreements with underwriters and dealers that require observation of a ban on all offers and sales in the United States or to U.S. nationals for ninety days after the completion of the distribution overseas;

b) The issuer places a statement regarding the prohibition on offers or sales in the United States or to U.S. nationals in invitation telexes, the prospectus, press releases, and tombstones;

c) In sales to other dealers, confirmations are delivered which restate the prohibition on offers or sales in the United States or to U.S. persons;

d) In requests for all-sold telexes, the issuer places a statement requiring the underwriter or dealer to confirm that the securities were sold outside the United States to persons other than U.S. nationals; and

e) At the closing of the offering, the issuer delivers a temporary global security. This is exchangeable for definitive securities only after ninety days following completion of the distribution and

28. See id at 89,139.
29. Id. Regulation S also places more restrictions on unregistered equity securities than unregistered debt securities. It is interesting to note, however, that in other countries the presumptions may be reversed. In West Germany, for example, debt securities are considered retail securities while equity is almost solely the domain of the institutional investor. Id.
30. The term “U.S. nationals” includes: 1) citizens, nationals or residents of the United States; 2) corporations, partnerships or other entities created or organized in or under the laws of the United States; or 3) estates or trusts, the income of which is subject to U.S. federal income taxation. See Beller & Berney, supra note 23, at 43 n.15.
31. An “all-sold” telex is a telex sent by a member of an underwriting syndicate to the lead manager of the syndicate advising the lead manager that its allotment of securities has been fully sold. See id. at 43.
certification of non-U.S. beneficial ownership.  

B. Equity Securities Under Release No. 4708

When an entity seeks to raise capital through overseas public offerings of equity securities, more severe restrictions are applied. The following measures represent standard practice under Release No. 4708, adopted by attorneys in response to SEC no-action letters on proposed overseas issues of equity securities:

a) The selling agent agrees not to offer or sell the securities in North America (United States and Canada) or to North American persons for the twelve-month period following completion of an offering;

b) The issuer places a conspicuous legend on the cover page of the prospectus stating that the securities have not been registered under the Securities Act and can not be offered or sold in North America or to North American persons for twelve months after the completion of the offering. After the twelve-month period, the securities may be sold in North America or to a North American person if the securities are registered or sold on the Stock Exchange in London;

c) Prior to any transfer of the equity securities, the purchaser certifies that he or she agrees to the offering restrictions and is not a North American person or acquiring the shares for any such person;

d) The issuer passes a bylaw requiring its directors to refuse to register transfers of the shares to North American persons prior to the end of the twelve-month period; and

e) The issuer places a legend on the certificates evidencing both the shares sold in the offering, as well as shares transferred or exchanged. The legend must reflect the restrictions on resale enumerated in paragraph b) above.  

32. For a typical no-action letter containing these restrictions, see Proctor & Gamble Co., SEC No-Action Letter (Feb. 21, 1985).

33. For a typical no-action letter containing these restrictions, see InfraRed Associates, Inc., SEC No-Action Letter (Sept. 6, 1985).
C. Convertible Debt Securities Under Release No. 4708

Borrowers often issue convertible debt\textsuperscript{34} to take advantage of the lower interest rates typically found in debt securities which are sweetened with an "equity kicker." Investors like the flexibility of convertible debt securities, which provide them with a reasonable certainty of receiving interest payments, as well as the ability to capture any of the capital growth in the issuer's equity stock.

Some issuers wish to sell convertible debt securities in overseas transactions exempt from registration under Release No. 4708. Such an issuer must first observe the restrictions applicable to overseas straight debt offerings, as outlined above.\textsuperscript{35} The issuer should then contract with investors to prohibit conversion for at least one year after completion of the overseas offering. This ensures that the offering will come to rest outside the United States. After one year has elapsed, the issuer can exchange equity for the outstanding debt, provided that it pays no consideration to the holder of the security, directly or indirectly, for soliciting such an exchange. An issue that follows these procedures falls within the statutory exemption of Section 3(a)(9) of the Securities Act.\textsuperscript{36} The original debt security is exempt from registration because it was offered and sold in compliance with Release No. 4708. The common stock issued to convertible debt holders in exchange for their debt securities is exempt from registration under section 3(a)(9) of the Securities Act.

The SEC has never addressed the following important question regarding convertible debt offerings: at what point can recipients of the common stock issued in exchange for the debt securities offer and sell such stock in the United States or to U.S. persons?\textsuperscript{37} The SEC staff, unfortunately, has never squarely answered the question. Instead, in a rather ambiguous fashion, the

\textsuperscript{34} A convertible debt security is a security which is originally issued as a simple debt security. Unlike "straight debt," however, a convertible debt security can be exchanged, after a specified period from the time of offering, with the issuer for the issuer's equity securities. The debt securities are convertible into equity stock at their principal amount. \textit{See} \textit{BARRON'S LAW DICTIONARY} 99 (2d ed. 1984).

\textsuperscript{35} See Section II, Subsection A of this article.

\textsuperscript{36} 15 U.S.C. § 77c(a)(9) (1988). This section provides an exemption from the registration requirements for any transaction involving the issuance of securities to present security holders in exchange for previously issued securities, provided that there is no commission paid for soliciting such an exchange.

\textsuperscript{37} This issue is equally applicable to the resales of straight debt and equity securities discussed above.
III. THE STRUCTURE OF REGULATION S

Regulation S is intended to clarify the extraterritorial reach of Section five of the Securities Act. Regulation S adopts a territorial approach in defining the scope of the Section five registration requirements. The general rule is that Section five does not apply to offers and sales that occur outside the United States.\textsuperscript{41} A Preliminary Note to Regulation S\textsuperscript{42} stresses that the new regulation can only exempt an issuer from the registration provisions of the Securities Act and in no way limits the application of the Act’s antifraud provisions.

The SEC staff has emphasized that the “territorial approach” adopted by Regulation S distinguishes it from its predecessor, Release No. 4708.\textsuperscript{43} In fact, both Regulation S and Release No. 4708 are territorial in nature, insofar as both exempt distributions which are made and come to rest outside the United States from registration under the Securities Act. The principal difference between the two, however, is how each defines “U.S. person.” Under Release No. 4708, the term “U.S. person” includes American citizens living abroad. Under Regulation S, the definition of “U.S. person” ex-

\textsuperscript{39} 15 U.S.C. § 77d(1) (1988). This section exempts offers or sales by any person other than an issuer, underwriter or dealer.
\textsuperscript{40} For no-action letters regarding the issuance of convertible debt under Release No. 4708, see Pan American World Airways, Inc., supra note 38; Sperry Rand Corp., SEC No-Action Letter (Jan. 15, 1974).
\textsuperscript{43} See SEC Releases Proposals, supra note 19, at 912.
cludes American citizens living overseas.\textsuperscript{44} Thus, for purposes of Regulation S, "U.S. person" means any natural person residing in the United States and any business entity organized under U.S. law.\textsuperscript{46}

Regulation S sets forth two methods for determining whether an offer or sale of securities occurs outside the United States. The first method, the general statement, lists four factors to be considered in determining whether an offer or sale occurs outside the United States.\textsuperscript{48} The second method consists of two safe harbors; the first safe harbor applies to issuers and members of the distribution network,\textsuperscript{47} and the second applies to resales of securities acquired in a Regulation S overseas offering.\textsuperscript{48} The safe harbors are designed to provide market participants with the protection of a clear rule rather than the nebulous protection afforded by no-action letters, releases, and the reading of tea leaves by practitioners.\textsuperscript{49}

A. The General Statement: Reliance on the Non-Safe Harbor Provision

Regulation S adopts a general statement that offers and sales that occur outside the United States are not deemed an offer or sale for purposes of Section five of the Securities Act.\textsuperscript{50} If a transaction falls within the scope of the general statement, the issuer need not register the subject securities. The general statement is set out in Rule 901(b), and lists the following "relevant considerations" which must be assessed in determining whether a given offer or sale falls within the scope of the registration requirements of Section five:

a) Locus of Offer or Sale;\textsuperscript{51}

\textsuperscript{44} See Offshore Offers and Sales, supra note 6, at 89,141.
\textsuperscript{45} See id.
\textsuperscript{49} See Beller & Quinn, supra note 13, at 58.
\textsuperscript{50} See supra note 43.
\textsuperscript{51} 54 Fed. Reg. 30,063, at 30,072 (1989) (to be codified at 17 C.F.R. § 230.901(b)(1)) (proposed July 11, 1989). Is the issuer directing the offer only to persons outside the United States? Is the buyer outside the United States at the time the buyer orders the securities?
b) Absence of Directed Selling Efforts in the United States;

c) Likelihood of Securities Coming to Rest Abroad;

d) Justified Expectations of the Parties.

According to Linda Quinn, whether an offering or a transaction falls within the general statement will be a question of the "facts and circumstances." Since issuers structuring their foreign offerings cannot accurately predict how the SEC will weigh each of the above factors, they are more likely to rely on the two safe havens than on the general statement. Most issuers will doubtlessly fall back on the general statement only if there is inadvertent noncompliance with some aspect of a safe harbor.

Do execution, payment and delivery occur outside the United States? Is the sale executed on a foreign securities exchange or market? Id.

52. 54 Fed. Reg. 30,063, at 30,072 (1989) (to be codified at 17 C.F.R. § 230.902(b)(2)) (proposed July 11, 1989). Although no single factor under the general statement may be determinative, the SEC appears to consider this factor of particular importance. The original release of Regulation S stated that the presence of directed selling efforts in the United States would generally lead the SEC to find that the transaction occurred within the United States. See Offshore Offers and Sales, supra note 6, at 89,131. The SEC, however, does not intend for the prohibition on directed selling efforts to include foreign marketing activities not targeted at U.S. markets.

"Directed selling efforts" is defined as any activity undertaken by the issuer, an underwriter, a dealer, a seller, or an affiliate of any of the foregoing, for the purpose of conditioning the market in the United States for any of the securities being offered in reliance on Regulation S. 54 Fed. Reg. 30,063, at 30,072 (1989) (to be codified at 17 C.F.R. § 230.902(b)(1)) (proposed July 11, 1989).

53. 54 Fed. Reg. 30,063, at 30,072 (1989) (to be codified at 17 C.F.R. § 230.901(b)(3)) (proposed July 11, 1989). Under this factor, the nature of the issuer and of the securities being offered must be examined closely. In the case of a U.S. issuer, or an issuer with a substantial U.S. market interest, the securities may be more likely to flow back to the United States. If the securities offered are equity securities, there is a greater likelihood of flowback to the issuer's home country or primary market after the distribution. Id.

54. 54 Fed. Reg. 30,063, at 30,072 (1989) (to be codified at 17 C.F.R. § 230.901(b)(4)) (proposed July 11, 1989). In many instances, a U.S. person may effect a transaction on a foreign market without any expectation that the registration provisions of the Securities Act will apply. In these cases, investors rely on local laws for protection. Id.

55. SEC Releases Proposals, supra note 19, at 912.

56. See Silverman & Braverman, supra note 4, at 220. The fact that the SEC has stated that it will no longer (assuming Regulation S is adopted), issue no-action letters under the regulation only underscores the undesirability of relying on the general statement. See id. This refusal to issue no-action letters contrasts sharply with the numerous no-action letters issued under Release No. 4708.

57. See H. Bloomenthal, supra note 11, § 4.15[4], at 4-121.
B. The Issuer Safe Harbor

The issuer safe harbor in Rule 905 represents the heart of Regulation S. It will particularly interest securities lawyers seeking to structure foreign offerings which avoid the registration requirements of the Securities Act. Rule 905 also applies to affiliates of the issuer, as well as underwriters and dealers participating, pursuant to a contractual arrangement, in the distribution of the issuer’s securities. In order for them to avoid liability for noncompliance with the registration requirements of the Securities Act, lawyers for any of these parties must also advise their clients about the parameters of Rule 905.

Two general conditions apply to any entity seeking an exemption under Rule 905. First, the offer or sale of the securities must be made as an “offshore transaction.” This prohibits any offer to persons in the United States. The offshore transaction must fulfill the following requirements: 1) the seller of the securities must reasonably believe that the buyer is outside the United States at the time the buy order is originated; and 2) either the execution and delivery must take place outside the United States or the transaction must be made on or through the facilities of a foreign stock exchange, without any prearrangement with a buyer in the United States.

Second, the issuer is prohibited from engaging in any directed selling efforts in the United States with respect to the securities offered under Regulation S. The SEC designed this prohibition to prevent issuers from conditioning the U.S. market, and thereby facilitating an indirect distribution in the United States of unregistered securities initially offered and sold overseas.

Additionally, the issuer safe harbor divides issuers and offerings into three categories based on the following two considerations: 1) the relative likelihood that the securities will flow back to

61. Id.
63. See Silverman & Braverman, supra note 4, at 221.
the United States; and 2) the degree of information available to U.S. investors regarding such securities. Where there is a greater likelihood of flowback to the United States, the issuer safe harbor mandates more offering and resale restrictions.

1. Rule 905(a): Safe Harbor for Qualifying Foreign Issuers

Regulation S imposes the least restrictions on the securities of foreign issuers with no substantial U.S. market interest either in the class of securities to be offered or sold (if equity is to be offered or sold) or in any of its debt securities (if debt is to be offered or sold). "Substantial U.S. market interest," as defined in the regulation, distinguishes between U.S. market interest in an issuer's equity securities and in its debt securities.

A foreign issuer may also qualify for the Rule 905(a) safe harbor if its securities, equity or debt, are offered and sold in an "overseas domestic offering." The statute defines an "overseas domestic offering" as "an offering of securities by a foreign issuer directed either to citizens or residents of the issuer's jurisdiction of incorporation or organization." Thus, a foreign issuer making an overseas domestic offering can qualify for the Rule 905(a) safe harbor, despite having a substantial U.S. market interest in its securi-

---

64. Offshore Offers and Sales, supra note 6, at 89,135.
65. Where little information is available to aid U.S. investors, the applicable safe harbor requires more offering and resale restrictions.
67. Under Rule 905(a), an issuer, whether foreign or not, is presumed to have a substantial U.S. market interest with respect to a class of its equity securities unless it can demonstrate at the commencement of the offering either: 1) that more than 50% of all recorded trading in its equity securities in the prior fiscal year occurred on or through the facilities of a single foreign exchange or securities market; or 2) that less than 20% of all recorded trading in the issuer's equity securities in the prior fiscal year occurred in, on, or through the facilities of U.S. exchanges, and such U.S. markets did not, in the aggregate, constitute the largest single market for such securities.
ties. Any foreign issuer making an overseas domestic offering may offer and sell securities with no U.S. restrictions other than the two previously described general conditions applicable to all safe harbors.

Release No. 6779, which originally introduced proposed Regulation S, gives notice that the SEC will henceforth treat distributions by issuers in Canada the same as distributions by issuers in any other foreign country. Previously, Release No. 4708 had expressly precluded an issuer that made a distribution in Canada from receiving an exemption from the U.S. registration requirements. This reflected the SEC's concern that issuers might use Canada as an avenue for making unregistered distributions of securities in the United States, since the securities distributed across the border could be expected to flow into the hands of American investors.

Rule 905(a) responds to this problem by limiting the availability of the 905(a) safe harbor to issuers who can demonstrate the absence of a substantial U.S. market interest in their securities. The SEC deems the absence of a substantial U.S. market interest, combined with the two general conditions applicable to all safe harbors, sufficient to guard against an unregistered distribution of the issuer's securities in the United States.

The foreign issuer safe harbor of Rule 905(a) reflects the SEC's recognition that, under principles of comity, an offshore offering by a foreign issuer with no substantial U.S. market interest should not trigger the registration provisions of U.S. securities laws. Thus, the SEC will allow local laws to determine what safeguards are adequate for the protection of investors. A U.S. person who invests in such a foreign issuer's securities is presumed to have no reasonable expectation of being protected by the registration requirements of Section five.

2. Rule 905(b): Safe Harbor for All Reporting Issuers and Debt Securities of Foreign Issuers

The safe harbor of Rule 905(b) is available to all issuers, for-

69. Regulation S, supra note 22, at 80,214.
70. See supra text accompanying notes 59-63.
71. Offshore Offers and Sales, supra note 6, at 89,129 n.64.
72. See supra text accompanying notes 59-63.
73. Offshore Offer and Sales, supra note 6, at 89,129.
eign and domestic, that file periodic reports under the Exchange Act. This safe harbor is also open to foreign issuers of debt securities that have a substantial U.S. market interest. The safe harbor offered by Rule 905(b) contains more restrictions than the Rule 905(a) safe harbor, since securities which are registered under the Exchange Act or which have a substantial U.S. market interest are more likely to flowback to the United States.

An offer or sale of securities made by a reporting issuer or by a foreign issuer of debt securities is deemed to have occurred outside the United States if: (a) the general conditions of Rule 904 are met, (b) the offering is not made in the United States or to a U.S. person for a period of forty days from the closing of the offering, or at any time by a distributor with an unsold allotment, (c) appropriate offering restrictions are adopted, and (d) during a forty day restricted period, a distributor who sells the securities to another distributor, dealer or person receiving a selling concession, fee or other remuneration on resale, delivers a confirmation or other notice to the purchaser. The notice must state that the purchaser is subject to the same restrictions on offers and sales that apply to the original distributor (i.e., (a)-(d) above).

---

74. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78kk (1988)). "Reporting issuer" is a defined term in Regulation S. Reporting issuer means an issuer that (a) has a class of securities registered pursuant to sections 12(b) or 12(g) of the Securities Exchange Act of 1934 or is required to file reports pursuant to section 15(d) of the Securities Exchange Act of 1934, and (b) has filed all the material required to be filed pursuant to sections 13(a) and 15(d) of the 1934 Act for a period of at least twelve months immediately preceding the offering of securities in reliance upon Regulation S. 54 Fed. Reg. 30,063, at 30,073 (1989) (to be codified at 17 C.F.R. § 230.902(j)) (proposed July 11, 1989).

75. See supra text accompanying notes 59-63.

76. Offering restrictions" are defined in Regulation S to mean that each distributor must agree in writing that all offers and sales during the restricted period of forty days shall be made only a) in accordance with Regulation S; b) pursuant to registration of the securities under the Securities Act; or c) pursuant to an available exemption from the registration provisions of the Securities Act. In addition, any offering materials and documents (e.g., offering circulars, press releases and advertisements) used in connection with offers and sales of the securities during the forty-day restricted period must include statements to the effect that the securities have not been registered under the Securities Act and may not be offered or sold in the United States or to U.S. persons (other than a distributor) within the restricted period unless: a) the securities are registered under the Securities Act; or b) an exemption from the registration requirements of the Securities Act is available. 54 Fed. Reg. 30,063, at 30,072 (1989) (to be codified at 17 C.F.R. § 230.902(f)) (proposed July 11, 1989).


78. Id.

79. Id.
and its distributors observe the above requirements, the offering will qualify for the 905(b) safe harbor, exempting it from the registration requirements of Section five.

Rule 905(b) imposes fewer restrictions on qualifying issuers than currently exist under Release No. 4708. In straight debt offerings,80 for example, issuers and distributors would be precluded from offers and sales in the United States or to U.S. persons for forty days under Rule 905(b), as opposed to ninety days under Release No. 4708. Also, the Rule 905(b) safe harbor would eliminate the present practice of issuing a temporary global security, which is later exchangeable for definitive securities.

In equity offerings, the difference between the proposed safe harbor of Rule 905(b) and current practice under Release No. 4708 is even more pronounced. First, reporting issuers under Rule 905(b) may offer and sell equity securities in Canada to Canadian persons; Release No. 4708 prohibits offers and sales of such equity securities in North America or to North American persons. Second, reporting issuers of equity would be subject to a restricted period of forty days; Release No. 4708 restricts offers and sales of equity to North American persons for twelve months following the closing of the offering. Third, under Release No. 4708, purchasers of equity securities have to certify their non-North American status; Rule 905(b) would not require such certification. Fourth, under Release No. 4708, issuers of equity have typically passed by-laws prohibiting their directors from registering transfers of securities to North American persons prior to the end of the restricted period. Such by-laws would be unnecessary under Rule 905(b). In

80. Convertible debt would be treated differently depending on the reporting status of the issuer. For reporting issuers, convertible debt securities would be subject to the same restrictions as straight debt securities by the issuer. See 54 Fed. Reg. 30,063, at 30,073 (1989) (to be codified at 17 C.F.R. § 230.905(b)) (proposed July 11, 1989). The underlying securities issued on conversion would be subject to the same restrictions as the convertible security for the remainder of the restricted period. See Offshore Offers and Sales, supra note 6, at 89,137. Convertible debt of a non-reporting foreign issuer, however, would be treated as equity. Id. at 89,139 n.122. Thus, for a non-reporting foreign issuer, both the convertible security and the security issued on conversion would be subject to the more restrictive equity offering requirements. The SEC deliberately places fewer restrictions on reporting issuers than non-reporting issuers, recognizing that U.S. investors are protected by the public availability of information about the reporting issuer, filed pursuant to Exchange Act requirements. Id. at 89,136. In the case of non-reporting issuers, U.S. investors are presumed to have less opportunity to make an informed purchase. Id. at 89,138. Thus, a reporting issuer offering convertible debt under Rule 905(b) would confront fewer restrictions than under Release No. 4708. A non-reporting issuer of convertible debt, however, would labor under restrictions substantially similar to those of Release No. 4708.
short, the 905(b) restrictions are less burdensome on issuers than the current practice under Release No. 4708. The SEC has recognized that once the issuer completes its foreign marketing effort, investors in the United States are protected by the periodic reporting under the Exchange Act.81

Issuers qualifying for the Rule 905(b) safe harbor, as opposed to those qualifying under the less restrictive 905(a) safe harbor, have taken steps to access the U.S. market by registering their securities with the SEC or, in the case of non-reporting foreign issuers, have a substantial U.S. market interest for their debt securities.82 The securities of 905(b) issuers are presumed to be more attractive to U.S. investors, and therefore incur greater restrictions than the securities of Rule 905(a) issuers. Thus, the 905(b) safe harbor aims to prevent indirect distributions of unregistered securities to U.S. persons, without subjecting issuers to burdensome U.S. restrictions.

The SEC’s decision to institute a forty-day restricted period for 905(b) issuers represents a compromise of sorts. The presence of the two general conditions in Rule 904,83 combined with the publicly available information about the reporting issuer, would seem to offer adequate protection for U.S. investors and would obviate the need for registration of the securities. Commentators, however, urged the forty-day restricted period, stating that in their experience all offerings tend to come to rest by that time.84 The prohibition of offers and sales to U.S. persons for forty days is designed to discourage flowback of unregistered securities before any preconditioning of the market has ceased. In the event of flowback after the end of the forty-day restricted period, Regulation S presumes that information about the issuer, publicly available under the Exchange Act, would be sufficient to ensure investor

81. See Offshore Offers and Sales, supra note 6, at 89,129. The periodic reporting requirement protects U.S. investors by assuring the presence of adequate public information concerning the issuer, which presumably allows the market to value the securities accurately. Id. With respect to non-reporting foreign issuers of debt, the SEC deems the that U.S. investor is more likely to be sophisticated, insofar as the market in the United States for debt securities is overwhelmingly an institutional market. Where the likely market is an institutional one, fewer restrictions are needed. Id. at 89,139.

82. Of course, a foreign issuer with a substantial U.S. market interest in its securities may qualify for the 905(a) safe harbor by electing to make an overseas domestic offering, as defined in Regulation S. 54 Fed. Reg. 30,063, at 30,072-73 (1989) (to be codified at 17 C.F.R. § 230.902(h), 230.905(a)(2)) (proposed July 11, 1989).

83. See supra text accompanying notes 59-63.

84. See Regulation S, supra note 22, at 80,215.
protection.85

3. Rule 905(c): The Residual Safe Harbor Category

The Rule 905(c) safe harbor is available to all issuers which do not qualify for the prior two safe harbors. This category includes both non-reporting domestic issuers and non-reporting foreign issuers of equity securities that have a substantial U.S. market interest. The 905(c) safe harbor is the most restrictive of the three issuer safe harbors. The restrictive procedures are a reflection of both the lack of public information available to the marketplace about the issuer and its securities, and the increased likelihood of flowback to the United States.

With respect to domestic issuers, the securities are more likely to flowback to the United States because such securities tend to trade in the market where the issuer does its principal business and has most of its employees.86 In the case of non-reporting foreign issuers of equity securities that have a substantial U.S. market interest, the degree of U.S. market interest, by itself, indicates the greater likelihood of flowback. In both cases, the SEC is particularly troubled by the prospect of flowback of securities where insufficient information will be available in the marketplace to ensure adequate investor protection.87

The nature of the 905(c) restrictions depends on whether the offering is of debt or equity securities.88 The Rule 905(c) safe harbor and the practice with respect to debt offerings under Release No. 4708 are nearly identical.89 Rule 905(c), however, is slightly

85. See Offshore Offers and Sales, supra note 6, at 89,136.
86. Id. at 89,138.
87. Id. The SEC also presumes that non-reporting issuers, particularly U.S. issuers, are more likely to make an offshore offering simply to avoid the costly registration process under the Securities Act. Id. at 89,139.
88. Issuers in this category making an offering of convertible debt should observe the restrictions applicable to equity securities. The lack of available public information and the likelihood of flowback necessitate this restrictive characterization of a convertible debt security as an equity security. See id. at 89,139 n.122.
89. In Rule 905(c) straight debt offerings, the offer and sale are deemed to occur outside the United States if: (a) the issuer and its distributors comply with the general conditions of Rule 904, see supra notes 59-63 and accompanying text; (b) the offering is not made, during a forty-day restricted period, in the United States or to U.S. persons (other than a distributor), except pursuant to registration or an available exemption from registration; (c) the issuer and distributors adopt appropriate offering restrictions, see supra note 77 and accompanying text; (d) a distributor selling debt securities to a distributor, dealer or a person receiving a selling concession, fee or other remuneration on resale, during a forty-
more liberal. The restricted period during which offers and sales in the United States or to U.S. persons are prohibited has been shortened from ninety days to forty days. In addition, Rule 905(c) introduces the concept of the "qualified institutional buyer" as an exception to Release No. 4708's blanket prohibition of sales to U.S. persons during the applicable restricted period.

The 905(c) equity safe harbor is the most restrictive safe harbor in Regulation S. Nevertheless, it is slightly more liberal than the current practice under Release No. 4708. The 905(c) equity safe harbor would prohibit offers and sales in the United States or to U.S. persons during the restricted period, rather than in North America or to North American persons, as under Release No. 4708. Rule 905(c) would allow a "qualified institutional buyer" to day restricted period, delivers a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to the distributor, 54 Fed.Reg. 30,063, at 30,074 (1989) (to be codified at 17 C.F.R. § 230.905(c)) (proposed July 11, 1989); and (e) the securities are represented upon issuance by a temporary global security which may not be exchanged for definitive securities until (i) the expiration of the forty-day restricted period, and (ii) certification of beneficial ownership of the securities by a non-U.S. person or a qualified institutional buyer as defined in Rule 144A ("qualified institutional buyer" is defined by Rule 144A to mean an institution, acting for its own account, that at the conclusion of its most recent fiscal year had assets invested in securities purchased for a total of more than US$100 million. 54 Fed. Reg. 30,076, at 30,085-86 (1989) (to be codified at 17 C.F.R. § 230.144A(a)) (proposed July 11, 1989). Rule 144A will work in tandem with Regulation S and will facilitate the purchase of foreign securities by U.S. institutional investors. (Such investors, because of their sophistication, are deemed less likely to require the protection afforded by the Regulation S safe harbors). An offering observing the above restrictions would thereby be exempt from the registration requirements of Section five.

In the case of an equity offering, the offer and sale are deemed to occur outside the United States if (a) the issuer and its distributors comply with the general conditions of Rule 904, see supra text accompanying notes 59-63; (b) the offering is not made, during a one-year restricted period, in the United States or to U.S. persons (other than distributors), except pursuant to registration or an available exemption from registration; (c) the issuer and distributors adopt appropriate offering restrictions, see supra note 77 and accompanying text; (d) the purchaser of the securities (other than a distributor) certifies either that it is not a U.S. person and is not acquiring the securities for the account or benefit of a U.S. person, or that it is a qualified institutional buyer as defined in Rule 144A, see supra note 89; (e) the purchaser of the securities (other than a distributor) agrees to resell such securities only in accordance with Regulation S, pursuant to registration under the Securities Act, or pursuant to an available exemption from registration; (f) the issuer refuses to register any transfer of securities not made in accordance with the provisions of Regulation S; and (g) during a one year period, distributor selling equity securities to a distributor, dealer or a person receiving a selling concession, fee or other remuneration on resale, delivers a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to the distributor. See 54 Fed. Reg. 30,063, at 30,074 (1989) (to be codified at 17 C.F.R. § 230.905(c)) (proposed July 11, 1989). An equity offering observing the above restrictions would thereby be exempt from the registration requirements of Section five.
purchase equity securities during the restricted period, despite its U.S. person status. No comparable exception exists under Release No. 4708. Finally, although the purchaser must agree to observe resale restrictions, there is no specific requirement in 905(c) that a legend outlining the restrictions on resale of the securities be placed on the certificates. The practice under Release No. 4708 is to place a restrictive transfer legend on the certificates that evidence the shares sold.

The more severe restrictions in the 905(c) equity safe harbor as opposed to the 905(c) debt safe harbor reflect the different natures of their respective markets. As discussed earlier,91 in the United States, equity is considered a retail security. Investors in retail equity securities, because of their relative lack of sophistication and resources, are deemed to require more protection than institutional investors purchasing debt securities.

C. The Resale Safe Harbor

The resale safe harbor serves to exempt certain secondary market trading in unregistered securities from the registration requirements of section five. Regulation S provides two safe harbors for resale transactions by persons other than the issuer, its distributors, and their affiliates. The first safe harbor is available to persons who do not receive any form of concession for selling the securities (i.e., non-dealers).92 The second safe harbor applies to persons receiving any form of selling concession.93 The main benefit afforded by the resale safe harbor is to permit investors who acquire restricted securities through a non-public offering to resell them abroad before the expiration of the three-year restricted period set forth in Rule 144 of the Securities Act.94 According to the release accompanying Regulation S, the availability of resale safe harbors is not intended to hinder the use of the statutory registration exemptions of sections 4(1)95 and 4(3)96 of the Securities Act.

91. See supra note 29 and accompanying text.
1. Rule 906(a): Resale Safe Harbor for Non-Dealers

The 906(a) resale safe harbor is available for all resales by persons other than dealers and persons receiving a selling concession, fee or other remuneration on resale. To avail themselves of this resale safe harbor, qualifying persons need only comply with the general conditions of Rule 904. In short, a qualifying person can resell securities under the 906(a) safe harbor if the sale is an offshore transaction and such person is not conducting any directed selling efforts in the United States. Such a resale will be deemed a sale made outside the United States and will not trigger the registration requirements of section five.

The SEC would permit resales on foreign exchanges pursuant to this safe harbor because it presumes that persons purchasing securities on a foreign securities exchange will rely on the protection of the local securities laws. Furthermore, such purchasers are not likely to expect that the registration provisions of the Securities Act will apply to their transaction. The practical effect of the 906(a) safe harbor is that it permits resales to U.S. persons before the expiration of any applicable restricted period. For example, a security originally offered overseas by a U.S. reporting issuer would be subject to a forty-day restricted period during which offers and sales to U.S. persons are prohibited. The 905(b) issuer safe harbor, applicable to primary distributions, contains a blanket prohibition on offers or sales to U.S. persons. The 906(a) resale safe harbor, applicable to non-dealers engaged in secondary trading, permits a seller to sell the security to a U.S. person in a foreign exchange transaction during the forty-day restricted period. The seller, however, must not prearrange the transaction with a buyer in the United States.

The 906(a) resale safe harbor represents a liberalization of restrictions employed by the SEC in Release No. 4708. Under Release No. 4708, investors acquiring securities in an exempt foreign offering could resell the securities on a foreign exchange to a U.S. person, but only after the expiration of the ninety-day or twelve-
month restricted period.\footnote{100. See text accompanying notes 30 \& 33.} Under 906(a), an investor who is not a dealer can immediately resell the securities on a foreign exchange to a U.S. person, so long as the sale was not prearranged with a buyer in the United States.\footnote{101. If Rule 144A, 54 Fed. Reg. 30,076 (to be codified at 17 C.F.R. § 230.144(A)) (proposed July 11, 1989) is adopted, unregistered securities distributed offshore could be resold at any time by the purchasers to qualified institutional buyers meeting the prescribed qualifications of the rule, whether in the United States or not. The rule does not differentiate between resales by dealers and other persons.}

2. Rule 906(b): Resale Safe Harbor for Dealers

The 906(b) safe harbor is available for resales by dealers or persons receiving a selling concession, fee or other remuneration for the offer or sale of the securities. This resale safe harbor is not available to the issuer, a distributor or any affiliate of either, that is attempting to sell any part of an unsold allotment or original subscription of unregistered securities.

First, the dealers must observe the two general conditions of Rule 904.\footnote{102. See supra text accompanying notes 59-63.} In addition, during the restricted period specified in Rules 905(b) or 905(c) (whichever is applicable to the particular security involved),\footnote{103. See supra notes 85-86, 89-90 and accompanying text.} neither the dealer nor any person acting on his behalf may make an offer or sell securities to a person whom he knows to be a U.S. person. Finally, if the dealer or any person acting on his behalf knows that the purchaser is either a dealer or a person who receives a concession for the sale of securities, the dealer/seller must deliver to the purchaser a confirmation or other notice stating that the securities may be offered and sold during the restricted period only: (a) in accordance with Regulation S; (b) pursuant to registration under the Securities Act; or (c) pursuant to an available exemption from the registration requirements of the Securities Act.

The 906(b) resale safe harbor is slightly more restrictive than the 906(a) safe harbor applicable to non-dealers. Under 906(a), a non-dealer/seller can knowingly sell unregistered securities to a U.S. person during the applicable restricted period by executing a sale through a foreign exchange. As long as the sale is not prearranged with the buyer in the United States, the transaction is deemed exempt from the registration requirements. Under 906(b),
PROPOSED REGULATION S

the dealer/seller cannot, during the applicable restricted period, knowingly sell unregistered securities to a U.S. person by effecting the transaction on a foreign securities exchange. Of course, if the dealer does not know the buyer in a foreign exchange transaction, his sale to a U.S. person would not violate the resale safe harbor. The ban on sales to U.S. persons only extends to buyers whom the dealer knows to be U.S. persons. The 906(b) resale safe harbor would be more liberal than current practice under Release No. 4708. It would not prohibit all resales to U.S. persons during the applicable restricted period. Under Release No. 4708, resales to U.S. persons through the facilities of a foreign securities exchange are permitted only after the ninety-day or twelve-month restricted period. Rule 906(b) would prohibit resales on a foreign exchange to a known U.S. person. Since most exchange transactions do not involve contact between the buyer and seller, however, much of the bite of the 906(b) prohibition is lost.

IV. PROPOSED CLARIFICATIONS AND CHANGES TO REGULATION S

Regulation S, like every other administrative or congressional attempt to proscribe or regulate conduct, inevitably contains its share of ambiguities and internal inconsistencies. The following is a brief discussion of several problem areas of Regulation S which appear to be at odds with its underlying purposes, as stated by the SEC.105

A. The U.S. Trustee and Non-U.S. Beneficiary Problem

The SEC, under Release No. 4708, has taken a no-action position with respect to sales nominally made to U.S. entities in circumstances in which the beneficial owner will not be a U.S. person. For example, an offer or sale to a U.S. broker-dealer or investment adviser acting in a fiduciary capacity for a foreign beneficial owner does not require registration. Viewed in the context of Release No. 4708, these transactions would not appear to involve

104. In these resale transactions, the SEC does not intend to create a duty to inquire whether or not the purchaser is a U.S. person. Offshore Offers and Sales, supra note 6, at 89,140.

105. The primary purposes of Regulation S are as follows: 1) to recognize principles of comity; 2) to protect the American investor; and 3) to encourage domestic corporations to access low-cost foreign capital markets.

sales to persons whom the securities laws intended to protect, or to constitute offers and sales for purposes of the registration provisions of the Securities Act.

This issue is addressed in Rule 902(m), which defines what constitutes a "U.S. person" for purposes of Regulation S. Under Rule 902(m)(1), any trust in which any trustee is a U.S. person, is a U.S. person. In addition, Rule 902(m)(1) defines any custodial account held by a dealer or other fiduciary organized, incorporated or residing in the United States, to be a "U.S. person." By focusing on the residence of the trustee, this rule marks a change from the practice under Release No. 4708, which focused on beneficial ownership. Rule 902(m)(2), however, redirects our focus towards beneficial ownership by stating that notwithstanding Rule 902(m)(1), a custodial or similar account held by a dealer or other fiduciary for a non-U.S. person shall not be deemed a "U.S. person." It is unclear, however, whether the language of Rule 902(m)(2) operates to place trusts held by U.S. trustees for a non-U.S. beneficiary outside the category of U.S. person.

Trustees are certainly fiduciaries as specified in Rule 902(m)(2). Whether a trust constitutes a "custodial account or similar account" is less certain. Nonetheless, the argument for finding a trust to be a "similar account" is compelling. The relationship between a trustee and beneficiary is identical to that of dealer and customer when the dealer holds the customer's securities in his or her own name or street name. In both cases, there is a separation of legal and beneficial interests. The SEC should continue to focus primarily on beneficial ownership and not on naked legal title.

As currently drafted, the regulation is unclear as to whether a trust, with American trustees and a non-U.S. beneficiary, would be considered a non-U.S. person. The rationale for treating dealers, who trade for non-U.S. customers, as non-U.S. persons, would apply equally as well to trustees acting for non-U.S. person beneficiaries. Regulation S should more clearly reflect the non-U.S. person status of such a trust.

B. Comity and an Expanded Scope for Rule 905(a)

The SEC, in proposing Regulation S, has stated that one of its purposes is to recognize principles of comity. Comity mandates

107. See Offshore Offers and Sales, supra note 6, at 89,128.
the limited application of sovereign powers to extraterritorial events and persons.\textsuperscript{108} Accordingly, the principles of comity would dictate that a foreign issuer that has not tried to access U.S. capital markets (e.g., by obtaining a listing on an exchange), be included in the least restrictive category available to issuers under Regulation S for overseas offerings.\textsuperscript{109}

Currently, Rule 905(a), the least restrictive category, is limited to foreign issuers making an overseas domestic offering or foreign issuers with no substantial U.S. market interest. This is overly restrictive. An approach distinguishing between foreign issuers' voluntary or involuntary entry into U.S. capital markets would be more consistent with principles of comity.

Foreign issuers that voluntarily seek access to U.S. capital markets implicitly agree to be governed by the laws of those markets. Foreign issuers which do not attempt to access U.S. capital markets should not be forced to comply with the more restrictive U.S. rules merely because U.S. investors are eager to buy their securities. The Rule 905(a) safe harbor should be available to this second category of foreign issuers. It would not be the first time the SEC has sought to distinguish between foreign issuers voluntarily seeking access to U.S. capital markets and foreign issuers whose securities are traded in the United States without the issuers' prompting.\textsuperscript{110}

American investors would be adequately protected under an expanded Rule 905(a). Foreign issuers would still have to comply with the two general conditions of Rule 904: 1) the offering would have to be an offshore transaction; and 2) the issuer could not conduct any directed selling efforts in the United States. There is little risk of flowback to the United States if the securities are not listed on American exchanges or quoted on NASDAQ, and the foreign issuer observes the two general conditions. Such securities would more likely be traded in the issuer's domestic market.

\textsuperscript{108} Id.

\textsuperscript{109} The least restrictive category is found in Rule 905(a) and is presently applicable to foreign issuers with no substantial U.S. market interest. See supra notes 66-73 and accompanying text.

C. Non-Dollar-Denominated Debt

The currency in which a debt instrument is issued is usually a good indicator of the investor base at which the issue is being aimed. American investors are notoriously parochial and generally are only interested in dollar-denominated debt. Those American investors typically interested in non-dollar-denominated debt are wealthy and sophisticated institutional investors. Such investors have no great need of the protection afforded by the registration provisions of the Securities Act.

Unfortunately, Regulation S does not distinguish between the nature of the offering and the nature of the issuer. Under Regulation S, the appropriate safe harbor available to an issuer is determined solely by reference to the nature of the issuer. For instance, the fact that a foreign issuer had more than 300 U.S. holders of its dollar-denominated debt securities, and no or few U.S. holders of its non-dollar-denominated debt securities is of no consequence under Regulation S. These facts would indicate that there is no substantial U.S. market interest in the issuer's non-dollar-denominated debt. Nevertheless, Regulation S, as currently proposed, would compel the issuer to observe the stricter standards of Rules 905(b) or 905(c), supposedly reserved for foreign offerings with substantial U.S. market interest and high likelihood of flowback.

Regulation S needs some fine tuning in this area. Its present focus on the nature of the issuer to the exclusion of the nature of the offering is overinclusive in light of the purposes of the regulation. Non-dollar-denominated debt will most likely be traded in the country whose currency is denominated in the security. Accordingly, the SEC should allow issuers of non-dollar-denominated debt to qualify for the least restrictive 905(a) safe harbor.

D. Resales After the End of the Restricted Period

Rules 905(b) and 905(c) impose "restricted periods" of forty days to twelve months on the sale of unregistered or exempt securities in the United States or to U.S. persons. Regulation S is silent,

113. For commentary supporting the view that there is little likelihood of flowback of non-dollar-denominated debt, see Silverman & Braverman, supra note 4, at 225 n.26.
however, on the question of when (after the expiration of the restricted period) resales can be made in the United States or to U.S. persons without registration. The SEC staff, under Release No. 4708, has expressed no view as to when or under what circumstances securities issued pursuant to Release No. 4708 could be resold in the United States or to U.S. persons. If pressed, the staff has treated the securities as restricted securities for purposes of Rule 144 and has allowed resale of the restricted securities after the expiration of the two year holding period.115

In determining the impact of Regulation S on resales in the United States or to U.S. persons after the expiration of the restricted period, it is necessary to examine the language in the offering restrictions.116 The prohibitions on offers or sales in the United States or to U.S. persons are phrased to apply "within the restricted period" or "during the restricted period."117 A prudent purchaser of such securities, reading the restrictions, would reasonably suppose that they apply only during the restricted period. The clear implication to the purchaser is that he or she can sell the securities without restriction after forty days or twelve months (depending on the nature of the security and the issuer). The proposed language in the offering restrictions of Regulation S differs subtly from the language required under Release No. 4708. The InfraRed no-action letter is a typical example of the practice under Release No. 4708.118 The InfraRed legend prohibits sales in the United States or to U.S. persons for twelve months. InfraRed, however, goes on to provide that thereafter (i.e., after the twelve month period) sales can only be made in the United States or to U.S. persons if the securities are registered or there is an available exemption. The legend of Regulation S imposes no explicit limitations on resales after the end of the restricted period. Regulation S appears to accept the proposition that after the restricted period, the securities can be resold in the United States or to U.S. persons in reliance on the section 4(1) registration exemption.

The apparent position of the SEC staff is more ambivalent

114. 17 C.F.R. § 230.114(a)(3) (1989) (restricted securities are securities "acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain or transactions not involving any public offering. . .").
117. Id.
118. See supra note 33 and accompanying text.
than the foregoing would suggest. In the original release proposing Regulation S, the staff analyzes the resale problem on the basis of whether the issuer is a reporting company under the Exchange Act or not. If the issuer is a reporting company, the purpose of the forty day restricted period is not to prevent flowback, but to prevent securities from entering the U.S. capital markets while the market has been preconditioned for such securities. In the event that flowback of unregistered securities in this category occurs after the restricted period, the information on the issuer and its securities, which is publicly available under the Exchange Act, is deemed sufficient to ensure investor protection. If the issuer is a non-reporting company, the purpose of the restricted period is to prevent an unregistered distribution of such securities in the United States. The lack of publicly available information about a non-reporting issuer and its securities makes their distribution to an ignorant public a matter of concern for the SEC.

Regulation S focuses on whether securities come to rest outside of the United States in determining whether a distribution is in fact completed outside of the United States. If the securities have come to rest, then the distribution in the Section 2(11) sense is completed and persons other than affiliates of the issuer ought to be able to resell the securities in reliance on the Section 4(1) exemption. Accordingly, once the restricted periods of the respective safe harbors expire, the securities should be deemed to have come to rest and the distribution ended. Thereafter, the securities should be resold in the United States in reliance on the Section 4(1) exemption. The SEC staff should explicitly provide in the regulation that after the expiration of the restricted period, the securities will be deemed to have come to rest and purchasers will be able to rely on the Section 4(1) exemption in selling them.

V. Conclusion

Regulation S represents an extraordinary and commendable effort by the SEC to provide a comprehensive framework for determining the applicability of the registration requirements of section five to foreign offerings. The proposed safe harbors will substitute

---

119. Offshore Offers and Sales, supra note 6, at 89,123.
120. Id. at 89,136.
121. Id.
122. Id. at 89,138.
certainty for the reading of tea leaves typical of practice under Release No. 4708. Regulation S, however, leaves some questions unanswered and some promises unfulfilled. Nevertheless, on the whole, Regulation S promises to significantly broaden the market for foreign offerings by U.S. issuers and to increase opportunities for U.S. investors to purchase part of a foreign offering.

MICHAEL REDMOND GIBBONS*

* The author acknowledges an indebtedness to Professor James S. Mofsky of the University of Miami School of Law, whose stimulating lectures on the law of securities left the author eager to learn more. This comment is dedicated to my parents, Frank and Janet, who continue to inspire me to aim higher.