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# Raising Debt or Equity Capital in the United States : US Legal Issues Confronting a Non-US Company

## **Abstract**

As companies seek to expand into the international markets, the need to finance that expansion and to gain international investor and consumer interest increasingly causes such companies to turn to the international capital markets which, today, are dominated by the capital markets of the United States, Europe and Japan. This article discusses the major legal issues under United States securities laws, confronting a non-North American company, referred to throughout as a 'foreign company' or 'foreign issuer', which seeks to raise either equity or debt capital from the public in the United States.

## **Keywords**

United States securities laws, international capital markets, debt or equity capital, foreign companies

# RAISING DEBT OR EQUITY CAPITAL IN THE UNITED STATES—US LEGAL ISSUES CONFRONTING A NON-US COMPANY



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## Introduction

As companies seek to expand into the international markets, the need to finance that expansion and to gain international investor and consumer interest increasingly causes such companies to turn to the international capital markets which, today, are dominated by the capital markets of the United States, Europe and Japan. This article discusses the major legal issues under United States securities laws, confronting a non-North American company, referred to throughout as a 'foreign company' or 'foreign issuer', which seeks to raise either equity or debt capital from the public in the United States.<sup>1</sup>

In recent years, an increasing number of foreign companies have raised capital in the United States. Some do so because their own domestic capital market is too small to fully satisfy their needs while the US market, by comparison, is much more liquid. Others look to the United States because of a desire to facilitate global trading in their shares which requires that those shares be traded in the major capital markets of the world.<sup>2</sup>

With some exceptions, a company, whether US or foreign, which seeks to have its securities<sup>3</sup> publicly traded in the United States will be required to file various reports with the United States Securities and Exchange Commission (the 'SEC'). Such reporting obligations are dealt with below, but the fact that a company is a 'reporting company' enables analysts,

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- 1 This article is solely concerned with 'public offerings' of debt or equity capital. Such offerings are to be contrasted with so called 'private-placements' of securities which, provided they are done in the correct manner, avoid many of the regulatory requirements imposed by the United States securities laws. The US Securities and Exchange Commission has recently proposed a regulation, Rule 144A which, if enacted, will simplify the procedure for private placements to institutional investors by allowing them to resell the securities without having to comply with the *Securities Act 1933*.
  - 2 Other reasons for accessing the US capital market are that it may be cheaper to raise capital in the United States than elsewhere, there are no foreign exchange controls or currency controls in the United States and US dollars may be required to finance future or current obligations.
  - 3 The word 'securities' is intended throughout this article to have the meaning given to it under s 2(1) of the United States *Securities Act of 1933*. That definition clearly includes both debt and equity instruments.

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'sophisticated' and institutional investors and therefore the market, to be well informed of that company's operations and financial condition and this in turn facilitates trading in the company's securities.

To take the greatest advantage of making a public offering of securities in the United States, many companies seek to list those securities on either the New York Stock Exchange or one of the other securities exchanges.<sup>4</sup> Alternatively, the securities can be traded on the over-the-counter market. This article includes a discussion of the requirements to be satisfied before any such listing or trading can occur.

## Overview of US Legal Considerations

A foreign company considering raising capital in the United States faces many legal issues capable of influencing the nature of such capital raising. For instance, there is a very complex body of legislation, rules and regulations administered by the SEC governing the offering, selling and trading in securities in the United States and hence close consultation with US lawyers is required. The following is an overview of those legal considerations.

## The Securities Act

*The Securities Act of 1933*, as amended (the '*Securities Act*'), governs the distribution and sale of securities in the United States by US and non-US issuers and certain of their affiliates. Under that Act, and subject to certain exceptions and exemptions, a foreign company making a public offering of securities in the United States must file a registration statement with the SEC. The registration statement consists of the proposed prospectus and other specified material, the contents of which are prescribed in the *Securities Act* and rules and regulations thereto. These provisions call for disclosure of certain information about the issuer (including detailed financial statements), the securities being offered and the underwriting.

If the registration statement contains information which is materially false or misleading or contains a material omission, the issuer, its directors and all persons signing the registration statement can be subject to civil liability under s 11 of the *Securities Act*. All parties except the issuer have a defence to such liability, commonly referred to as the 'due diligence defence', if they can prove that, after making a reasonable investigation they had reasonable grounds to believe, and did believe, that the registration statement did not contain any material omission or any false or misleading information. Over the years, US lawyers have devised procedures for arranging and investigating the affairs of the issuer which seek to minimize the risk of any liability arising under s 11 of the Act.

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<sup>4</sup> Other exchanges include the American Stock Exchange and several smaller regional exchanges. In 1987 the New York Stock Exchange accounted for 50% of trading of listed stocks in the US.

## Securities Exchange Act of 1934

The registration requirements of the *Securities Act* relate to specific offerings of securities and are designed to protect potential investors in such offerings. On the other hand, trading in securities which have previously been offered is regulated under the *Securities Exchange Act of 1934*, as amended (the '*Exchange Act*'), in a manner designed to ensure that material and accurate current information about publicly traded securities is widely disseminated through the securities market. The *Exchange Act* seeks to achieve this by imposing both its own registration statement filing requirements and periodic reporting obligations. Fundamental to the Act is its recognition of the efficient market theory which states that if all material information about a company and its securities is widely disseminated amongst securities analysts, arbitraguers and other sophisticated investors, that disseminated information is quickly and accurately reflected in the price of the securities.<sup>5</sup>

Unless an exemption is available, an *Exchange Act* registration statement must be filed with the SEC by any company with securities listed on a securities exchange in the United States<sup>6</sup> or with, at the end of its last fiscal year, total assets of a least US\$5,000,000 and a class of equity security held of record by 500 or more persons.<sup>7</sup>

There are two important exemptions from the registration requirements imposed by the *Exchange Act* available to non-US companies. The first is under *Exchange Act* Rule 12g 3-2(a) if the company has fewer than 300 holders of record resident in the United States. The second exemption arises under *Exchange Act* Rule 12g 3-2(b) and is available to a foreign company which lodges with the SEC all information it distributes to its shareholders or makes public in its home country or files with any stock exchange on which its securities are traded and which is then made public by that exchange.<sup>8</sup>

The periodic reporting provisions of the Act apply to a foreign issuer required to register securities under the *Exchange Act* or which has registered securities under the *Securities Act*. Each such foreign issuer must file with the SEC an annual report on Form 20-F within six months after the end of each financial year and must file a report on Form 6-K if certain other 'significant' information concerning the company is made public, including information the company has filed with a non-US stock exchange or distributed to its security holders. Generally speaking, because these reports must meet the SEC's very detailed standards for disclosure of financial information, the disclosure obligations under the Act are burdensome for non-North American companies and consequently it is important that the possibility of an exemption be thoroughly considered.

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5 See Fama, Efficient Capital Markets: A Review of Theory and Empirical Work, (1970) 25 J Fin 383; Banoff, Regulatory Subsidies, Efficient Markets, and Shelf Registration: An Analysis of Rule 415, (1985) Securities Law Review 95.

6 *Exchange Act*, s 12(b).

7 *Exchange Act*, s 12(g).

8 It is common for Australian companies raising capital in the United States to apply to the SEC for an exemption under Rule 12g 3-2(b) and such exemptions are frequently granted.

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Under s 18(a) of the *Exchange Act*, if any information filed by a company pursuant to its periodic reporting obligations contains materially false or misleading statements, the company, its directors and officers are liable to compensate any person who purchases or sells the company's securities for any loss sustained by that person as a result of relying upon that information. However no such liability is imposed in relation to information filed by a company which, by virtue of Rule 12g 3-2(b) of the *Exchange Act*, is exempt from the Act's registration requirements. Nevertheless, a company having such an exemption and its directors and officers may still be held liable under Rule 10b-5 of the *Exchange Act* which prohibits fraudulent and misleading conduct in relation to the purchase and sale of a company's securities. Since there is no liability under Rule 10b-5 unless it can be proved that the misleading statements were made knowingly or recklessly, it is more difficult to succeed in an action under that provision than under s 18(a) of the *Exchange Act*. Rule 10b-5 would apply to any material a company lodges with the SEC or otherwise makes available to the public in the United States.

### The Trust Indenture Act

When a foreign company offers debt securities to the public in the United States, it will execute a trust indenture and appoint a commercial bank or trust company to act as trustee for the benefit of the security holders. Such indenture frequently places restrictions on the ability of the issuer to raise additional debt or sell or pledge its own, or its subsidiaries', assets. The trust indenture will be subject to, and must comply with, the requirements of the US *Trust Indenture Act of 1939* which requires that the trustee be independent, disclose certain events to security holders and conduct itself according to a prescribed standard. The indenture must be filed with the SEC together with the *Securities Act* registration statement.

### The Investment Company Act of 1940

If the foreign company is an 'investment company' as defined in the *Investment Company Act of 1940*<sup>9</sup> (the '*Investment Company Act*'), it must be registered under that Act before offering securities to the public in the United States. Prior authorization from the SEC is required for such registration. Compliance with the *Investment Company Act*'s registration and other requirements is particularly onerous and hence, for many foreign companies, it may not be worthwhile proceeding with a public offering in the United States unless a prior exemption from the Act can be obtained from the SEC.

A foreign company will qualify as an 'investment company' under the Act if it is primarily engaged in the business of investing or trading in securities. Accordingly, a company which, either itself or through various subsidiaries or affiliates, is significantly involved in the provision of financial services or insurance may be subject to the *Investment Company Act*. Whilst US banks and insurance companies have for a long time been exempt from the Act, no such exemption extends to foreign companies

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<sup>9</sup> See *Investment Company Act*, s 3(a)

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engaged in these activities except that, effective December 4, 1987, Rule 6c-9 under the *Investment Company Act* exempts foreign banks and certain foreign bank finance subsidiaries from the Act's requirements for the purpose of offering debt securities and non-voting preferred stock. This exemption does not appear to be available to any non-bank parent company of a foreign bank which accordingly should apply to the SEC for an exemption before offering securities in the United States.

### Commencing a Public Offering

The *Securities Act* regulates not only 'sales' of securities, but 'offers' to sell or buy securities and, subject to certain exemptions discussed below, makes it unlawful for any company to offer or sell its securities to the public unless a registration statement relating to the offering has been filed with the SEC.<sup>10</sup> The activities of 'selling' and 'offering' securities are broadly defined,<sup>11</sup> with the result that 'offers' may only be made orally or by means of a preliminary prospectus which meets the requirements of the Act. If 'offers' are made by preliminary prospectus, that document will form part of the registration statement filed with the SEC.

Because of these requirements, a company proposing an offering must be careful that those involved do not engage in promotional or other conduct which the SEC would regard as constituting an 'offer' or 'sale' of the securities, since generally such promotional conduct would not meet the requirements for a preliminary prospectus and hence would result in a breach of the Securities Act. The SEC is very sensitive here and treats material used simply to promote the company, even if it does not refer to the proposed offering itself, as violating the Act. Actual sales of securities, as distinct from offers, cannot be made until the SEC has had the opportunity to review the registration statement containing the final prospectus and has declared that registration statement effective. A copy of the final prospectus must be delivered to each purchaser on or before confirmation of sale.

Once the registration statement is prepared, the offering proceeds by filing the registration statement with the SEC which then examines it to ensure compliance with the requirements under the *Securities Act* and applicable rules and regulations, including the requirement that it does not contain any material misstatement or omit to state any material fact. Later, when the issuer and underwriters, if any, are ready to commence selling the securities, they will file a 'pricing amendment' with the SEC setting out any corrections or additional information, the offering price and other specific terms of the securities (such as, in the case of debt securities, interest rate and sinking fund provisions) and aspects of the underwriting arrangements. When requested to do so by the issuer, the SEC is often willing to declare the registration statement effective shortly after the pricing amendment is filed. Hence, it is unusual for the issuer and the underwriters to get together at the close of trading on the day before they wish to commence selling the securities to prepare and file the pricing amendment. This minimizes the risk to the issuer and

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10 See *Securities Act*, s 5.

11 See *Securities Act*, s 2(3)

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underwriters of incurring losses or facing difficulties as a result of adverse changes in the market for the securities which could occur between the time of finalizing the price and other specific terms mentioned above and the time selling commences.

### Form and Contents of Registration Statement

As mentioned above, the *Securities Act* governs offers and sales of securities whereas the *Exchange Act* regulates trading in securities that have previously been offered and requires companies having registered securities under either Act to comply with periodic reporting obligations designed to ensure that the securities market is kept informed of each issuer's current financial position and other fundamental changes. The two Acts are also intended to simplify and reduce the *Securities Act* registration procedures for all companies proposing to offer securities in the United States by enabling issuers to incorporate into the *Securities Act* registration statement, material furnished by the company in its periodic reports.

The *Securities Act* registration statement filed by a foreign company commencing a public offering of securities must comply with one of three forms prescribed under the Act. Those forms are Form F-1, the so-called 'long-form' registration statement, and Forms F-2 and F-3, shorter form registration statements which rely upon incorporation by reference of material filed under the *Exchange Act*.

A foreign issuer proposing an initial public offering of securities in the United States will not generally have been subject to the periodic reporting requirements of the *Exchange Act* and accordingly will be required to prepare a long-form registration statement on Form F-1. Form F-1 contains two parts, the first being the prospectus itself which includes a description of the business of the issuer, its financial statements, a description of both the securities to be offered and the use of proceeds from the offering and a management discussion and analysis of the company's financial condition and results of operations. The second part is comprised of information such as expenses of the offering and indemnification of directors and officers and is available for public inspection and copying at the offices of the SEC.

Forms F-2 and F-3, being short-form registration statements, rely to a great extent on incorporation by reference of the issuer's most recent Annual Report on Form 20-F, and hence are only available to a company which has previously filed periodic reports under the *Exchange Act*. To be eligible to use Form F-3, the shortest form of registration statement, an issuer must have filed all required *Exchange Act* reports for the previous 36 months, not have committed certain defaults (including interest and sinking fund defaults) and be a 'world class issuer', i.e., have outstanding voting shares held by non-affiliates with an aggregate market value of at least US\$300 million. This latter requirement need not be satisfied if the issuer is offering for cash so-called 'investment grade' non-convertible debt securities.<sup>12</sup> In addition to the above, if the securities

12 An 'investment grade' debt security is one rated in one of the four highest rating categories by a nationally recognized US statistical rating organization such as Moody's Investors Service or Standard & Poor's Corporation.



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are not investment grade non-convertible debt securities or if the offer is other than to existing securityholders, an issuer can only use Form F-3 if its most recent Form 20-F, or an amendment thereto, contains financial statements presented in the prescribed manner, as discussed below.

Since the Form F-3 registration statement incorporates by reference the issuer's most recent Form 20-F, it will itself only contain business or financial information which constitutes a material change since the end of the last financial year.

An issuer not eligible to file on Form F-3 may use Form F-2 in certain circumstances, provided it has filed at least one Annual Report on Form 20-F and is a 'world class' issuer offering 'investment grade' non-convertible debt securities. When Form F-2 rather than Form F-3 is used, the Form 20-F and any Form 6-K incorporated therein must be delivered with the prospectus to the purchasers of securities.

Foreign issuers should be aware of the requirement in Rule 3-19 of Regulation S-X<sup>13</sup> that the financial statements in the registration statement be not more than six months old at the date the registration statement becomes effective. This can cause problems for those foreign companies which, unlike United States' companies reporting under the *Exchange Act*, are not required to prepare quarterly financial statements. To ensure compliance with Rule 3-19, a foreign issuer may need to file interim unaudited financial statements on Form 6-K which are then incorporated by reference in the Form F-3 or F-2.

## Presentation of Financial Statements

A major purpose of the United States securities laws is to require an issuer of securities to the United States public to accurately disclose sufficient information to enable the market and potential investors to assess the risks of an investment. Whether a foreign company is commencing an initial public offering in the United States or already has securities publicly traded there, the company must ensure that, in preparing its registration statement or filing its annual report, it meets the SEC's standards for disclosure of financial information. Satisfying those standards is one of the major problems faced by a foreign company seeking to offer securities in the United States and any such company should ensure it has access to accountants familiar with the SEC's accounting practice.

Under the basic rule followed by the SEC for all filings by foreign companies, financial statements prepared in accordance with the accounting principles of the issuer's home country will be accepted if the SEC considers that those principles constitute a 'comprehensive body of accounting principles' and the financial statements include a reconciliation with United States Generally Accepted Accounting Principles ('USGAAP'). The SEC regards the accounting principles of several countries, including Australia, the United Kingdom, France and New Zealand, as constituting

13 Regulation S-X, inter alia, sets out the requirements for the filing of financial statements under the *Securities Act* and the *Exchange Act*.

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a comprehensive body of accounting principles. In the case of Japanese issuers, whilst recognizing that Japan has a comprehensive body of accounting principles, the SEC views them as irreconcilable with USGAAP and requires Japanese issuers to restate their financial statements using USGAAP.

Financial statements must be presented in the currency of the issuer and should include the exchange rates between the issuer's home currency and the US dollar over the preceding five years and any recent financial information relating to revenue and income which the issuer has made available to the public. In addition, the SEC requires that audited financial statements be signed by accountants who follow procedures that are the same as US Generally Accepted Auditing Standards and who are independent of the issuer, its parent, its subsidiaries and its other affiliates.

### Shelf Registration

The registration procedures outlined above are for specific offerings of securities proposed to be made shortly after filing the registration statement. However, since 1982, Rule 415 under the *Securities Act* has permitted issuers, including foreign companies, which meet the requirements of the Rule to file what is called a 'shelf' registration statement. This allows an issuer to register an amount of securities which it reasonably believes it will offer in the following two years.

Shelf registration is designed to assist companies seeking to raise capital. Whilst no securities can be offered to the public unless a registration statement containing current and accurate information has been filed with the SEC, shelf registration allows a prospective issuer to prepare and file that registration statement well in advance of a particular securities offering. As long as that registration statement is updated in the manner discussed below, so that it does in fact contain all the required current information, an issuer can proceed with an offering almost immediately the market conditions are suitable without being subject to lengthy delays for preparation of the registration statement and review by the SEC. Accordingly, since a new registration statement is not required for each particular offering, shelf registration allows an issuer to offer securities on a delayed or continuous basis and is ideal for debt securities.

Generally, because it relies heavily on incorporation by reference of *Exchange Act* filings, shelf registration is only available to foreign companies who are either eligible to use Form F-3 or are proposing a continuous offering on Form F-1 or F-2 which will commence shortly after effectiveness and will continue for more than 30 days. The latter type of offering includes a medium-term note programme which is sold on a 'best efforts' basis, but would not include equity offerings which, as discussed below, are usually sold in the United States in a 'firm commitment' underwriting.

A foreign company wishing to take advantage of the shelf registration procedure, assuming eligibility, must first file what is called a 'base' registration statement setting forth information about the issuer, a basic

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description of the securities to be offered, and the possible methods of distribution.

Since, as stated, above, the *Securities Act* requires that the prospectus disclose all current material information concerning the issuer, the securities and other matters, updating and correcting information in the base prospectus must be done before securities are actually offered or sold. Such updating can be done by means of either a post-effective amendment or a prospectus supplement. The disadvantage of a post-effective amendment is that it must be filed with the SEC and declared effective, thus requiring a short waiting period for review, before securities can be offered or sold. On the other hand, a prospectus supplement does not need to be declared effective by the SEC but can be filed within two business days after the securities are priced or the offering commences. Hence, for an issuer to be able to proceed as quickly as possible with a particular sale or 'takedown' it should ensure that the necessary amendments can be done by prospectus supplement.

Updating by post-effective amendment is required where there is a 'fundamental change'<sup>14</sup> in the information set forth in the registration statement, such as the occurrence of circumstances which adversely change the earnings or sales figures. Where the issuer is using a registration statement on Form F-3 there is no need to file a post-effective amendment if such changes are included in reports under the *Exchange Act* such as those on Form 6-K which are incorporated by reference into the registration statement.

As with 'non-shelf' registered offerings, presentation of financial statements, particularly compliance with Rule 3-19 of Regulation S-X mentioned above, can present problems for foreign companies seeking to utilize the shelf registration procedures. Because such companies wish to be in a position to offer securities at any time, they must prepare interim financial statements (which need not be audited) which are filed by post-effective amendment. This should be done in a manner which ensures that, either at the start of a delayed offering, or at all times during a continuous offering, the financial statements filed are not more than six months old. Other matters, including the terms of the securities, the actual plan of distribution, names of the underwriters and the offering terms, can be disclosed by prospectus supplement.

With the necessary groundwork in place, the shelf registration procedures enable an issuer to complete the offering virtually overnight, once the decision to proceed is made. Recently, a large number of foreign issuers have been using shelf registration for the implementation of medium-term note programmes in the United States.

Since these programmes provide for medium-term notes to be offered on a continuous basis, as the need arises, they are ideally suited to shelf registration.

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14 The SEC, in Release No. 33-6383, has stated that the term 'fundamental change' does not include all material changes, but rather is limited to major and substantial changes in information contained in the registration statement. Such a change would include a major change in operations or business which required financial statements to be restated.

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In such a programme the base prospectus will often provide that the terms of the securities, including the principal amount, denomination, maturity, interest rate, time of interest payments, redemption provisions and any initial public offering price together with recent financial information and material business developments, will be included in a prospectus supplement. The indenture agreement will provide for similar flexibility so that at the time a particular offering occurs only a brief 'terms agreement' specifying the terms of the securities and the precise method of distribution need be completed.

### **American Depositary Receipts**

As a matter of convenience, a foreign company raising equity capital in the United States usually does so by having its shares sold and traded as American Depositary Receipts ('ADRs') pursuant to a 'sponsored' ADR programme. To implement an ADR programme, the foreign company usually enters into a 'deposit agreement' with an American bank (the 'depository'). Pursuant to this agreement the issuer deposits some of its shares with a foreign branch or foreign correspondent of the depository, resident in the issuer's home country. This foreign branch acts as custodian of the shares. The American depository then issues receipts, called ADRs, which designate the owner of the ADRs as the beneficial holder of shares of the foreign company. To further facilitate trading in the company's securities, the ADRs are denominated in what are called 'American Depositary Shares' ('ADSs'), each of which represents a number of the issuer's shares determined in a manner designed to ensure that the securities are priced in a range which is common in the United States.

The advantages of using an ADR programme are largely mechanical. For instance, a foreign company with shares traded in the United States as shares issued in its own country would encounter problems upon each share trade such as transferring the stock on foreign share registries and the possibility of stamp duty or transfer tax liability. Since an ADR is transferable on the books of the US bank, these problems are avoided. Often the deposit agreement calls for the depository to disseminate notices and other information to the ADR holders and to collect dividends paid on the underlying shares, convert the dividends to US dollar amounts and pay them to the ADR holders.

When an ADR programme is implemented, the *Securities Act* requires registration of both the ADSs represented by the ADRs and the underlying deposited shares. The ADSs must be registered on Form F-6, a very brief registration statement, to which the deposit agreement is exhibited. The Form F-6 must be signed by the depository, the issuer and its directors and various officers and should contain a description of the terms of the programme. The deposited shares should be registered on either a Form F-1, F-2 or F-3, depending on the status of the issuer, as discussed above.

Rather than file two registration statements, a foreign company offering ADRs may register them on Form F-1 or one of the other forms available for the registration of the underlying deposited shares provided certain

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information required by the Form F-6 is included in the registration statement signed by the depositary.

The SEC will not declare effective any registration statement for an ADR programme unless the issuer is either complying with the periodic reporting requirements of the *Exchange Act* or is exempt from complying with those requirements by virtue of being qualified for an exemption under Rule 12g 3-2(b).

### Stock Exchange listing and the over-the-counter market

The largest volume of securities trading in the United States takes place on the stock exchanges. Trading of securities conducted other than on a stock exchange occurs on the over-the-counter market or 'OTC' and is regulated by the National Association of Securities Dealers (the 'NASD').

In addition to the registration requirements under the *Securities Act*, if the issuer has its securities listed on an exchange or traded over-the-counter, the issuer must register the securities under the *Exchange Act* by filing a Form 20-F containing essentially the same information as that required in the *Securities Act* registration statement. Where listing is sought on an exchange, the Form 20-F should be filed at the same time as the *Securities Act* registration statement. If OTC rather than exchange listing is sought, the issuer must file the Form 20-F within 120 days of the end of its fiscal year.

### The OTC

The shares of the larger OTC companies are quoted on the National Association of Securities Dealers Automated Quotations (called 'NASDAQ'). NASDAQ is a computerized quotational reporting system operated by the NASD and the prices reported include the last sale price and prices at which market makers<sup>15</sup> make bids to buy, and offers to sell, particular shares. A foreign company offering securities in the United States is only eligible to have its securities quoted and traded on NASDAQ if the securities are registered under section 12(g) of the *Exchange Act* and if the issuer meets various other requirements. Securities registered in the NASDAQ system can, if certain additional criteria are satisfied, be included in the NASDAQ National Market System, which reports, in addition to the market makers' bid and asked prices, daily high and low prices, the last sale price and current trading volume.

### Listing on the NYSE

The major stock exchange in the United States is the New York Stock Exchange (the 'NYSE'). The other exchanges are the American Stock Exchange and five "regional" exchanges.

Foreign companies wishing to maximize the marketability of their securities often consider listing them on the NYSE because it has by far

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<sup>15</sup> Market makers are broker-dealers who make a market in the securities by always being prepared to buy and sell a particular company's securities on their own account.

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the largest volume of trading of any US stock exchange. Normally shares are listed in the form of ADRs. However, the difficulty such an issuer faces is in satisfying the Exchange's listing requirements.

Foreign companies are eligible to have their securities listed on the NYSE if they meet the minimum requirements for domestic companies or the alternative listing standards for non-US companies. The minimum requirements for domestic companies are 2,000 holders in the United States of 100 or more shares or at least 2,200 shareholders in the United States together with an average monthly trading volume of at least 100,000 shares during the preceding six months, at least 1,100,000 shares publicly held, an aggregate market value of publicly held shares of not less than US\$18 million and net tangible assets of at least US\$18 million.

The alternative listing requirements available to foreign companies focus on the world wide distribution of the company's shares. Such companies are required to have a minimum of 2.5 million shares publicly held with a market value of at least US\$100 million, at least 5,000 holders of 100 or more shares, minimum net tangible assets of US\$100 million and an aggregate pre-tax income for the preceding three years of at least US\$100 million. Additional listing requirements include publishing quarterly earnings reports, preparing consolidated financial statements and adopting certain corporate governance standards which demand the appointment of outside directors and audit committees. The need to publish quarterly earnings reports is particularly onerous for foreign companies since most prepare only semi-annual financial reports and new provisions allow the Exchange to waive compliance with this and with other requirements where such compliance would be inconsistent with the laws or practices of the issuer's country of domicile.

## **Underwriting in the US**

A company proposing a public offering of its securities in the United States will typically consult closely with a US investment bank to organize the mechanics of the offering. The most common type of underwriting arrangement in the United States is a 'firm commitment' underwriting in which the underwriters agree as principals to purchase all securities being offered to the public. Generally, the issuer will select certain investment banks to act as managers and will enter into an 'Underwriting Agreement' or 'Purchase Agreement' with those firms. The managing underwriters organize and conduct the offering in a manner designed to ensure that the distribution results in the establishment of an active and successful trading market in the securities.

The managing underwriters will either sell the securities directly to the public or will enter into an agreement, called an 'Agreement Among Underwriters', with other investment banks which agree to act as additional underwriters in the offering. The Agreement Among Underwriters authorizes the managing underwriters to enter into the underwriting agreement on behalf of all underwriters, set the amount of compensation to be paid to the underwriters, and take all steps necessary to successfully complete the public distribution of the securities, including the timing of the offering.

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Rather than sell all the securities to the public, the underwriters may enter into a further agreement, called the 'Selling Agreement' or 'Dealer Agreement', with securities dealers who act as dealers, but not underwriters. Pursuant to this agreement the dealers are sold a portion of the securities not sold by the underwriters to their clients.

The compensation received by the underwriters is the 'spread' between the price at which they purchase the securities and the price at which they sell them. If a Selling Agreement is entered into, the selling group is sold the securities at a discount from the public offering price.

Many other legal issues arise in connection with the underwriting arrangements. The registration statement and the underwriting agreement must be filed with the NASD which examines them to ensure all aspects of the underwriting arrangements, including the underwriters' compensation and method of payment, are fair and reasonable. Foreign underwriters and dealers not registered under the *Exchange Act* are prohibited from making sales to US persons. In addition, the parties should ensure that Rules 10b-6 and 10b-7 under the *Exchange Act* are complied with. These Rules are designed to protect the public from the possibility of the underwriters and dealers participating in the offering, artificially raising the market price of the securities being offered.

With certain exceptions, Rule 10b-6 prevents the issuer, underwriters and broker-dealers participating in the offering from, during the course of the distribution, purchasing securities of the issuer of the same class and series as those being offered. Investment grade non-convertible debt securities and non-convertible preferred stock are excluded from the prohibition in Rule 10b-6 because, being traded on the basis of their yield, they are not considered susceptible to manipulation.

Another exception to Rule 10b-6 is provided in Rule 10b-7 which permits the lead managing underwriter to engage in price stabilizing activities with respect to the offered securities as long as the stabilizing is done according to the requirements of the Rule. Generally, this means the stabilizing can only be done to prevent or reduce a decline in the market price of the securities. Often the Agreement among Underwriters contains a provision authorizing the syndicate manager to stabilize the price. To do so, the manager will contact a specialist in the stock and put in a so-called 'stabilizing bid' to buy the securities if there are no higher bids. This pegs the price at the point which is close to the price at which the underwriters are selling the securities. These Rules can present serious problems if the United States offering is one part of a multi-national offering, since in some European countries the lead manager is expected to effectively lead the market.

Not all securities are offered in the United States by way of a firm commitment underwriting. Medium-term notes are frequently offered pursuant to an agency agreement which appoints investment banks and other dealers as agents for the issuer for the purpose of soliciting or receiving offers to purchase the notes.

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## Tax Matters

Before any foreign company proposes raising capital in the United States it should seek advice from US tax attorneys familiar with such transactions.

Often, foreign companies are accustomed to offering their securities in bearer, rather than registered, form. The United States Internal Revenue Code forbids, in certain circumstances, the issuance of bearer obligations to US persons. This prohibition is derived from the *Tax Equity and Fiscal Responsibility Act* of 1982 ('TEFRA'). Provided the foreign issuer is not 'significantly engaged in interstate commerce in the United States with respect to the obligation'<sup>16</sup> and all interest is payable outside the United States<sup>17</sup> the TEFRA prohibitions will not be contravened and, in addition, regardless of whether bearer or registered securities are offered, payments of principal and interest will not be subject to US withholding tax.

## Other Matters

**Blue Sky Laws.** In addition to compliance with Federal securities laws, a public offering of securities in the United States but generally comply with registration and qualification requirements imposed under state securities laws. Often these requirements can be satisfied by use of the materials prepared for the purpose of satisfying Federal securities laws.

**Multinational Offerings.** If the US offering is one tranche of a multinational offering or if the issuer has in the past offered, or intends in the future to offer, securities outside the United States, for instance in Europe, other US securities law considerations arise. For example, if the issuer is planning to offer securities in the Euro-markets and the United States, one matter that needs to be addressed is possible integration of the Euro tranche with the US tranche. Such integration would require *Securities Act* registration of the entire issue.<sup>18</sup> Issuers involved in multinational offerings also need to be aware of the fact that underwriting and distribution techniques used in non-US markets may be different to those techniques employed in the United States. As discussed below, the British Petroleum equity offering, which went to the market just after the October 19 market break in 1987, illustrates how these differences can result in serious losses to the underwriters.

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16 The IRS apparently does not regard a foreign company which merely offers debt securities in the United States as being subject to the TEFRA prohibition.

17 As long as the issuer is not a 'controlled foreign company', within the meaning of the legislation and its interest payments are not United States source, interest will be treated as payable outside the United States even if made by a transfer to a US account or by mail to a US address.

18 Because of the uncertainty as to the extraterritorial reach of the US securities laws a foreign issuer with a US market for its securities should, when proposing a purely non-US securities offering, determine whether it is necessary to register the securities under the *Securities Act* prior to them being offered for sale. In an effort to clarify this area of US securities law, the SEC has proposed, in *Securities Act* Release No. 6779 (June 10, 1988), to define the extent of the extraterritorial application of the registration requirements of the *Securities Act* and has proposed for comment Regulation S, a series of rules establishing safe harbours for certain offers and sales outside the United States.



## Raising Debt or Equity Capital

As previously mentioned, in the usual US-style underwriting, the underwriters agree to buy the securities being offered at a fixed price, just below market price. Since the *Securities Act* makes it unlawful for securities, which are part of a public offering, to be sold prior to the registration statement being declared effective by the SEC, the underwriters face the risk that the market price of the securities being offered will fall between the time they commit themselves to buy the securities at a fixed price and the time they can commence selling those securities. Accordingly, to reduce that risk, US underwriters usually do not commit themselves to a price until the day before the registration statement is declared effective by the SEC. This is possible because the SEC will accelerate the time which it declares a registration statement effective in certain circumstances so that the declaration can be made in a matter of hours. Contrary to that usual practice, in the British Petroleum offering, the US underwriters agreed to conform to the English underwriting procedure and bound themselves to purchase the securities at a fixed price on October 15, some two weeks before the registration statement was declared effective and selling in the US could commence. When the London stockmarket crashed on October 19, 1987, the US underwriters found themselves having purchased the shares at a price substantially higher than that at which they could sell them to investors. As a result, those underwriters incurred significant losses.

Unlike the constraints imposed on the US underwriters by US securities laws, the UK underwriters in the BP offering were each able to reduce their exposure to the risk of a market downturn by, prior to October 15, entering into sub-underwriting agreements whereby various sub-underwriters contracted to take up a proportion of that underwriter's commitment. In fact, there were about 400 sub-underwriters involved, many of which were institutions buying the securities for investment rather than for further distribution. The position of the US underwriters was significantly aggravated by the fact that the underwriting agreements did not contain the usual 'market-out' conditions which would have enabled them to cancel their commitment without breaching those agreements.

Other matters that need to be addressed in multinational offerings are possible problems under *Securities Act* Rule 10b-6, discussed above, and the different disclosure requirements in the markets in which the securities are to be offered.

## Conclusion

As can be seen from the above, there is a considerable amount of regulation which must be considered and complied with before a non-US company proceeds to issue medium term notes, bonds or other debt instruments to the public in the United States. Whilst some of that regulation is not very different from regulation applying to public offerings of shares and debentures in Australia, that is not true in all instances.

Intending issuers should particularly take note of the periodic reporting requirements which exist in the United States and in particular the requirement relating to the disclosure of financial information.

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Finally, as the BP offering demonstrates, a potential issuer should take note of the underwriting practice in the United States and considerations as to timing of the offering. Needless to say, the costs involved in undertaking a public offering of debt in the United States capital market is considerable and the offering should be planned well in advance.