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PRACTICAL COMPANY EXPERIENCE IN ENTERING U.S. MARKETS: SIGNIFICANT ISSUES AND HURDLES FROM THE ISSUER'S PERSPECTIVE

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I suppose one of the reasons I was invited to participate in this Conference today is that if Fletcher Challenger Limited ("Fletcher Challenge") was capable of achieving a registration with the Securities and Exchange Commission ("SEC"), probably any other company could to do an issue of targeted or letter stock as well. Our history and background are probably more complex, and we have a longer history of differences than most other companies and corporations.

Fletcher Challenge is a diversified international company headquartered in New Zealand, with operations in New Zealand, Australia, Canada, the United States, Brazil, China, Asia, the South Pacific, and the United Kingdom. Fletcher Challenge's primary businesses are in: newsprint and pulp production; plantation forestry, which is growing forests from seedlings and harvesting the solid wood; oil, gas, and methanol production; and building materials and construction around the Pacific Rim.

Initially we were only going forward with registration as a vehicle for listing our shares. Following registration, we became the first non-U.S. company to do an issue of stock based on our plantation forestry business, which had a fair number of unusual issues. That was an interesting experience. That particular registration was done very quickly, to say the least. We achieved that registration in one month. The process can be effected very, very quickly.

Let me go through a little bit of our history. New Zealand was probably the hardest hit country following the 1987 market collapse. We probably had one of the most hyped-up equity markets around the world, having had the highest returns of any market for the last eighteen months before October 1987, and then we had the hardest crash as well, which was hardly a surprise.

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Following the crash, most other markets in the world recovered, but New Zealand did not. One of the reasons why the New Zealand market did not recover is that the trust and confidence in the New Zealand regulatory and accounting standards was basically shattered by the events after the crash, such as one or two large companies failing, and poor regulatory enforcement. Many of the investors who had actually lost money used the accounting standards as the excuse for the loss, rather than the fact that they had really bought things that no one in their right mind should have purchased. But in that environment, once you lose trust, it is very hard to attract investors back to a market.

Fletcher Challenge, having diversified shareholdings worldwide, with up to twelve to fourteen percent of its shareholdings being held by U.S. investors, fourteen percent by Australian investors, and a like number by European investors, with only just slightly more than fifty percent in our home market, had to address that confidence issue up-front and actually solve it, otherwise we would only end up going one way—being owned by someone else very quickly. We decided that the only way we could solidify investor confidence, especially coming from a New Zealand accounting background, which utilizes revaluation accounting in the British form, was to adopt U.S. generally accepted accounting principles (“GAAP”), the most accepted benchmark of accounting worldwide.¹ So we engaged in a process to conform our accounting as much as possible with U.S. GAAP, where New Zealand GAAP and New Zealand law allowed, and once completing that process, to go forward with a SEC registration.

We needed to conform with U.S. GAAP for our own markets as much as we needed it to go forward with a U.S. issue, and if we were going to have offerings in Asia. There are just too many

1. See Richard C. Breeden, *Foreign Companies and U.S. Markets in a Time of Economic Transformations*, 17 FORDHAM INT'L L.J. S77, S85-96 (1994) (discussing superiority of U.S. disclosure requirements and accounting practices); Pat McConnell, *Practical Company Experience in Entering U.S. Markets: Significant Issues and Hurdles from the Advisor's Perspective*, 17 FORDHAM INT'L L.J. S120, S122 (1994) (discussing superiority of U.S. disclosure requirements and accounting practices). But see William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 FORDHAM INT'L L.J. S10, S23-24 (1994) (noting difficulty of reconciling with U.S. GAAP); James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 FORDHAM INT'L L.J. S58, S61-67 (1994) (noting need for more flexibility in U.S. accounting requirements).

equity securities being offered around the world these days for people not to be able to understand and trust your financial statements and your presentations easily. U.S. GAAP gave us that credibility in presentation.²

In reality, the cost of actually achieving financial statements in accordance with U.S. GAAP is low. Once you've got your accounting system set up to produce the information, you go forward and just produce it as part of your normal process. We have found very little difficulty in continuing, updating, and producing the information once we were able to calculate exactly what is needed.

We have made acquisitions of companies that haven't maintained accounting standards in accordance with U.S. GAAP, and in particular we acquired a number of privatized companies from the New Zealand government, where we have had horrendous problems replicating the information that they should have produced; being government-owned companies, they tended to use cash-type accounting methods, common to government accounts. So we haven't had huge problems in conforming to U.S. accounting standards other than solving one or two acquisition-type issues.

However, we have had some significant conceptual issues. In some instances, New Zealand accounting methods covers items that U.S. GAAP does not address. When you get into differences of geography and businesses, you will find certain practices that are just different. You've actually got to formulate and try to work out what the U.S. GAAP rules would be for certain items that U.S. GAAP does not in fact consider. That was one of our troublesome areas to work through.

In the registration path we followed, we found the need to thoroughly understand the accounting crisis we were about to undergo. There was no point in going to the SEC, probably the supreme regulatory body in the world, without actually having some knowledge of what we were trying to achieve and what the difficulties of that achievement would be.³ We spent a fair

2. See Breeden, *supra* note 1, at S85-96 (discussing superiority of U.S. disclosure requirements and accounting practices). *But see* Decker, *supra* note 1, at S23-24 (noting difficulty of reconciling with U.S. GAAP); Cochrane, *supra* note 1, at S61-67 (noting need for more flexibility in U.S. accounting requirements).

3. See Frode Jensen, III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective*, 17 *FORD-*

amount of time trying to understand the role of the lawyers, the independent accountants, the SEC, and ourselves in what this process should actually look like and how it should be done.⁴

One of the decisions we made, rightly or wrongly, was that we would do the registration without trying to do an immediate public offering — the reason being that we effectively were able to cut one player, the investment banker, from the registration process, thus simplifying the process somewhat.⁵ Furthermore, simply listing without an immediate and corresponding offer of securities removed the market imposed time pressure associated with such public offerings, which assured us the luxury of planning the registration at our own pace. If we ran into problems, we wouldn't have to worry about the offering window closing on us, which would result in fatal consequences; we could just defer registration to a later date.⁶ In fact, I think that process actually allowed us to achieve a quicker registration than if we had said, "We've got to do an issue in six weeks' time; can we please have a registration?" I know it was a lot more pleasant for us to do than to go down the market constraint timetable route.

The start of the process was with an audit — we actually had a joint audit between KPMG Peat Marwick ("Peat Marwick") and Coopers & Lybrand ("Coopers"). We went spent a lot of time understanding what the accounting entries were from a U.S. point of view while trying to get the New York offices of Coopers and Peat Marwick to understand us, which was not a trifling exercise.⁷ We did not want any surprises as we worked through the process.⁸ We knew that knowledge in the end was the only thing that was going to protect us and lead us safely down the registration path. So we put a lot of time into establishing communications and getting people to understand what we wanted. We had

HAM INT'L L.J. S25, S32-34 (1994) (discussing role of management in registration process).

4. See Decker, *supra* note 1, at S20-21 (noting role of key players in registration process).

5. See *id.* (discussing various roles of key players in securities offering in United States by non-U.S. company); Jensen, *supra* note 3, at S32-34 (discussing role of management in registration process).

6. See Decker, *supra* note 1, at S15-16 (discussing listing alternative); Jensen, *supra* note 3, at S33-34 (discussing registration time frame).

7. See Jensen, *supra* note 3, at S32-34 (highlighting importance of management's involvement in registration process).

8. See *id.* at S29-34 (discussing registration process for non-U.S. companies in United States).

people from New York spend time in New Zealand and people from New Zealand spend time in New York.⁹ We spent a fair number of weeks just basically talking.

It's surprising the number of things that you wouldn't even dream of being issues, because they are minor things you do by habit or instinct, that turn out to be issues that you actually have to work through. For example, the use of different terms for the same thing probably caused more problems than those issues expected to be major problems.¹⁰

One of the areas where we did run into problems was how we calculate deferred taxation.¹¹ New Zealand has always been on the liability method of deferred taxation, but our New Zealand grouping rules and our method of recognizing benefits created problems that we never would have dreamed of under the liability method of accounting.¹² We had to work through those. Those were issues that really were a bit of a surprise in the end.

Interest capitalization to long-term assets was something that we had traditionally thought would be identical. However, there were a lot of the differences in terminology as much as differences in actually what you do. We spent probably eighty percent of our time making sure that we were saying the same thing to each other and finding there really wasn't a problem in the end.

The other area that seemed insurmountable from our point of view to the U.S. point of view is the way hedging and covering of risk, interest rate, and foreign currency is dealt with. But, once identified, we were able to work through those issues. Some of them you just have to accept as different. If you are operating under a different set of rules, they are the rules of the market you've gone to, and you have to accept them. And also, by the very fact you want to go there, you are acknowledging that

9. *See id.* (discussing registration process for non-U.S. companies in United States).

10. *See id.* (discussing difficulties that arise during registration process of non-U.S. companies entering U.S. capital markets).

11. *See* M. Elizabeth Rader, *Accounting Issues in Cross Border Securities Offerings*, 17 FORDHAM INT'L L.J. S129 (1994) (discussing key accounting and disclosure issues facing non-U.S. companies); Matthew M. McKenna, *Tax Issues in Cross Border Securities Offerings*, 17 FORDHAM INT'L L.J. S140 (1994) (discussing tax issues that arise in securities offerings by non-U.S. companies in U.S. capital markets).

12. *See* Rader, *supra* note 11, at S129 (discussing key accounting and disclosure issues facing non-U.S. companies); McKenna, *supra* note 11, at S140 (discussing tax issues that arise in securities offerings by non-U.S. companies in U.S. capital markets).

they're probably the best in the world and result in the best product coming out. We are the first to acknowledge that the product that comes out of the U.S. process is superior to the product that comes out of any other process, and therefore, the United States is the most attractive market to deal with. Simplicity doesn't necessarily actually end up producing the best result.

The whole process we worked through probably took two years because we changed our own accounts from being very strongly New Zealand domestic-type accounts with some things that other people would think were strange.¹³ We might still think they produced a better accounting result, but the result was just not acceptable to anyone outside of New Zealand. So we conformed our accounts as much as possible to U.S. GAAP under our rules, which took a good eighteen months to work through.

We reduced our U.S. GAAP differences to things we just couldn't avoid. There are just some things that New Zealand and New Zealand GAAP don't allow or require that U.S. GAAP requires.¹⁴ Those conflicts will continue, I think, probably until Judgment Day. You're never going to get all the sets of regulators to accept the same standards. Different influences produce different results.

Once we had identified all of the issues and those things we couldn't resolve, we moved to a pre-filing conference with the SEC.¹⁵ Most importantly, the conference gave us a resolution on outstanding items. As an international entity, you should not go forward in an offering with a feeling of uncertainty.¹⁶ You actually produce your documents and produce your registration

13. See Jensen, *supra* note 3, at S32-34 (highlighting importance of management's involvement in registration).

14. See Breeden, *supra* note 1, at S85-96 (discussing superiority of U.S. disclosure requirements and accounting practices); McConnell, *supra* note 1, at S122 (discussing superiority of U.S. disclosure requirements and accounting practices). *But see* Decker, *supra* note 1, at S23-24 (noting difficulty of reconciling with U.S. GAAP); Cochrane, *supra* note 1, at S61-67 (noting need for more flexibility in U.S. accounting requirements).

15. See Richard Kosnik, *The Role of the SEC in Evaluating Foreign Issuers Coming to U.S. Markets*, 17 *FORDHAM INT'L L.J.* S97 (1994) (noting willingness of SEC to assist non-U.S. companies entering U.S. capital markets); Rader, *supra* note 11, at S129 (noting flexibility of SEC in accommodating non-U.S. companies entering U.S. capital markets).

16. See Kosnik, *supra* note 15, at S97 (noting willingness of SEC to assist foreign companies entering U.S. markets); Rader, *supra* note 11, at S129 (noting flexibility of SEC in accommodating non-U.S. companies entering U.S. capital markets).

statement knowing what's expected. I think going forward with something that you know is an area of uncertainty and hoping that it gets through the SEC after filing would be a rather foolhardy approach to take. It would just be too much work to handle such accounting issues after filing. Approaching the SEC first, clearly proved to be a more prudent way to proceed.

In terms of dealing with the SEC, I think we would have to describe our experience as very pleasant. The SEC staff was always helpful, always trying to assist us through the problems.¹⁷ As uncompromising as SEC standards are, the SEC staff was always seeking to help us through the process to find a solution that was workable. I think that was the key. I think everyone was trying to find a workmanlike solution to difficulties that arose, one that allowed the transaction to go forward, not to block it. I don't think we could express our appreciation for how strongly we felt supported through that process, and helped through it as well. We didn't expect compromise or a different set of standards, but the willingness to understand and help was always there, and as was the willingness to put the time and effort into it.

Our whole approach was to register and achieve the benefits of registration with the least amount of tension and conflict as possible.¹⁸ I think we were actually quite successful. For example, we followed our initial registration by registering our forestry stock rather quickly. This was something that was not only a leader stock, it was an unusual asset. We wanted to set unusual rules for ourselves in terms of dividend distribution and those sort of things. I think our approach worked. I think a more oblique approach would not have made the whole transaction possible. We got through the process very quickly. Probably from start to finish, the total process including breaking out the various divisions was less than two months. Our main problems were actually with stock exchanges outside of the United States, not with the SEC, which was a little bit of a surprise to us, in terms of the New Zealand Stock Exchange regulations and voting rights, which is one of the things some jurisdictions have a

17. See Kosnik, *supra* note 15, at S97 (noting willingness of SEC to assist foreign companies entering U.S. markets); Rader, *supra* note 11, at S129 (noting willingness of SEC to assist foreign companies entering U.S. markets).

18. See Decker, *supra* note 1, at S16-17 (discussing listing alternative).

fair degree of concern about, rather than the disclosure-type issues that concern the SEC.

Generally, Fletcher Challenge, with its wide business activities and fairly wide investor base, plus quite a number of private placements in the U.S. debt markets, equity listings in Canada and London, has stood us in good stead to actually work through the process. Different environments and different regulations weren't something that particularly worried us. We learned to accept these things and that's the way you actually live.

So I think we were probably ideally placed. We may have had a more complex organization to actually take us through the registration process, as a result of our unusual history and background, but I think our attitude was probably more focused on flexibility and understanding that you have to do things differently when a company enters a different market, especially when you're going to the one that you believe is the best market to actually be traded in.

The ongoing requirements, once you set them up to run through your system properly, are not real difficulties with future registrations. Overall, the experience is one that we would recommend to other foreign issuers considering a U.S. offering. Our experience has shown that the registration process was much easier than the skeptics suggested it would be.