The SEC's Proposed Regulations of Foreign Securities Issued in the United States

Harold Schimkat
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INTRODUCTION

In recent years, American investors have dramatically increased their purchases of foreign securities.¹ Because of Securities Exchange Commission (“SEC”) filing and registration regulations, however, foreign companies have been reluctant to issue stock in United States public markets.² SEC disclosure, accounting, and reporting requirements are far more stringent than those of other nations.³ Most foreign companies find that the cost of complying with SEC regulations outweighs the benefits of offering their stock to the American public.⁴ Foreign companies that decide to offer their securities in the United States, despite the cost involved, generally trade their securities on the over-the-counter (“OTC”) market.⁵ The SEC allows foreign companies whose securities trade on the OTC to report financial information pursuant to the foreign company’s home country disclosure regulations.⁶ These companies, however, are prohibited from raising capital by offering their securities to


⁴ See 56 Fed. Reg. 27,564, supra note 1, at 27,565; 56 Fed. Reg. 27,582, supra note 2, at 27,582.

⁵ See 56 Fed. Reg. 27,564, supra note 1, at 27,565. Approximately 425 foreign issuers trade securities on a national exchange and report to the SEC as a domestic company would under the Securities Exchange Act of 1934. Approximately 1,100 foreign issuers trade securities on the OTC market. See id.

The over-the-counter market is defined as “[p]urchases and sales of securities by brokers for themselves, between themselves, and for their customers rather than on an exchange.” Black’s Law Dictionary 996 (5th ed. 1979).

⁶ See 56 Fed. Reg. 27,564, supra note 1, at 27,565. Foreign companies listing securities on the OTC market are exempt from Securities Exchange Act reporting requirements pursuant to Rule 12g3-2(b). See id. For an explanation of exemption from Exchange Act reporting requirements pursuant to Rule 12g3-2(b), see infra note 49.
American investors on a public market. The SEC has proposed easing the current registration regulations of the Securities Act of 1933 ("Securities Act") to permit foreign companies to issue securities in the United States continuously throughout the year without filing quarterly financial statements. The SEC has also proposed easing registration and filing requirements for foreign offerors in tender, exchange, and rights offers. These proposed regulations are designed to encourage foreign corporations to register their securities in the United States and to encourage the inclusion of American shareholders in the above-mentioned transactions. Traditionally, foreign companies have excluded American shareholders from such transactions to avoid registering their securities with the SEC.

This Note analyzes the SEC's proposed regulations. Part I describes American Depository Receipts ("ADRs"), the form most foreign securities assume when traded in the United States. Part I also discusses how ADRs are traded and regulated in United States markets. Part II then provides an overview and analysis of the proposed regulations. This Note concludes that the proposed regulations will likely encourage foreign issuers to include American shareholders in tender, exchange, and rights offers, but that the proposed regulations will do little to encourage additional foreign companies to issue securities in the United States.


9. See 56 Fed. Reg. 27,562, supra note 2, at 27,562; see also infra notes 94-126 and accompanying text (discussing the proposed regulations).

10. See 56 Fed. Reg. 27,582, supra note 2, at 27,582-83. A tender offer is defined as "[a]n offer to purchase shares made by one company direct to the stockholders of another company ... communicated to the shareholders by means of newspaper advertisements and ... by a general mailing to the entire list of shareholders, with a view to acquiring control of the second company." Black's Law Dictionary 1316 (5th ed. 1979).

11. See 56 Fed. Reg. 27,582, supra note 2, at 27,582-84. An exchange offer is an offer for the exchange of securities and "[n]ormally occurs in a merger, or consolidation, of two corporations, whereby the securities of one firm are exchanged for those of another on a mutually agreeable basis." L. Davids, Dictionary of Banking and Finance 90 (1978).


16. For a description of ADRs, see infra notes 18-30 and accompanying text.

17. See Demick, supra note 1, at 9-C. Canadian securities are an exception to this generalization. See id. at 13-C.
I. STRUCTURE OF THE ADR MARKET

ADRs are certificates that represent an ownership interest in foreign securities, either equity or debt,\(^8\) held by a depository institution\(^9\) ("depository") in a custodial account.\(^1\) Each ADR represents a proportionate interest in the foreign securities held by the depository.\(^2\) The depository, a United States bank or trust company,\(^2\) does not actually retain possession of the foreign securities, but appoints a custodian in the country of the foreign issuer to hold the issuer's securities while the ADRs remain outstanding.\(^2\) The American investor may demand delivery of the underlying foreign security at any time or may sell the security in a foreign market.\(^2\) After selling the foreign security, the investor must return the ADR to the depository.\(^2\) The depository then releases the underlying security for delivery against the sale in the foreign market.\(^2\)

Unlike the foreign company's stock, ADRs are denominated in American dollars.\(^2\) ADRs are fully negotiable certificates that are traded on both United States stock exchanges and the OTC market.\(^2\) The companies sponsoring ADRs are usually large, international corporations.\(^2\)

At the close of 1990, over 800 foreign companies had their securities traded in the United States in the form of ADRs.\(^2\) These companies come from over thirty foreign countries,\(^2\) but the majority of trading takes place in ADRs issued by Japanese and Western European


\(^9\) A depository is defined as "[t]he party or institution (e.g., bank or trust company) receiving a deposit... The obligation on the part of the depository is that he keep the thing with reasonable care, and, upon request, restore it to the depositor, or otherwise deliver it, according to the original trust." Black's Law Dictionary 396 (5th ed. 1979).


\(^2\) See id. at 24,421.

\(^2\) See id. at 24,422; Moxley, The ADR: An Instrument of International Finance and a Tool of Arbitrage, 8 Vill. L. Rev. 19, 22-23 (1962).

\(^2\) See id.

\(^2\) See id.

\(^2\) See id.

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\(^2\)See id.
American investors derive several benefits from buying ADRs rather than buying shares in an international equity mutual fund or buying stock in a foreign market. ADRs allow investors to purchase stock in specific foreign companies while avoiding the complications and costs associated with purchasing securities in overseas markets. The purchase and sale of an ADR is recorded only in the depositary’s records which allows the investor to avoid complex foreign settlement regulations and to reduce or eliminate fees such as global custodian safekeeping fees.

In addition, ADRs are denominated in United States dollars and are traded like domestic stocks, thus allowing American investors to avoid currency-conversion calculations when buying or selling ADRs. Moreover, ADR holders receive dividends in United States dollars after the depositary converts the foreign currency dividend at a competitive exchange rate. Before issuing the dividend, the depositary deducts any foreign tax applicable to the dividend paid on the underlying foreign security. The American investor may claim a tax credit on his tax return for the foreign tax withheld from his dividend by the depositary. Finally, pursuant to SEC regulations, the ADR annual report and other correspondence must be printed in English, and foreign companies with listed ADRs must report financial information “comparable to that of American companies.”

ADRs are issued through either sponsored or unsponsored facilities. Depositaries generally establish unsponsored ADR facilities in response to market demand, from either investors or broker-dealers, for a foreign security. The depositary does not enter into a formal agreement with the foreign company to create the ADR facility. Instead, the depositary obtains a letter from the foreign issuer which states that the foreign

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32. See 56 Fed. Reg. 24,420, supra note 18, at 24,422.
33. See Maturi, supra note 20, at 10.
34. See id.
36. See Maturi, supra note 20, at 10; Moxley supra note 23, at 23.
37. See Maturi, supra note 20, at 10.
38. See Bank of N.Y., supra note 35, at 1.
39. See Maturi, supra note 20, at 10.
40. See, e.g., Herman & Sesit, supra note 30, at C1 (“ADRs ‘are great for the American who wants to take advantage of foreign stocks without the hassle of converting dollars into local currencies.’ ”)(quoting Jonathan S. Paris, Vice President at European Investors, Inc.).
41. See Bank of N.Y., supra note 35, at 1; Maturi, supra note 20, at 10.
42. See Maturi, supra note 20, at 10; Moxley, supra note 23, at 24.
43. See Moxley, supra note 23, at 24.
44. Maturi, supra note 20, at 10.
45. See 56 Fed. Reg. 24,420, supra note 18, at 24,422.
46. See id.
47. See id.; Bank of N.Y., supra note 35, at 2.
The depository then requests the foreign issuer to report financial information pursuant to the Securities Exchange Act of 1934 ("Exchange Act") or to establish an exemption from the Exchange Act under Rule 12g3-2(b). Once the foreign issuer complies with this request, the depository files a registration statement with the SEC pursuant to the Securities Act.


49. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988). The Exchange Act requires certain corporations to register their securities with the SEC and to periodically disclose financial information. See Robert C. Mangone, Walter, Conston, Alexander & Green, P.C., Avenues to the U.S. Capital Markets: American Depositary Receipts (ADRs) and Rule 144A, 2 [hereinafter Walter, Conston, Alexander & Green](on file with Fordham L. Rev.). Companies are subject to the Exchange Act if they have securities listed on a national exchange in the United States or if they have total assets of more than five million dollars and have more than 300 American equity shareholders and 500 shareholders worldwide. See id. The Exchange Act is designed to keep current financial information disclosed by the company when it initially registered under the Act. See Rogers & Wells, supra note 7, at 15.

The Exchange Act provides for two exemptions from its periodic reporting and disclosure requirements. See Walter, Conston, Alexander & Green, at 2-3. First, any foreign company whose securities are held by fewer than 300 investors who reside in the United States, regardless of how many shareholders there may be worldwide, need not abide by the Exchange Act's disclosure requirements. See id.

Second, Rule 12g3-2(b) provides an exemption from the Exchange Act for companies that agree to provide the SEC with information they are required to: (1) make public under the laws of their home countries; (2) file with any exchanges on which their securities trade; and (3) distribute to their securityholders. See id. "In effect, the issuer agrees to put the SEC on its mailing list and furnish the SEC whatever it is already required to disclose elsewhere." Id. The Rule 12g3-2(b) exemption is only available for foreign companies whose securities trade on the OTC market. See 56 Fed. Reg. 24,420, supra note 18, at 24,427-28.

50. See 56 Fed. Reg. 24,420, supra note 18, at 24,422. For an explanation of Rule 12g3-2(b), see supra note 49.

51. See 56 Fed. Reg. 24,420, supra note 18, at 24,422. The registration statement is filed on Form F-6. See id. Form F-6 requires a prospectus with a description of the ADRs. See id. at 27,427. The description must provide information regarding "procedures for voting, dividend collection and distribution, transmission of notices, reports and proxy soliciting materials, and restrictions upon the right to withdraw and deposit the underlying securities." Id. at 27,427 n.59. All fees and charges must be disclosed. See id. at 27,427. In addition, Form F-6 requires the registrant to disclose that documents are available at the SEC regarding the issuer's reporting requirements under the Exchange Act. See id. Usually, the ADR certificate contains the information required on Form F-6 and may serve as a prospectus. See id. As exhibits to Form F-6, the registrant must file "the deposit agreement (if any), other agreements relating to the custody of the deposited securities or the issuance of the ADRs, material contracts between the depositary and the issuer of the deposited securities relating to such securities, and an opinion of counsel regarding the legality of the ADRs." Id.

ADRs may be registered using Form F-6 if "the deposited securities . . . [are] registered or exempt from registration under the Securities Act." Id. at 27,426-27. In addition, the ADR holder must have the right to withdraw the underlying securities at any time subject only to temporary administrative delays. See id. at 27,427 & n.53. Finally, Form F-6 requires the issuer to report financial information under the Exchange Act or be exempt from reporting pursuant to Rule 12g3-2(b). See id. at 27,427.

The depositary then begins accepting deposits of the foreign securities against which it issues ADRs.53

Any number of depositaries may create a facility for unsponsored ADRs of a specific foreign company.54 A depositary will usually charge the holder of an unsponsored ADR for the deposit and withdrawal of securities, the conversion of dividends into American dollars, and the disposition of non-cash distributions.55 Unsponsored facilities are generally not required to provide shareholders with correspondence issued by the foreign company,56 nor are they obligated to pass voting rights to ADR holders.57 Foreign companies dislike unsponsored facilities due to the lack of control they have over the facilities and the costs associated with them.58 Today, unsponsored ADRs are rarely established and are considered obsolete.59

Sponsoring ADRs is the preferred method of establishing an ADR facility.60 Sponsored ADRs are established jointly by the depositary and the foreign issuer.61 The foreign company and the depositary enter into a deposit agreement that governs the rights and responsibilities of the is-
suer, the depositary, and the ADR holder. Deposit agreements usually require the depositary to distribute notices of shareholder meetings, voting instructions, and shareholder communications to the ADR holder. Both parties are also required to sign the registration statement. Generally, the foreign issuer and the ADR holder will share the costs of the ADR facility; the issuer will often bear the depositary's dividend payment fees while the investor bears the deposit and withdrawal fees.

There are three levels of sponsored ADR facilities, each requiring different registration and reporting procedures pursuant to the Securities Act and the Exchange Act. Level I ADRs trade on the OTC market and do not require the foreign issuer to comply with United States Generally Accepted Accounting Principles ("GAAP") or full SEC disclosure requirements, because of the exemption created by Rule 12g3-2(b) of the Exchange Act. The issuer, however, is prohibited from raising capital in the OTC market. To establish a Level I program the depositary and the issuer must file Form F-6 with the SEC, and the deposited securities must be registered unless they are exempt from registration pursuant to Rule 12g3-2(b) of the Exchange Act. Because Form F-6 requires disclosure about the securities to be issued rather than about the company issuing the securities, and because most companies are exempt from registration under Rule 12g3-2(b), the foreign issuer is able to trade its securities in the United States without having to comply with the securities laws to which American companies are subject.

Level II ADRs are quoted on the NASDAQ system or listed on a national securities exchange, but have not been offered to American in-
vestors in a public offering. A Level II program is registered with the SEC pursuant to the Securities Act on Form F-6 which subjects the registrant to minimal disclosure requirements. The issuer of a Level II ADR, however, is not allowed to claim a Rule 12g3-2(b) exemption from Exchange Act disclosure requirements. The Exchange Act requires the foreign issuer to file Form 20-F with the SEC. Form 20-F requires detailed information about the issuer and requires the issuer to reconcile its financial statements with United States GAAP.

A Level III program also utilizes Form 20-F for Exchange Act disclosure purposes, forcing the issuer to reconcile its financial statements with United States GAAP. In addition, a Level III program must be registered with the SEC pursuant to the Securities Act on Form F-1, which, unlike Form F-6, requires detailed disclosure about both the issuer and the securities being offered to the public. The primary advantage of a Level III program is that it allows the issuer to raise capital by listing its ADRs on a national exchange or on the NASDAQ market.

II. PROPOSED REGULATIONS

Foreign companies have been reluctant to list their securities on American securities markets due to the SEC’s stringent accounting and reporting requirements. In most instances the SEC requirements are

75. See 56 Fed. Reg. 24,420, supra note 18, at 24,422 n.21. The NYSE and AMEX allow only sponsored ADRs to be listed. NASDAQ “strongly recommend[s]” that issuers sponsor an ADR program before the ADRs are quoted. See id. at 24,423-24.
76. For a discussion of Form F-6 disclosure requirements, see supra note 51 and accompanying text.
77. Rule 12g3-2(b) exemptions are only allowed for foreign stocks trading on the OTC market. See supra note 49.
79. See id.; Dechert, Price & Rhoads, supra note 7, sec. 3, at 7-8. Form 20-F requires information about the issuer including financial data for the last five years, the names of the issuer's directors and officers, their compensation and their interest in transactions with the issuer, any control of the issuer exerted by another company, and non-routine legal proceedings pending against the company. Financial statements must be reconciled with United States GAAP. See 56 Fed. Reg. 24,420 supra note 18, at 24,427-28; Dechert, Price & Rhoads, supra note 7, sec. 3, at 7-8; Rogers & Wells, supra note 7, at 15-18.
81. See Rogers & Wells, supra note 7, at 4-8, 11.
82. See Dechert, Price & Rhoads, supra note 7, at sec. 4; Bank of N.Y., supra note 35, at 2.
83. See 56 Fed. Reg. 27,582, supra note 2, at 27,582; 56 Fed. Reg. 27,564, supra note 1, at 27,565. See generally Demick, supra note 1, at 9-C, 13-C (reporting that the major exchanges are seeking a relaxation of rules for foreign listings); Karmel, supra note 15, at 3-4 (discussing steps the SEC has taken in recent initiatives to ease the foreign issuer's burden of complying with United States disclosure and accounting requirements). Most sponsored ADR programs are Level I programs. See Bank of N.Y., supra note 35, at 2. Sponsored Level I programs allow foreign issuers to avoid SEC periodic reporting and disclosure requirements, and, as a result, the foreign issuers do not have to prepare financial statements under United States GAAP. See id. Generally, the term "listing a stock" refers to an ADR program being quoted on NASDAQ or listed on a national securities exchange. Such a program requires compliance with the periodic reporting and disclo-
radically different from those demanded by foreign regulatory agencies. The cost of complying with SEC regulations, along with foreign companies' reluctance to disclose certain information required by the SEC, prevents many foreign companies from issuing stock in the United States despite the companies' desire to access American capital markets.

In the past, the SEC had no incentive to ease reporting requirements for foreign companies because demand for foreign securities was scant. Recently, however, American investors have dramatically increased their purchases of foreign equity. As "technological advances and regulatory initiatives bring about more globalized securities markets," American investors are likely to continue increasing their purchases of foreign securities. These developments have prompted the SEC to propose regulations that would relieve foreign issuers of the arduous task of preparing quarterly financial statements and would allow foreign issuers to issue interim financial information without preparing this information under United States GAAP. Furthermore, the SEC has proposed regulations designed to encourage foreign companies to include their American shareholders in tender, exchange, and rights offers which have traditionally excluded American investors.

A. Reporting Requirements

Unlike their American counterparts, foreign companies are generally not required to issue quarterly financial statements by their home countries. Moreover, foreign companies are often allowed a longer period of time than American companies to prepare, file, and update their financial statements. The SEC and adherence to United States GAAP. See id. For a description of sponsored ADR programs, see supra notes 67-82 and accompanying text.

84. For example, many foreign countries do not require public corporations to disclose the salaries of top officers or file quarterly financial statements. See Demick, supra note 1, at 9-C. In some countries corporations are allowed to maintain hidden reserves which would be considered a fraudulent act in the United States. See id. at 13-C.

85. See 56 Fed. Reg. 27,582, supra note 2, at 27,582; Demick, supra note 1, at 9-C.

86. See Demick, supra note 1, at 9-C.

87. See id. at 13-C.

88. See supra note 1 and accompanying text.

89. 56 Fed. Reg. 24,420, supra note 18, at 24,421.

90. See id.


94. See Demick, supra note 1, at 13-C; 56 Fed. Reg. 27,562, supra note 2, at 27,562. For example, United Kingdom companies are only required to publish annual and semi-annual financial statements. See id.
Currently, however, SEC Rules 3-19(b)\textsuperscript{96} and 3-19(c)\textsuperscript{97} of Regulation S-X\textsuperscript{98} of the Exchange Act\textsuperscript{99} require a foreign company to report its financial condition quarterly if it wishes to issue equity in the United States without interruption or delay throughout the year.\textsuperscript{100} The rules require that on the effective date of the registration statement “[f]inancial statements in the filing . . . be as of a date within six months of the effective date, and . . . if the effective date falls more than five months after the registrant's fiscal year end,”\textsuperscript{101} an audited year-end statement must be included in the filing.\textsuperscript{102} By requiring an interim report within six months of the effective date of a stock offering, the SEC is effectively forcing foreign companies to supply quarterly reports.\textsuperscript{103}

The SEC has proposed amending Rules 3-19(b)\textsuperscript{104} and 3-19(c)\textsuperscript{105} “to reduce the impediments to foreign issuers making securities offerings in the United States.”\textsuperscript{106} The proposed amendments would enable a foreign issuer to offer its securities, including ADRs, to the public continuously during the year provided that the company can “provide audited fiscal year financial statements within six months following the end of the fiscal year and unaudited interim financial statements within four months fol-

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\textsuperscript{95} See 56 Fed. Reg. 27,562, supra note 2, at 27,562. See generally Demick, supra note 1, at 13-C (discussing differences between European and United States accounting and disclosure requirements).

\textsuperscript{96} 17 C.F.R. § 210.3-19(b) (1991). Rule 3-19(b) requires that “[i]f the filing . . . is made within six full months after the end of the registrant's fiscal year . . . on the effective date the filing shall include a balance sheet as of an interim date within six months of the effective date . . . and Provided Further, [i]f the effective date falls after five months subsequent to the end of the most recent fiscal year, the filing shall include an audited balance sheet for the most recent fiscal year.” Id. (emphasis in original).

\textsuperscript{97} 17 C.F.R. § 210.3-19(c) (1991). Rule 3-19(c) requires that “[i]f the filing is made after six full months subsequent to the end of the most recent fiscal year, the filing shall include a balance sheet, which may be unaudited, as of an interim date within six months . . . of the effective date.” Id.


\textsuperscript{100} See 56 Fed. Reg. 27,562, supra note 2, at 27,562. These regulations affect Level II and Level III ADR programs. Level I programs are exempt from Exchange Act reporting and disclosure requirements under Rule 12g3-2(b). See supra notes 67-70 and accompanying text.

\textsuperscript{101} 56 Fed. Reg. 27,562, supra note 2, at 27,562.

\textsuperscript{102} See id.

\textsuperscript{103} See id. For example, a United Kingdom company is required to prepare audited annual financial statements within six months of the end of its fiscal year. See id. An unaudited semi-annual financial statement must be prepared within four months of the end of the semi-annual period. See id. Thus, a United Kingdom company with a fiscal calendar year would not have financial statements meeting Rule 3-19 requirements until October 31 each year. See id. The result is that the United Kingdom company is unable to issue stock from January through October in the United States. See id. This period during which the foreign company is unable to issue stock is known as a “black-out” period. See id.

\textsuperscript{104} 17 C.F.R. § 210.3-19(b) (1991).

\textsuperscript{105} 17 C.F.R. § 210.3-19(c) (1991).

\textsuperscript{106} 56 Fed. Reg. 27,562, supra note 2, at 27,562.
lowing the end of the semi-annual interim period."\textsuperscript{107} This would reconcile the SEC's updating requirement with that of a "substantial majority of the major industrial countries."\textsuperscript{108} The amendment would grant a one-month extension for updating requirements for annual audited financial statements and a four-month extension for interim unaudited financial statements.\textsuperscript{109} In addition, as the SEC explains, "the maximum age of financial statements permitted to be used in a . . . filing would be extended from six months to one year."\textsuperscript{110}

Rules 3-19(b) and 3-19(c) in their current form impede the ability of foreign companies to issue securities in the United States.\textsuperscript{111} Foreign issuers that do not report financial information in compliance with Rule 3-19 are "black[ed] out"\textsuperscript{112} of American capital markets until they comply with the Rule.\textsuperscript{113} Most foreign companies prefer being blacked out to having to file quarterly results with the SEC, thereby limiting the availability of their securities in American markets.\textsuperscript{114} The result of the proposed amendment would be to end this black-out period\textsuperscript{115} without requiring the foreign companies to prepare quarterly financial statements.\textsuperscript{116} Both foreign issuers and American investors stand to benefit from eliminating the black-out period due to the increased access American investors would have to foreign securities.\textsuperscript{117} American investors, however, should be aware that, under the amended Rules, the information being provided by the foreign issuer would, in many instances, be considerably older than the information that would be supplied by an American corporation in a similar situation.\textsuperscript{118}

The proposed amendment will benefit foreign companies present in American markets who are not obligated, except by the SEC, to prepare

\textsuperscript{107} 56 Fed. Reg. 27,562, supra note 2, at 27,562. For example, a foreign company with fiscal year beginning January 1st and ending December 31st could have a registration statement go effective on June 29, 1991, with an unaudited statement for the six-month period ending June 30, 1990, provided the issuer continues to be able to provide an audited year-end statement within six months of the end of the fiscal year, and an unaudited interim statement with four months of the semi-annual period. See id.

\textsuperscript{108} 56 Fed. Reg. 27,562, supra note 2, at 27,562.

\textsuperscript{109} See id.

\textsuperscript{110} Id.

\textsuperscript{111} See id.; Sullivan & Cromwell, Comment to the SEC 4 (July 15, 1991) (response to the SEC's request for comments on proposed 3-19 amendments) (on file with the Fordham L. Rev.).

\textsuperscript{112} 56 Fed. Reg. 27,562, supra note 2, at 27,562. A "black-out" period is a period of time during which a company may not offer its securities to the public. See id.

\textsuperscript{113} See Sullivan & Cromwell, supra note 111, at 4.

\textsuperscript{114} See id. at 4-5.

\textsuperscript{115} See 56 Fed. Reg. 27,562, supra note 2, at 27,562.

\textsuperscript{116} See Sullivan & Cromwell, supra note 111, at 4.

\textsuperscript{117} See 56 Fed. Reg. 27,562, supra note 2, at 27,562; Sullivan & Cromwell, supra note 111, at 4-5.

\textsuperscript{118} See 56 Fed. Reg. 27,562, supra note 2, at 27,562; Deloitte & Touche, Comment to SEC 3 (July 19, 1991) (response to SEC's request for comments on proposed 3-19 amendments) (on file with the Fordham L. Rev.). For an example of the proposed amendment's effect on a foreign company's registration statement, see supra note 107.
quarterly financial statements. Such companies will no longer bear the cost of preparing quarterly financial information that was prepared primarily to comply with SEC requirements. Beyond this, however, the proposed amendments’ major achievement will be the elimination of the black-out period. Most foreign private issuers opt to be blacked out of United States securities markets to avoid preparing quarterly financial statements. By eliminating the black-out period, the proposed amendment will allow American investors greater access to foreign securities.

The proposed amendment, however, is not likely to cause a dramatic increase in foreign companies listing their securities in the United States. Foreign issuers will continue to be required to comply with SEC reporting and disclosure requirements, including reconciling financial statements with United States GAAP.

To encourage foreign companies to issue securities in the United States, the SEC should allow foreign issuers to register their securities on the basis of their home country disclosure and accounting regulations. The SEC could do this by either creating Multi-Jurisdictional Disclosure Systems ("MJDS") with foreign countries or by extending Rule 12g3-2(b) reporting exemptions to foreign issuers listing their securities on a national exchange. Alternatively, international standards for accounting, auditing, and disclosure requirements could be created that would permit companies to list in a number of markets pursuant to one reporting system.

Rule 3-19(f) requires interim financial information reported by for-

119. See generally 56 Fed. Reg. 27,562, supra note 2, at 27,562 (discussing proposed amendments to current regulations requiring foreign companies to file quarterly financial statements to promote the offering of foreign securities in United States markets).
120. See id.
121. See Sullivan & Cromwell, supra note 111, at 3-4. See generally 56 Fed. Reg. 27,562, supra note 2, at 27,562 (proposed amendment to Rule 3-19 is intended to eliminate the black-out period).
123. See id. at 4-5.
124. See Karmel, supra note 15, at 3.
125. See generally 56 Fed. Reg. 27,562, supra note 2, at 27,562 (the proposed amendment to Rule 3-19 would affect only the age of financial statements, not their substance).
126. See Karmel, supra note 15, at 3.
127. See Roberta S. Karmel, Kelley, Drye & Warren, Comment to SEC 3 (Sept. 6, 1991)[hereinafter Karmel, Comment to SEC](response to SEC's request for comments on proposed Rule 3-19 amendment) (on file with the Fordham L. Rev.); Roberta S. Karmel & Mary S. Head, Kelley, Drye & Warren, Report and Recommendations to the New York Stock Exchange, Inc. on Barriers to Foreign Issuer Listing 20 (Feb. 15, 1991)[hereinafter Karmel, Report to NYSE](on file with the Fordham L. Rev.).
128. See Karmel, supra note 15, at 3. An MJDS is simply an agreement between two or more countries that allows companies from those countries to register their securities with the regulatory agencies of any of the countries party to the agreement on common disclosure documents. See id.
129. See Karmel, Comment to SEC, supra note 127, at 2; Karmel, Report to NYSE, supra note 127, at 18-19.
130. See Karmel, Report to NYSE, supra note 127, at 29-32, 114.
eign issuers to shareholders, exchanges, or others to be included in any registration statement filed with the SEC. This information must be reconciled with United States GAAP. The SEC proposes amending Rule 3-19(f) to eliminate the requirement that foreign companies adhere to United States GAAP on interim financial statements if the issuer provides adequate narrative disclosures of any material accounting variation not previously disclosed in an annual or semi-annual statement. The SEC hopes the proposed amendment will "overcome one disincentive to more frequent reporting of interim financial information." The proposed amendment, however, is unlikely to induce foreign companies to issue interim financial reports more often than they do now. For many foreign companies, the most costly part of reconciling financial statements with United States GAAP is determining the differences between accounting methods, not preparing the statements. Foreign companies deciding whether or not to issue interim reports primarily consider requirements of the issuer's home country, demands of the international marketplace, and the requirements of the markets in which the company's securities trade. Thus, it is unlikely that the amendment to Rule 13(f) will, by itself, cause foreign companies to begin issuing interim financial reports on a more frequent basis.

B. Tender Offers

The SEC has proposed amending tender offer regulations for foreign securities, including ADRs, traded in the United States. Foreign companies routinely exclude American ADR holders from tender offers for a foreign company's securities because of the costs of complying with United States securities regulations. Exclusion prevents American in-

133. See id.
134. See id. For Level II or Level III programs, financial statements provided by the issuer must be reconciled with United States GAAP. See supra notes 75-82 and accompanying text.
135. 56 Fed. Reg 27,562, supra note 2, at 27,563.
138. See Sullivan & Cromwell, supra note 111, at 5.
139. For a definition of a tender offer, see supra note 10.
140. The proposed regulations discussed in this Note pertain to different types of foreign securities traded in the United States, not just ADRs. This Note, however, focuses on ADRs because "most foreign stocks traded in the United States do in the form of American Depositary Receipts." Demick, supra note 1, at 13-C.
141. See 56 Fed. Reg. 27,582, supra note 2, at 27,583-86.
142. See id. at 27,582.
vestors from receiving a premium on their ADRs and forces Americans to pay the transaction costs associated with selling their ADRs on the market. As the number of transnational tender offers increase, the SEC hopes the proposed amendments will encourage foreign companies to include American ADR holders in tender offers for foreign securities.

The proposed rules would permit tender offers for a foreign private company’s securities, including ADRs, that trade in the United States to proceed pursuant to the procedure and disclosure regulations of the target company’s home jurisdiction. Eligible offers “would not be subject to the disclosure, filing, dissemination and minimum offering period requirements, proration and withdrawal rights, and other requirements” to which tender offers are normally subject. Insider trading prohibitions, however, would remain in effect. The proposed rules would not be available for securities issued by investment companies.

The proposed regulations would not be available for tender offers where American investors owned more than ten percent of the securities sought in the offer. Any single American investor holding more than ten percent of the securities, however, would not disqualify the tender offer under the proposed regulations. Additionally, the tender offer would need to fulfill the following conditions: (1) the offeror would have to provide the SEC with an English language translation of the offering documents; (2) American shareholders would have to be included in the transaction on terms not less favorable than the terms

143. See id. at 27,583.
144. See id. If the American shareholder does not sell into the market, he will become a minority shareholder with less liquidity and could be “cashed out in a subsequent ‘freeze-out’ merger.” 56 Fed. Reg. 27,582, supra note 2, at 27,583.
145. See id. at 27,583. Transnational tender offers have increased in recent years due in part to the prospect of a unified Europe in 1992. See id. In 1990, 667 tender offers were completed having an aggregate value of $61.1 billion dollars. This was an increase of 109% from 1989 during which 717 transactions were completed having an aggregate value of $29.1 billion dollars. See id. at 27,583 n.14.
146. See id. at 27,583, 27,585.
147. See 56 Fed. Reg. 27,582, supra note 2, at 27,583, 27,585. “Home jurisdiction . . . is generally defined as the place of incorporation, organization or chartering of the foreign target company. Proposed Rule 802(a)(4)(to be codified at] 17 C.F.R. 230.802(a)(4)).” Id. at 27,583 n.25.
148. Id. at 27,583.
149. See id. at 27,583.
150. See id. at 27,584. This rule would apply to companies “registered or required to be registered under the Investment Company Act of 1940 [15 U.S.C. sec. 80a-1 (1988)].” Id.
151. ADRs exchangeable or convertible for the foreign securities would be included in calculating the percentage owned by American investors. See 56 Fed. Reg. 27,582, supra note 2, at 27,586. Ownership of the foreign securities would be determined as of the issuer’s latest fiscal year end. See id.
152. See id. at 27,583.
153. See id.
offered to other securityholders;\textsuperscript{154} and (3) if the target company's home jurisdiction required that notice of the tender offer be provided to shareholders, the offeror would be required to notify American shareholders on a comparable basis.\textsuperscript{155}

To facilitate the inclusion of American investors in tender and exchange offers, the SEC has proposed requiring that a foreign issuer disclose both the number of Americans investing in its securities and the percentage of the issuer's securities held by American investors.\textsuperscript{156} This information would allow an interested party to determine whether an offer for a foreign company's securities could proceed under the proposed regulations.\textsuperscript{157}

The proposed regulations will likely facilitate the inclusion of American investors in tender offers for the securities of a foreign company,\textsuperscript{158} thereby providing investors with potentially valuable investment opportunities. The SEC, however, should consider raising the eligibility ceiling to include transactions where American investors hold up to twenty percent of the target securities.\textsuperscript{159} A higher ceiling would further encourage foreign companies to include American shareholders in tender offers where they otherwise might exclude American investors due to the high costs involved.\textsuperscript{160} The higher ceiling would also be consistent with the SEC's interest in protecting American investors, given the belief that most purchasers of foreign securities are sophisticated individuals or institutional investors and, therefore, require less SEC supervision in select-

\textsuperscript{154} See id.

\textsuperscript{155} See id. at 27,583-84. The offering circular sent to American securityholders must be in English and must disclose that the offer is being conducted pursuant to the laws of the target company's home country. See id. at 27,587. If dissemination of the offer is done by publication, it must be published in the United States in a newspaper of general circulation. See id.


\textsuperscript{157} See id.

\textsuperscript{158} See Pepper, Hamilton & Scheetz, Comment to SEC 1 (Sept. 6, 1991) (response to SEC's request for comments on proposed tender, exchange, and rights offers regulations) (on file with the Fordham L. Rev.); Securities Industry Association, Comment to SEC 2 (Sept. 9, 1991) (response to SEC's request for comments on proposed tender, exchange, and rights offers regulations) (on file with Fordham L. Rev.); see also British Merchant Banking and Securities Houses Association, Comment to SEC 2 (Sept. 5, 1991)(hereinafter British Banking Association)(response to SEC's request for comments on proposed tender, exchange, and rights offers regulations) (on file with Fordham L. Rev.) (predicting the regulations will encourage a "fair proportion" of issuers to extend offers to American shareholders, but fear of litigation will continue to act as a deterrent to some issuers).

\textsuperscript{159} See Pepper, Hamilton & Scheetz, supra note 158, at 2-3; Securities Industry Association, supra note 158, at 8-9.

\textsuperscript{160} See Securities Industry Association, supra note 158, at 8. The Securities Industry Association cites an estimate by Linklaters & Paines, "a prominent United Kingdom law firm," that the costs to a foreign issuer to comply with United States regulations to extend an offer to American "shareholders can equal or exceed the costs for the offer to foreign shareholders, even where Americans hold as little as two percent of the outstanding securities." Id.
ing investments.\textsuperscript{161} As an illustration of such expanded eligibility, the Multi-Jurisdictional Disclosure System between the United States and Canada initially proposed a twenty-percent ceiling to protect American investors and eventually adopted a forty-percent ceiling.\textsuperscript{162}

Despite the proposed regulations, foreign issuers, due to their fear of litigation in the United States, may remain reluctant to extend tender offers to American shareholders.\textsuperscript{163} Documents prepared pursuant to foreign requirements will be subject to civil liability under the antifraud provisions of the Exchange Act.\textsuperscript{164} Foreign companies are usually advised to expect litigation alleging that financial documents prepared during a tender offer contain misleading information.\textsuperscript{165} The United States is perceived as having a "legal culture"\textsuperscript{166} which favors plaintiffs with "a marginal cause of action."\textsuperscript{167} Regardless of the ultimate success or failure of the proposed regulations, the SEC should be commended for attempting to facilitate foreign tender offers by accepting foreign regulations rather than insisting on full disclosure under United States securities law.

C. Exchange Offers

The SEC has also proposed regulations\textsuperscript{168} to facilitate the inclusion of American ADR holders in exchange offers\textsuperscript{169} involving a foreign target company that has an ADR program in the United States.\textsuperscript{170} Exchange offers differ from cash tender offers in that exchange offers involve the offer and sale of securities in the United States.\textsuperscript{171} The acquiring company establishes a continuing presence in the United States capital mar-

\textsuperscript{161.} See Pepper, Hamilton & Scheetz, supra note 158, at 3.
\textsuperscript{162.} See id.; Securities Industry Association, supra note 158, at 9.
\textsuperscript{163.} See British Banking Association, supra note 158, at 1-2; Pepper, Hamilton & Scheetz, supra note 158, at 9; Securities Industry Association, supra note 158, at 3-8.
\textsuperscript{164.} See 56 Fed. Reg. 27,582, supra note 2, at 27,587; Securities Industry Association, supra note 158, at 4. "[I]nside trading and other kinds of fraudulent and manipulative conduct would be the only substantive antifraud provisions applicable to these types of transactions." 56 Fed. Reg. 27,582, supra note 2, at 27,587 (citations omitted).
\textsuperscript{165.} See Pepper, Hamilton & Scheetz, supra note 158, at 9.
\textsuperscript{166.} Securities Industry Association, supra note 158, at 4.
\textsuperscript{167.} Id. at 5.
\textsuperscript{168.} See 56 Fed. Reg. 27,582, supra note 2, at 27,584. The proposed regulations would not be available for securities issued by an investment company under the Investment Company Act of 1940. See id. at 27,588.
\textsuperscript{169.} For an explanation of an exchange offer, see supra note 11.
\textsuperscript{170.} See 56 Fed. Reg. 27,582, supra note 2, at 27,582.
\textsuperscript{171.} See id. at 27,588. Exchange offers can provide a valuable tax advantage over cash tender offers. See Willkie, Farr & Gallagher, The Use of American Depositary Receipts in Acquisitions 2 (on file with Fordham L. Rev.). The shareholder in a tender offer must pay tax at the end of the year on the cash he receives from the tender of his shares. See id. In an exchange offer, the shareholder in the acquired company does not pay any tax until he sells the shares he received in the acquiring company. Thus, an exchange offer provides a tax benefit to an investor who does not wish to incur a taxable event in the year of the offer. See id.
kets\textsuperscript{172} and, therefore, is required by the Securities Act and the Exchange Act to comply with SEC registration and reporting requirements.\textsuperscript{173} Many foreign companies, particularly first-time foreign issuers, exclude American ADR holders from exchange offers to avoid registering with the SEC.\textsuperscript{174} They believe that the costs of complying with SEC regulations, particularly the costs of reconciling financial statements with United States GAAP, outweigh the benefits of including American ADR holders in the exchange offer.\textsuperscript{175}

The SEC has proposed two procedures to facilitate the inclusion of American ADR holders in exchange offers made for a foreign company's securities.\textsuperscript{176} The proposed procedures would allow exchange offers to be regulated by the disclosure standards of the target company's home country.\textsuperscript{177} Proposed Rule 802\textsuperscript{178} would exempt a foreign company from registering its securities pursuant to the Securities Act\textsuperscript{179} when the company offers to exchange its stock for the securities (including ADRs) of the foreign target company if "the aggregate dollar amount of the securities being offered in the United States does not exceed [five] million [dollars]."\textsuperscript{180} Instead, the offer would be subject to the regulations of the target company's home country.\textsuperscript{181} A Rule 802 exemption would be available to American as well as foreign companies,\textsuperscript{182} and to third-party bidders or even to the issuer of the target stock itself.\textsuperscript{183} The proposed rule neither limits the type of securities that may be offered in the transaction\textsuperscript{184} nor requires any offeror or security eligibility standards.\textsuperscript{185} Nonetheless, Rule 802 would require that American shareholders be allowed to participate in the exchange offer on terms not less favorable

\textsuperscript{172} See 56 Fed. Reg. 27,582, supra note 2, at 27,588.
\textsuperscript{173} See id. at 27,582-83.
\textsuperscript{174} See id. at 27,588.
\textsuperscript{175} See id. Furthermore, "preparation of a registration statement and the potential for Commission review create greater time pressure than in a cash tender offer and are more likely to be inconsistent with the foreign tender offer scheme." Id.
\textsuperscript{176} See id. at 27,584, 27,588.
\textsuperscript{177} See id. at 27,584. Documents submitted to the SEC would not be reviewed by the staff. Any review would be done by the regulatory agencies of the foreign target company's home country. See id.
\textsuperscript{178} To be codified at 17 C.F.R. § 230.802. See id.
\textsuperscript{179} Rule 802 exemption provided pursuant to § 3(b) of the Securities Act. See id. at 27,588.
\textsuperscript{180} Id. at 27,588. "Proposed Rule 802 defines 'aggregate dollar amount' of the securities being offered to mean the total consideration the offeror proposes to issue upon exchange for securities held by U.S. holders, for a single class of securities, assuming that all securities of the class held in the United States are exchanged." Id. at 27,589 (citation omitted). If the offeror makes another offer for a different class of securities of the target or any other foreign company, the new offer would be subject to its own $5 million ceiling. See id.
\textsuperscript{181} See id. at 27,584.
\textsuperscript{182} See id. at 27,589.
\textsuperscript{183} See id.
\textsuperscript{184} See id.
\textsuperscript{185} See id.
than those offered other shareholders. Any notice sent to American shareholders would be required to explain that the offer is being conducted pursuant to laws of the target company's home country which may affect the rights of American securityholders.

The second proposal, Form F-12, would allow a foreign issuer to register its offered securities pursuant to the foreign target's home country disclosure requirements if no more than five percent, excluding American shareholders who individually hold ten percent or more of the target securities, of the foreign target company's securities are held by American investors prior to the exchange, and if certain other eligibility standards are met. Form F-12 would only be available if (1) the offeror is a foreign private issuer; (2) the offeror is a reporting company under the Exchange Act or is exempt from reporting under Rule 12g3-2(b); (3) American securityholders are permitted to participate in the exchange offer on terms not less favorable than those offered other securityholders; (4) the offeror is in compliance with the reporting regulations of a "designated offshore securities market" on which the offeror's equity securities have been listed "for the [thirty-six] months immediately preceding the [exchange] offer" (if the offeror is a newly listed company and cannot meet the listing requirement, the offeror could still qualify for Form F-12 by having a thirty-six month operating history and outstanding stock valued at seventy-five million dollars); (5) the offeror provides American shareholders with an English translation of the prospectus or circular for the offer; and (6) any informa-

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186. See id. If a state's blue sky laws do not allow a registration exemption similar to Rule 802, the offeror would be allowed to offer cash to the ADR holders in that state if cash is being offered to securityholders in any other jurisdiction. If the offeror is not offering cash anywhere else, the offeror would be allowed to exclude the securityholders in that state. See id.

187. See id.

188. See id. at 27,590. If the offeror is not incorporated in the same jurisdiction as the target company, the offeror could use its home country disclosure documents if permitted by the target company's home country. See id.

189. See id. Calculation of the percentage of United States ownership is done on the same basis as for tender offers. See supra note 151.

190. See id. at 27,584, 27,590.

191. See 56 Fed. Reg. 27,582, supra note 2, at 27,584. This provision applies to offers by third-party bidders and to offers by the issuer of the foreign securities. See id.

192. See id. at 27,590. The proposed regulation would allow a company to qualify for Form F-12 if it "made an initial submission pursuant to . . . [R]ule [12g3-2(b)] on or before the filing of Form F-12." Id. at 27,590. For an explanation of Rule 12g3-2(b), see supra note 49.

193. See 56 Fed. Reg. 27,582, supra note 2, at 27,590.

194. Id. at 27,582. "The list of designated offshore securities markets currently includes 19 offshore exchanges and off exchange markets." Id. at 27,590.

195. Id. at 27,584.

196. See id. at 27,584. Form F-12 would be available to register securities in a merger transaction. See id. This would allow the foreign issuer to include the listing history of its predecessors to fulfill the three year listing requirement. See id. at 27,591.

197. See id. at 27,591. The prospectus would have to inform investors that, as a result of the exchange offer, they may have foreign tax consequences and they "may have to
tion delivered abroad to the target company’s securityholders is provided to American securityholders with appropriate legends attached.\textsuperscript{198} The offeror would be exempt from any reporting obligations that might arise under section 15(d) of the Exchange Act due to the filing of Form F-12,\textsuperscript{199} and Form F-12 would not disqualify the offeror from maintaining its exempt status under Rule 12g3-2(b).\textsuperscript{200} An issuer’s “Form F-12 would become effective upon filing” with the SEC, thereby allowing the offer to American ADR holders “to proceed on the same time schedule as the” offer overseas.\textsuperscript{201} The foreign issuer would be subject to the civil liability and antifraud regulations of the United States.\textsuperscript{202}

The proposed regulations will likely encourage foreign issuers to include American securityholders in exchange offers for a foreign target company’s securities.\textsuperscript{203} Rule 802 and Form F-12 allow foreign companies to prepare financial statements under foreign GAAP and foreign auditing standards,\textsuperscript{204} thereby lowering costs for the company making the offer.\textsuperscript{205} For the reasons set forth in the tender offer section,\textsuperscript{206} the SEC should consider raising eligibility ceilings, although for Rule 802 this would require a statutory amendment to Section 3(b) of the Securities Act.\textsuperscript{207} Finally, notwithstanding the efforts of the SEC, fear of litigation may lead foreign issuers to continue to exclude American investors from exchange offers.\textsuperscript{208}

D. Rights Offers

Rights offers,\textsuperscript{209} though a popular financing device among foreign cor-

\begin{footnotesize}

\begin{enumerate}
\item See id.
\item See id.
at 27,584.
\item See id. For explanation of Rule 12g3-2(b), see supra note 49.
\item Id. at 27,592.
\item See id.
\item See Pepper, Hamilton \& Scheetz, supra note 158, at 1; Securities Industry Association, supra note 158, at 3.
\item See Karmel, supra note 15, at 4.
\item See Securities Industry Association, supra note 158, at 3.
\item See supra notes 158-62 and accompanying text.
\item See British Banking Association, supra note 158, at 4; Pepper, Hamilton \& Scheetz, supra note 158, at 11; Securities Industry Association, supra note 158, at 9.
\item See Securities Industry Association, supra note 158, at 6-7; supra notes 163-67 and accompanying text.
\item A rights offer is a corporate financing device used by public companies to raise capital. Before offering stock to the general public, the company offers its existing shareholders the “right” to purchase their proportionate share of the new stock offering based on the shareholder’s percentage ownership interest in the company. See 56 Fed. Reg. 27,564, supra note 1, at 27,567. The existing shareholder is often able to purchase the new shares at a lower price than the general public. See id. This allows the existing shareholders to avoid dilution of their ownership interest because the shareholder is given the opportunity to preserve his percentage ownership interest in the company. See id. at 27,566.
\end{enumerate}
\end{footnotesize}
corporations, are rarely used by American companies to raise capital. Unfortunately, American investors, especially those holding OTC securities, are often “excluded from or cashed out of” foreign companies’ rights offers. Exclusion from a rights offer harms the investor by denying the investor an attractive investment opportunity, and may cause the investor’s ownership interest to be substantially diluted.

There are several reasons that foreign companies exclude American shareholders from rights offers: (1) foreign issuers are reluctant to comply with the Securities Act which requires filing a registration statement with the SEC; (2) foreign companies seek to avoid periodic reporting requirements required by the Exchange Act for issuers “who conduct public offerings in the United States;” and (3) some foreign issuers fear delay in the processing time of the registration statement at the federal and state levels.

The SEC has proposed a new rule and a new registration form to encourage foreign companies to include American shareholders in rights offers.

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210. See id. at 27,565-66. In part, the popularity of rights offers among foreign companies is due to preemptive rights statutes. See id. at 27,566. These statutes “protect existing shareholders against dilution” by requiring companies to offer shares in a new stock offering to existing shareholders before offering the new shares to the general public. See id. The existing shareholders are entitled to purchase shares in proportion to the percentage of their current holdings. See id. at 27,566-67. “Rights offers are particularly common in the United Kingdom and Europe, where many countries have some form of preemptive right statutes.” Id. at 27,566 n.17.

211. See id. at 27,565-66.

212. Level I ADRs, those ADRs that trade on the OTC market, are exempt from Exchange Act reporting and disclosure requirements pursuant to Rule 12g3-2(b). See supra note 49 and accompanying text. A rights offer is considered the offer or sale of a new security (Level III ADR) for which a Rule 12g3-2(b) exemption is not available. See id. Therefore, the foreign issuers must comply with SEC registration, reporting, and disclosure regulations enacted under the Securities Act and the Exchange Act. See 56 Fed. Reg. 27,564, supra note 1, at 27,565. To avoid the costs of complying with the Exchange Act and the Securities Act, foreign companies exclude their American shareholders from rights offers. See id.

213. 56 Fed. Reg. 27,564, supra note 1, at 27,565.

Where there is a trading market for the rights in the issuer’s home country, the issuer may cash out its U.S. shareholders by causing the rights to be sold in the open market on their behalf. U.S. investors that are cashed out generally do not receive the full benefit of the offering, however, as they are usually responsible for selling expenses and other transaction costs, including underwriters’ commissions. Id. at 27,565 n.14.

214. See id. at 27,565. Depositary banks estimate that in 1990, American ADR holders were excluded from more than twenty-five rights offers and cashed out of approximately sixty more. See id.

215. See id.

216. See 56 Fed. Reg. 27,564, supra note 1, at 27,565. Rights offers are considered to be offers or sales of new securities to the general public. New issues require registration pursuant to the Securities Act. See id. See generally supra notes 80-82 and accompanying text (explaining Level III ADR programs registration procedures necessary to offer foreign securities on United States public markets).

217. 56 Fed. Reg. 27,564, supra note 1, at 27,565.

218. See id.
Rule 801 would exempt foreign issuers from registering a rights offer in the United States if the "aggregate offering price" does not exceed five million dollars. The new registration form, Form F-11, would permit registering rights offers of any size pursuant to the issuer's home country disclosure requirements and procedures.

The proposed Rule and Form would only be available to foreign private issuers reporting in the United States under the Exchange Act who are "current with respect to such filing obligations at the time of the offering." If the foreign company is exempt from reporting under the Exchange Act pursuant to Rule 12g3-2(b), the company would be eligible for the proposed Rule or Form if it has securities on at least one "designated offshore securities market" and the company complies with the listing requirements of that market. The securities must be listed or quoted continuously for the thirty-six months immediately prior to the offering, or the listed securities must have a market value of seventy-five million dollars. The proposed Rule and Form, however, "would not be available for securities issued by an investment company that is registered . . . under the Investment Company Act of 1940." Additionally, only companies engaged in all cash transactions offering the same class of securities as held by American investors could rely on the proposed regulations. The proposed Rule and Form would require the offer to be made to American securityholders on terms not less favorable than those terms offered other shareholders.

Rule 801 would not require that any specific information be sent to

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219. See id. at 27,565.
220. "The proposed Rule defines 'aggregate offering price' of the securities to mean the total gross sales price to be received by the issuer for issuance of the securities upon exercise of the related rights, assuming that all such rights were exercised." Id. at 27,569-70. "Separate rights offerings by the same issuer would be subject to separate $5 million ceilings." Id. at 27,570.
221. See id. at 27,565. The five million dollar exemption is permitted pursuant to Section 3(b) of the Securities Act. See id. at 27,567.
222. See id. at 27,565.
223. Id. at 27,567. Pursuant to Rule 801, the offer would commence on the day the securities are first offered to shareholders; Form F-11 transactions would commence on the day the registration statement is filed with the SEC. See id. at 27,568.
224. "As defined in Rule 902 of Regulation S under the Securities Act (17 C.F.R. § 230.902(a) [(1990)])." Id. at 27,568 n.43.
225. See id. at 27,568.
226. See id. Foreign private issuers formed as a result of a merger, spinoff, or other reorganization would be allowed to include the listing history of their predecessors to satisfy the three-year listing requirement. See id.
227. Id. at 27,569. Section 7(d) of the Act prohibits a foreign investment company from publicly offering its securities for sale in the United States. See id. at 27,569 n.51.
228. See id. at 27,569.
229. "[F]or purposes of the proposed system, [American securityholders] are persons for whom U.S. addresses appear on the records of the issuer or its agents, including depositaries for sponsored and unsponsored ADR facilities and transfer agents." Id. at 27,569.
230. See id.
American shareholders.\textsuperscript{231} If information is provided to shareholders in the issuer's home jurisdiction,\textsuperscript{232} however, an English translation must be provided to American shareholders.\textsuperscript{233} An issuer offering securities under Rule 801 would be able to claim any other exemptions available under the Securities Act.\textsuperscript{234} Issuers would still be subject to antifraud and civil liability laws.\textsuperscript{235}

To register securities in connection with a rights offer on Form F-11, the foreign issuer would be required by section 5(b) of the Securities Act\textsuperscript{236} to deliver a prospectus,\textsuperscript{237} in English, to all American securityholders.\textsuperscript{238} In addition, the issuer would be required to add disclosure statements to the prospectus that warn the investor of the following: (1) that the investor may have to pay taxes in the foreign country;\textsuperscript{239} (2) that American investors "may have to pursue legal remedies in a foreign jurisdiction;"\textsuperscript{240} and (3) that financial statements in the registration statement were neither prepared in accordance with United States GAAP nor audited in accordance with United States auditing standards.\textsuperscript{241} An English language translation of any information delivered to foreign securityholders would have to be provided to American investors.\textsuperscript{242}

Under the proposal, Form F-11 would become effective upon filing, enabling the offeror to coordinate the United States offering with the overseas offering.\textsuperscript{243} Filing Form F-11 will not subject the foreign issuer to periodic reporting under the Exchange Act if the issuer does not already have such an obligation.\textsuperscript{244} Form F-11 would not exempt foreign companies from antifraud provisions of the United States securities regulations.\textsuperscript{245}

The proposed rights offers regulations are likely to encourage foreign companies to extend such offers to American securityholders.\textsuperscript{246} The proposed regulations will benefit companies exempt from Exchange Act

\textsuperscript{231} See id. at 27,570.
\textsuperscript{232} Home jurisdiction is defined as "the issuer's country of incorporation or organization or, if different, the jurisdiction of the primary market for the issuer's equity securities that are listed on a designated offshore securities market." \textit{Id.} at 27,570.
\textsuperscript{233} See id.
\textsuperscript{234} See id. at 27,569.
\textsuperscript{235} See id.
\textsuperscript{236} 15 U.S.C. § 77e(b) (1988).
\textsuperscript{237} The prospectus would consist of all the documents used to offer the rights in the issuer's home jurisdiction. \textit{See 56 Fed. Reg. 27,564, supra} note 1, at 27,570.
\textsuperscript{238} See id.
\textsuperscript{239} See id.
\textsuperscript{240} Id.
\textsuperscript{241} See id.
\textsuperscript{242} See id.
\textsuperscript{243} See id. at 27,571.
\textsuperscript{244} See id. The issuer would be able to retain its 12g3-2(b) exemption. \textit{See id.} For explanation of Rule 12g3-2(b), see \textit{supra} note 49.
\textsuperscript{245} See 56 Fed. Reg. 27,564, \textit{supra} note 1, at 27,571.
Proposed regulations and companies required to report information under the Exchange Act. In contrast to its approach to the proposed tender and exchange offer regulations, the SEC has determined that it will not restrict the use of Form F-11 to transactions where American investors own a limited percentage of the foreign issuer's securities. This SEC decision will not have an adverse impact on American investors. Eligibility for Form F-11 requires the issuer to restrict the rights offer to existing American securityholders. In addition, the offeror must prohibit securityholders from transferring their rights to other investors. These restrictions ensure that only American investors who purchased the stock based on foreign disclosure documents will be able to participate in the rights offer and, therefore, Form F-11 is unlikely to adversely affect American investors.

Finally, foreign issuers may continue to be concerned with possible litigation in the United States arising from the rights offers and, therefore, may continue to exclude American investors. Although the proposed regulations seem to give foreign companies an advantage over domestic companies to raise capital in the United States, most American investors will welcome the opportunity to be included in the rights offers.

CONCLUSION

The SEC's proposed regulations are intended to encourage foreign issuers to participate in the American capital markets and are a good preliminary step to achieve that end. The proposed regulations, by easing some SEC requirements, should lead foreign companies to include American investors in tender, exchange, and rights offers where the foreign company has a relatively small shareholder base in the United States. Foreign companies with a greater percentage of American shareholders, and who receive a substantial benefit from American investment, would remain subject to the same disclosure and reporting requirements as a domestic corporation (with the exception of a foreign company engaged in a rights offer under Form F-11).

247. See supra note 49 for a description of Rule 12g3-2(b) exemption from the Exchange Act's reporting requirements.
248. See Simpson, Thacher & Bartlett, Comment to SEC 2 (Sept. 17, 1991) (on behalf of Barclays PLC) (response to SEC's request for comments to rights offerings release) (on file with Fordham L. Rev.). For an explanation of exemption from Exchange Act reporting requirements under Rule 12g3-2(b), see supra note 49.
249. See Pepper, Hamilton & Scheetz, supra note 158, at 18.
250. See id.
251. See id.
252. See 56 Fed. Reg. 27,564, supra note 1, at 27,569; Pepper, Hamilton & Scheetz, supra note 158, at 18.
253. See Pepper, Hamilton & Scheetz, supra note 158, at 18.
254. See Securities Industry Association, supra note 158, at 4-5.
255. See Leth & Grauman, supra note 246, at 7.
The proposed regulations, however, will do little to attract foreign companies who do not already trade their securities in the United States. To issue securities in the United States, foreign companies are required to prepare financial statements pursuant to American disclosure and reporting requirements, including preparing documents pursuant to United States GAAP. Foreign companies are reluctant to comply with SEC requirements. The SEC has recognized this fact and has attempted, with limited success, to attract foreign investors to the United States by permitting foreign companies to issue securities in the United States private market without requiring the foreign companies to comply with SEC reporting and disclosure requirements. The SEC should take the next step and allow foreign companies to issue securities in United States public markets without having to comply with SEC disclosure requirements. The SEC could accomplish this by entering into MJDS agreements with foreign countries, by adopting an international standard of GAAP, or by extending the Rule 12g3-2(b) exemption to foreign securities listed on a national exchange. If the SEC does not take action to open United States markets to foreign securities, foreign companies will continue to avoid issuing their securities here, thereby depriving American investors of potentially lucrative investment opportunities.


257. See supra notes 127-30 and accompanying text.