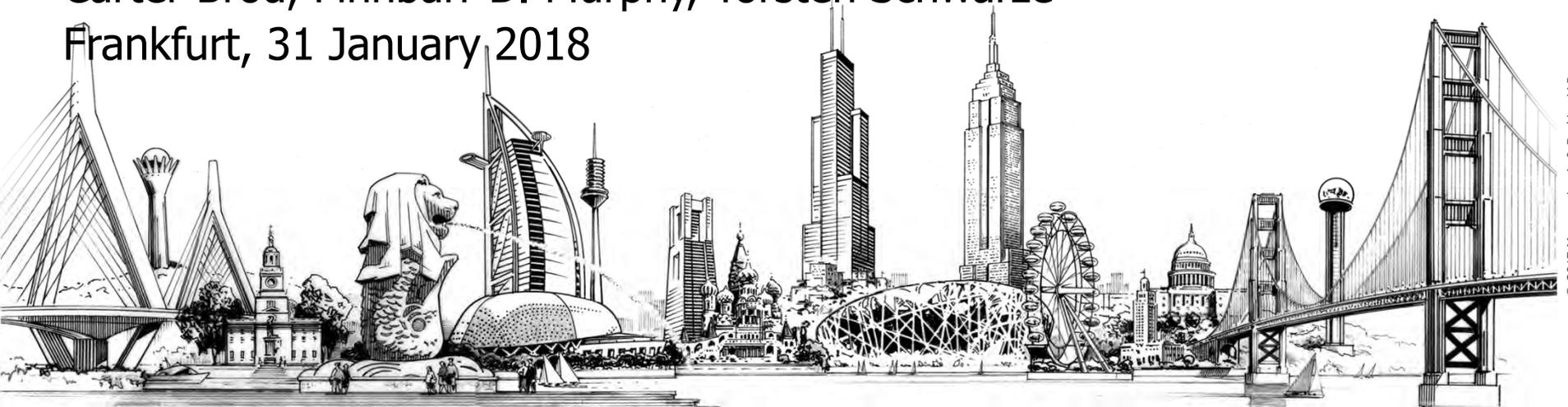


Morgan Lewis

# THE EXTRATERRITORIAL REACH OF THE U.S. SECURITIES LAWS

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# Agenda

1. Introduction
2. Regulation S
  - Primary offerings
  - Secondary transactions
3. U.S. extraterritorial jurisdiction and liability
4. Questions & answers

**SECTION 01**

# **INTRODUCTION**

**TORSTEN SCHWARZE**

# Morgan Lewis Global Expertise

- Founded in 1873 Morgan Lewis comprises more than **2,200 legal professionals** in **30 offices\*** worldwide advising on all areas of business law including more than **200 specialized securities lawyers** in North America, Asia, Europe and the Middle East counseling on
  - IPOs
  - private placements
  - bond offerings and restructurings
  - follow-on offerings
  - stock exchange regulations
  - listed company compliance
- Morgan Lewis's Frankfurt office is the German hub of Morgan Lewis's global platform and hosts a team of highly specialised lawyers who concentrate on **capital markets transactions**.



**SECTION 02**

# **REGULATION S**

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# Regulation S

- Regulation S (Rules 901-905): a safe harbor that allows securities to be offered and sold outside the U.S. without SEC registration
- Two safe harbors
  - Issuer safe harbor (Rule 903): An exemption covering sales by the issuer, a distributor (a party that has entered into a contractual relationship with the issuer to sell the securities) any of their respective affiliates or any person acting on their behalf
  - Resale safe harbor (Rule 904): Rule 904 is an exemption covering resales by parties other than the issuer, a distributor, any respective affiliate (except directors and officers of affiliates solely by virtue of their position) or any person acting on their behalf

# Regulation S – Primary Offerings (Issuer Safe Harbor)

- Rule 903
  - Two basic conditions:
    - The offer and sale must be made in an “offshore transaction”
    - No “directed selling efforts” may take place in the U.S.
      - Defined as any activity for the purpose of, or that could reasonably be expected to have the effect of, conditioning the U.S. market for the securities being offered

# Regulation S – Primary Offerings (Issuer Safe Harbor)

- Additional requirements
  - Issuers/offerings are classified into three categories, and depending on category, additional requirements may apply
- Category 1 (Low-risk offerings)
  - Who qualifies?
    - Foreign issuer
    - No SUSMI (“Substantial U.S. Market Interest”) if a non-governmental issuer
    - Overseas directed offering
  - Additional requirements
    - None

# Regulation S – Primary Offerings (Issuer Safe Harbor)

- Category 2 (Medium-risk offerings)
  - Who qualifies?
    - equity securities of a reporting non-US issuer
    - debt securities of a reporting US or non-US issuer
    - debt securities of a non-reporting non-US issuer
  - Additional requirements
    - Distribution compliance period (“DCP”)
      - 40 days
      - includes requirement that no offers and sales can be made to a U.S. person other than a distributor
    - Notice requirement
    - Offering restrictions
      - Written agreement by dealers to comply with DCP; legends in prospectus

# Regulation S – Primary Offerings (Issuer Safe Harbor)

- Definition of “U.S. person”
  - A natural person resident in the U.S. or corporation/partnership organized or incorporated under U.S. laws
  - Non-U.S. partnerships and corporations formed by U.S. persons principally to invest in unregistered securities (unless organized and owned by accredited investors who are not natural persons, estates or trusts)
  - U.S.-located agencies or branches of foreign entities
  - A non-discretionary account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person
  - A discretionary account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated or resident in the U.S. (unless it is held for the benefit or account of a non-U.S. person)
  - A trust or estate with a trustee, executor or administrator who is a U.S. person (unless the trust or estate gives sole or shared investment power to a non-U.S. trustee, executor or administrator, as applicable; and (in the case of a trust) no beneficiary and no settler of a revocable trust is a U.S. person or (in the case of an estate) the estate is governed by a foreign law)
- Expressly not a U.S. person:
  - A non-U.S. branch of a U.S. bank or insurance company regulated substantively in the jurisdiction where it is located
  - A discretionary account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated or resident in the U.S. that is held for the benefit or account of a non-U.S. person
  - An employee benefit plan set up and administered under non-U.S. law

# Regulation S – Primary Offerings (Issuer Safe Harbor)

- Category 3 (High-risk offerings)
  - Who qualifies?
    - All others
  - Additional requirements
    - DCP – 40 days for debt; 1 year for equity (non-reporting issuer)
    - Additional transaction restrictions and offering restrictions
    - Debt securities must be represented by a temporary global note not exchangeable for definitive securities during the 40-day DCP

# Regulation S – Secondary Transactions (Resale Safe Harbor)

- Resales under Regulation S (Rule 904)
  - Applies to securities acquired in U.S. offerings or non-U.S. offerings if being resold outside U.S.
  - Cannot be used by the issuer, a distributor, any of their respective affiliates (except any officer or director who is an affiliate solely by virtue of holding such position) or any person acting on behalf of any of the foregoing (as such persons need to utilise Rule 903)
  - Basic requirements
    - Resale must be made in an “offshore transaction”
    - Resale must not involve “directed selling efforts”

# Regulation S – Secondary Transactions (Resale Safe Harbor)

- Additional restrictions for Regulation S resales:
  - For resales by participating dealers (securities firms and persons receiving selling concessions or fees) in an offering by a Category 2 or 3 issuer:
    - No resales to U.S. persons during distribution compliance period
    - Confirmations provided to purchasers who are dealers
  - For resales by certain affiliates (an officer or director of the issuer or a distributor who is an affiliate of the issuer or distributor solely by virtue of holding such position):
    - No selling concession, fee or other remuneration can be paid in connection with such offer or sale other than the usual and customary broker's commission that would be received by a person executing such transaction as agent (otherwise would need to utilise Rule 903)

**SECTION 03**

# **U.S. EXTRATERRITORIAL JURISDICTION AND LIABILITY**

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# Application of U.S. Federal Securities Laws

- **“Conduct or Effects” (superseded by *Morrison in 2010*)**
  - U.S.-based conduct has sufficient impact on non-U.S. shareholders or non-U.S. conduct has sufficient impact on U.S. investors
  - “Foreign cubed”
- **“Transactional” Test (*Morrison (2010)*)**
  - U.S. federal securities law applies to misstatements or alleged misstatements made in connection with the purchase and sale of a security “listed on a U.S. stock exchange” or the purchase and sale of any other security “in the United States”
  - Substantially limits extraterritorial scope of Rule 10b-5 anti-fraud claims
  - *Application continues to develop in courts; particularly for complex instruments/situations*

# U.S. Transaction

## Potential factors for determining if there is a U.S. Transaction

- Where the contract was formed
- Where the purchase order was placed
- Where title passed
- Where money was exchanged
- Non-exclusive list of factors
  
- Stock mergers signed outside the U.S. likely non-U.S. transactions for shareholders (*In re Vivendi SA*)

# Complex Financial Transactions

- **ADRs**

- OTC vs. listed

- **Derivatives**

- Porsche case. New York law-governed derivatives executed in U.S. with underlying German-exchange listed securities not subject to U.S. federal securities laws; “functional equivalent” of trading underlying German securities

- **Cross Listings**

- Case law supporting proposition that if a transaction occurs on non-U.S. exchange, the mere existence of dual listing in U.S. does not result in application of U.S. securities laws to that transaction

# Additional Bases of Potential Liability

- **Criminal**

- In 2013 Second Circuit held that could only be convicted for criminal securities fraud under U.S. federal law if alleged fraudulent action occurred in transaction effectively meeting the standard set by the *Morrison* U.S. “transaction” test

- **Regulatory**

- SEC and DOJ jurisdiction, under Dodd-Frank Act, over regulatory enforcement actions regarding (1) conduct within U.S. that constitutes significant steps in furtherance of the violation, even in the securities transaction occurs outside the U.S. and involves only foreign investors, or (2) conduct occurring outside the U.S. that has a foreseeable substantial effect within the U.S.

- ***Uncertainty remains for criminal and regulatory matters***

## SECTION 04

# QUESTIONS & ANSWERS



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# Biography



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Carter Brod counsels corporations, banks, governments, investment banks, and investors on international capital markets transactions in emerging and developed markets. Dual-qualified in the United States and England and Wales, Carter handles a broad range of securities matters including Eurobond offerings, GDR and other equity offerings, convertible bonds, MTN programs, high yield notes, sovereign bonds, regulatory capital instruments and restructurings of outstanding debt securities.



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# Biography



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Torsten Schwarze counsels clients on acquisition finance and real estate finance transactions, restructurings, derivatives, regulatory matters, and capital markets transactions. His clients include banks, financial service institutions, investment companies, stock and derivatives exchanges, and other companies.

In 2007, Torsten was seconded to Morgan Lewis's New York office, where he advised clients on securitization, structured finance, and investment law. In that role, he also worked on several securitization transactions.



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