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FINANCING HEAVY DUTY II: ACCESSING THE U.S. CAPITAL MARKETS

Bruce A. Wolfson

Warren S. Green

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Bruce A. Wolfson[*] *& Warren S.Green*[**]

I. INTRODUCTION

As is the case with most emerging market enterprises, Heavy Duty II ("HDII") may be presumed to face domestic capital markets which are unable to satisfy the country's need for growth capital, or offer fewer financing alternatives than external financial markets. These conditions persist despite many recent initiatives by emerging market securities commissions and central banks which have brought greater transparency to their capital markets, introduced new instruments and exchanges and attracted increased participation by foreign investors.[1] Thus offshore financing opportunities are often more attractive to emerging market issuers even taking into account the foreign exchange risk resulting from the issuance of convertible or preferred debt securities denominated in a foreign currency.[2] This article will explore some of the financing alternatives and regulatory concerns facing an emerging market issuer seeking to access the United States capital markets.

Because of the peculiarity of the U.S. regulatory scheme, certain financing alternatives have traditionally been available only from

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* Senior Managing Director, Legal Department, Bear, Stearns & Co. Inc.; Director of Emerging Markets Traders Association, Inc.; University of Pennsylvania Law School, J.D. 1977; University of Pennsylvania, B.A. 1974.

** Vice President, Legal Department, Bear, Stearns & Co. Inc.; New York Law School, J.D. 1994; State University of New York at Oneonta, B.A. 1974.

1. *See, e.g.*, Enrique R. Carrasco & Randall Thomas, *Encouraging Rational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539 (1996).

2. *See* Joel Seligman, *The Obsolescence of Wall Steet: A Contextual Approach to the Evolving Structure of Federal Securities Regulation*, 93 MICH. L. REV. 649 (1995); Les Riordan, *Three Proposals for a Latin American Stock Exchange in Miami: Full-Service Exchange, Private Offshore Market, or a Computerized Financial Information Service*, 27 U. MIAMI INTER-AM. L. REV. 585 (1996).

commercial banks, while others have been offered exclusively by investment banks.[3] Moreover, both the primary and secondary securities markets in the United States have long been among the most rigorously regulated in the world.[4] However, the rush towards globalization of the world's financial markets has resulted in a number of recent changes to the regulatory framework which ease the burden on foreign issuers wishing to access the U.S. capital markets.[5] Most prominent among these changes, as far as foreign issuers like HDII are concerned, is the adoption of Rule 144A[6] and Regulation S[7] under the Securities Act of 1933 ("'33 Act").[8] Rule 144A enables issuers to access some of the most important investors in the United States capital markets without complying with the registration requirements of §5 of the '33 Act,[9] some of which are particularly troublesome for some non-U.S. issuers.[10]

Regulation S clarifies the circumstances under which securities may be offered and sold outside of the United States without registering the offering with the Securities and Exchange Commission ("SEC" or "Commission") pursuant to § 5 of the '33 Act,[11] or endorsing the securities with a restrictive legend pursuant to certain exemptions from the registration requirements of the '33 Act.[12] Although the Commission has

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3. In 1933 Congress prohibited separated commercial banks from performing investment bank functions and investment banks from performing commercial bank functions. The Glass-Steagall Act of 1933 (codified as amended at 12 U.S.C. § 24 (1996)). *See also*, Don More, *The Virtues of Glass-Steagall: An Argument Against Legislative Repeal*, 1991 COLUM. BUS. L. REV. 433 (1991); Vincent di Lorenzo, *Public Confidence and the Banking System: The Policy Basis for the Continued Separation of Commercial and Investment Banking*, 35 AM. U. L. REV. 647 (1986); Bruce W. Nichols, *Legislative History of the Glass-Steagall Act*, *in* The Glass-Steagall Act: Banks and the Securities Industry 15, 32-34 (1984).

4. *See* RICHARD W. JENNINGS, ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1573 (7th ed. 1992).

5. *See* Edward A. Perell et al., *Regulation S and Rule 144A: A Non-US Issuer's Perspective*, INT'L FIN. L. REV. Supp. 13-21 (1990).

6. 17 C.F.R. § 230.144A (1996).

7. 17 C.F.R. § 230.901 (1996).

8. Securities Act of 1933, 15 U.S.C. § 77 (1996).

9. 15 U.S.C. § 77e (1996).

10. Some troublesome requirements are the requirement that the issuer have a substantial operating history and utilize American generally accepted auditing procedures for financial statements. 15 U.S.C. § 77g (1996) (stating the requirements to be included in a prospectus); *see also* Perell, *supra* note 5.

11. 15 U.S.C. § 77e (1996); 17 C.F.R. § 230.903 (1996).

12. *See infra* part V.

recently proposed lengthening the holding period for certain securities offered by U.S. issuers pursuant to Regulation S,[13] no such new restrictions were proposed for foreign issuers.

II. CERTAIN ASSUMPTIONS CONCERNING HDII

Before entering into a discussion of the capital formation alternatives available to a company like HDII, it is necessary to state some assumptions. First, HDII is a successor corporation to Heavy Duty I; it has emerged from bankruptcy healthy and looking to grow. To facilitate a discussion of the unique challenges facing a foreign business entity attempting to tap the United States capital markets, we will assume that HDII is organized and doing business in one of the emerging markets in Latin America. We will also assume that HDII requires American capital investment to survive, although some possible scenarios may include simultaneous offerings in HDII's home market, the United States and other foreign markets. However, we will not discuss the legal requirements of any securities market other than the United States, as a discussion of diverse regulatory schemes and the differences between them is beyond the scope of this article.

III. ALTERNATIVES TO ACCESSING THE U.S. CAPITAL MARKETS

One way for HDII to raise capital for expansion is to seek additional investments from the family which controls it. An obvious method to achieve that goal would be to sell additional common stock to the family. Alternately, the family might elect to not to increase its permanent investment in the company, but to lend money to HDII, either in the form of a traditional loan or through the purchase of debt securities or preferred shares issued by HDII. Even if the amount of capital that HDII needs exceeds the ability of the family to provide it, the family may want to participate in any new offering of equity to avoid having its ownership interest diluted by new investors.[14] On the other hand, the family may be unwilling or unable to invest any further amounts in HDII.

Another method that HDII's management could use to raise capital is to sell a minority equity interest in HDII to one or more major non-U.S.

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13. Offshore Offers & Sales, International Series Release No. 33-7392; 34-38315 (Feb. 20, 1997), 1997 SEC Lexis 382.

14. *See, e.g.*, Edgarplus filing on Bank United Corp., filed February 11, 1997.

suppliers, customers or other private investors.[15] A benefit to equity financing is that there is no out-of-pocket cost to HDII or the family owning HDII. The problem for the family is that it would be giving up partial ownership of HDII. Another advantage of raising capital from a small number of investors is that you do not have the cost and delays typically associated with a public offering.[16]

Instead of offering its suppliers and customers a percentage of its equity, HDII could form a joint venture to produce some or all of its products. The joint venturer could be a local or foreign partner interested in establishing or increasing its presence in the local market.[17] HDII and its partner could form a new business entity whose equity and profits and losses could be allocated in a manner agreed upon by the parties. Benefits to HDII and its shareholders include avoidance of additional debt service expense or dilution of the existing owners' control of HDII. However, the economic benefit to HDII of future growth in the relevant business would be limited to its share of the joint venture. Furthermore, HDII and its shareholders may be unwilling to give up control of even a portion of the enterprise to a joint venture partner.

Another method of capital formation for HDII could be a sale-leaseback arrangement.[18] In a sale-leaseback, HDII sells plant or equipment to a third party, which then leases the equipment back to HDII. This financing tool is available for borrowing against existing assets or for purchases of new plant or equipment. This can be an especially effective way for a capital starved entity to finance its acquisition of much needed plant and equipment. One limitation is that HDII can only finance its purchase of plant and equipment and cannot use the capital for other purposes.[19]

Another financing alternative available to HDII is a commercial loan. While loans could be extended by a local commercial bank, given the lack of liquidity typical in emerging markets, HDII would probably need to identify a commercial bank doing business in its home country.[20] A

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15. *See, e.g., Pepsico Is Preparing to Return to Venezuela*, N.Y. TIMES, Nov. 14, 1996, at D3 (a joint venture with Polar).

16. JENNINGS ET AL., *supra* note 4, at 87.

17. *See, e.g.*, Edgarplus filing on Edge Petroleum Corp Form S-4, filed February 5, 1997.

18. Market St. Assoc. Ltd. Partnership v. Frey, 941 F.2d 588, 591-92 (7th Cir. 1991) (explaining a sale-leaseback arrangement).

19. Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 586 (1995).

20. Many money center banks maintain substantial operations in Latin American

commercial bank would make the loan only if HDII could demonstrate adequate cash flow to service the loan and may require additional protection for the bank.[21] Such protection might include a requirement that a substantial portion of the company's assets be pledged as collateral for repayment of the loan and imposition of covenants restricting the conduct of its business throughout the term of the loan. A bank might also charge an excessively high interest rate if it has lingering doubts about the creditworthiness of HDII or the soundness of the economy in which it operates. Finally, a bank might limit the maximum term of the loan, posing a problem if HDII needs a long-term capital investment.

One way to improve the terms on which a lender may be willing to extend credit is to assign HDII's foreign receivables to a bankruptcy remote off-shore entity organized for the sole purpose of borrowing money and holding the receivables as collateral for such loan.[22] The loan can be repaid from the proceeds of the receivables, thereby eliminating the credit risk of HDII and the country risk associated with local market credits. HDII's management may resist giving up its principal source of foreign exchange, but this may be the only way for HDII to get a loan it needs on acceptable terms and conditions.

A final alternative to accessing the international capital markets is to issue securities in the local, emerging stock market.[23] HDII might take this route despite the fact that it cannot raise enough capital in the local stock market to meet its needs. One reason to do so is to take advantage of the opportunity to obtain favorable terms from investors who are most familiar with the company and most comfortable with the country risk. Moreover, as we shall see, a local trading market may be essential to allow HDII to consider certain types of offerings in the American securities markets.[24]

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countries, usually consisting of a representative office lending from abroad, but increasingly including banking operations in the local market. *See, e.g.*, Carol Bere, *Latin Custody American Style; Custodial Services; Latin Custody 1995*, LATIN FINANCE, Sept. 1995, at LC4.

21. J. Robert Brown, Jr., *Article: In Defense of Management Buyouts*, 65 TUL. L. REV. 57, 122 (1990).

22. *See, e.g.*, Blaire Houchens Miller, *What U.S. Treasurers Should Learn From Mexico's Financial Crisis*, 16 CORP. CASHFLOW MAG. (1995).

23. *See, e.g.*, Wietse de Jong, *Brazil Booklet 1: Commentary*, *in* INTERNATIONAL SECURITIES REGULATION 1, 23 (Robert C. Rosen et al. eds., 1997). *See also* Teófilo G. Berdeja Prieto, *Mexico Booklet 1: Commentary*, *in* INTERNATIONAL SECURITIES REGULATION 49 (Robert C. Rosen ed., 1992).

24. *See infra* part V, for a discussion of registered and privately placed American Depository Receipts.

IV. ACCESSING THE U.S. PUBLIC MARKETS

The United States capital markets remain the largest and most liquid in the world. A company in need of capital will therefore frequently look to our market to satisfy that need. In many cases, the capital requirements of an issuer can be met through private placements of securities which do not require registration with the SEC. However, for issuers which require larger amounts of capital and which can satisfy the requirements of the '33 Act, the U.S. public markets may provide the most favorable financing terms. Let us first explore how HDII might avail itself of such financing.

The process by which investors access the U.S. public market is called an underwriting.[25] In an underwriting, a group of securities dealers,[26] under the leadership of one or more managing underwriters,[27] join together as a syndicate for the purpose of purchasing securities[28] from an issuer[29] for resale or distribution to the investing public. The lead underwriter[30] assists the issuer and its counsel to prepare the registration statement which must be filed with the SEC[31] and coordinates the efforts of the other members of the syndicate, including preparation of agreements among the syndicate members setting forth their respective responsibilities and share of fees and expenses to be paid by the issuer.[32] The reason for a syndication is not

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25. *See* JENNINGS ET AL., *supra* note 4, at 85. *See also* § 2(11) of the '33 Act.

26. 15 U.S.C. § 77b(12) (1996).

27. *See* JENNINGS ET AL., *supra* note 4, at 90. A U.S. underwriting is typically lead by a single institution, referred to as the lead manager, assisted by a number of co-lead managers. Occasionally joint lead managers will be appointed by an issuer. In the case of simultaneous offerings in the United States and foreign capital markets, a lead manager and co-lead managers may be appointed for each such offering, with their efforts coordinated by a single institution acting as the global lead manager. *Id.*

28. *See* JENNINGS ET AL., *supra* note 4, at 88. An underwriter purchases shares for resale to investors, as contrasted with a placement agent, which typically arranges for sale of securities directly from the issuer to the investor. Public offerings are normally underwritten. *Id.*

29. 15 U.S.C. § 77b(4) (1996).

30. *See* JENNINGS ET AL., *supra* note 4, at 90.

31. The registration statement typically includes a prospectus, which is the disclosure document to be delivered to each investor, and additional material which is filed with the SEC where it is available to the investing public. The form of registration statement will vary depending on whether the issuer is foreign or domestic, whether it is a reporting company under the '34 Act and the nature of the securities being issued. *See* 15 U.S.C. § 77b(8) (1996) and the requirements of Form S-1.

32. For a comprehensive review of the syndication process, *see* U. S. v. Morgan, 118 F.Supp. 621, 679-701 (S.D.N.Y. 1953) (holding that the syndication process is not a

only to effect the widest possible distribution of the securities, but also to spread the risk of bringing the new issue to market.

There are three different kinds of underwriting.[33] First, there is a firm commitment underwriting, in which the underwriting syndicate agrees to purchase all or a specified percentage of the securities offered, subject to certain limited circumstances under which the underwriter may be released from its underwriting commitment.[34] HDII may be able to arrange for a firm commitment underwriting, but would likely find underwriters reticent to provide such a commitment in light of its recent financial problems.

Second, there is a "stand-by" underwriting,[35] whereby a new issue is offered to existing shareholders, while the underwriter agrees to "stand-by" to purchase any unsold securities. HDII could not have a "stand-by" underwriting in the American market because it has no existing U.S. shareholders.

The third type of underwriting is a "best-efforts" underwriting,[36] in which the underwriters purchase from the issuer only those securities which investors have previously committed to purchase from them. HDII could use a "best efforts" underwriting[37] should an investment bank be unwilling to agree to purchase shares not sold to the public.

A principal responsibility of an American underwriter is to ensure compliance with the federal and state regulations[38] pertaining to the public distribution of securities. Although we have assumed that HDII desires to engage in a public distribution subject to the registration requirements of the '33 Act[39], this may be a good time to review what constitutes such a public distribution and what the aforesaid regulations require.

A threshold issue in determining whether '33 Act registration is necessary is to ascertain whether the instruments to be offered by HDII fits

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violation of the anti-trust laws).

33. JENNINGS ET AL., *supra* note 4, at 88.

34. There are certain circumstances whereby an underwriter can cancel the underwriting, usually when there is a "material, adverse event affecting the issuer that materially impairs the investment quality of the offered securities." JENNINGS ET AL., *supra* note 4, at 88 n.32 (citing Walk-In Med. Ctr., Inc. v. Breuer Capital Corp., 818 F.2d 260, 264 (2d Cir.1987)).

35. JENNINGS ET AL., *supra* note 4, at 88.

36. *Id.*

37. *Id.*

38. The federal regulations for the distribution of securities is set forth under the Securities Act of 1933, 15 U.S.C. § 77a-77z(2) (1996), and state regulations are established by each individual state.

39. 15 U.S.C. § 77e (1996).

within the definition of a security under the '33 Act.[40] If so, compliance with the registration requirements of the '33 Act is required in connection with any public distribution thereof. Severe civil and criminal penalties[41] are imposed for failure to comply with these requirements. It is therefore necessary to consider what procedures the '33 Act put in place to protect the investing public.

The purpose of the '33 Act is to provide investors "with material information concerning securities offered for public sale; and to prevent misrepresentation, deceit and other fraud in the sale of securities."[42] To fulfill those aims, the '33 Act requires that a security may be offered upon the filing of a registration statement, provided that no sale may be confirmed until the registration statement is effective.[43] The registration statement must contain a "description of the registrant's properties and business; description of the significant provisions of the security to be offered for sale and its relationship to the registrant's other capital securities; information about the management of the registrant; and financial statements certified by independent public accountants."[44] Once the registration statement is filed, the '33 Act provides for a twenty-day period before the registration statement becomes effective.[45] During the twenty-day period, the SEC will review the registration statement. If the Commission determines that there are inaccuracies in the statement, it will request corrections or an explanation of the inaccuracies. Should the SEC decide that circumstances so warrant, it may issue a stop order to suspend future sales of the security covered by the registration statement.[46] The SEC does not arrange for rescission of sales made prior to the stop order,

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40. 15 U.S.C. § 77b(1) (1996). The Supreme Court, developed what has become known as the *Howey* test to ascertain whether compliance with the '33 Act is necessary. In SEC v. W. J. Howey Co., an "investment contract" is "a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment'. . . . " SEC v. W. J. Howey Co., 328 U.S. 293, 298 (1946) (quoting State v. Gopher Tire & Rubber Co., 177 N.W. 937, 938 (Minn. 1920)).

41. 15 U.S.C. § 77l (1996).

42. WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 1405 (1995) [hereinafter CARY & EISENBERG].

43. 15 U.S.C. § 77e(a)(1)-(2) (1996). Section 5 prohibits the use of the mail or any means of transportation to sell a security or to be carried through the mails or in interstate commerce unless a registration statement is in effect as to that security. *Id.*

44. CARY & EISENBERG, *supra* note 42, at 1406. For the information required in the registration statement, *see* 15 U.S.C. § 77g (1996).

45. 15 U.S.C. § 77h(a) (1996).

46. 15 U.S.C. § 77h(b), (d), (e) (1996).

but those investors who have already purchased the suspect security may be able to pursue their own remedies.[47]

It should be noted that the SEC rarely relies upon its right to issue stop orders to encourage fuller disclosure. You will recall that the '33 Act allows the SEC twenty-one days from the time an application is complete to act upon registration statements. However, the Commission is granted authority to accelerate approval at its discretion. To the trader of securities, especially more volatile emerging market securities, twenty-one days can be an eternity. Thus the Commission can utilize its discretionary authority to accelerate approval to obtain desired concessions from issuers and underwriters.

For the issuer, underwriters and attorneys working to bring a new offering to the market, liability for fraud under the '33 Act is a major concern.[48] Such liability attaches to those who sign a false or misleading registration statement.[49] Underwriters' liability can be avoided, however, by performing "due diligence," i.e., a comprehensive review of the business and financial condition of the issuer and the markets in which it operates is performed by the underwriters and their legal counsel and the registration statement is carefully read to correct any material misstatements or omissions of material facts.

V. ACCESSING THE U.S. PRIVATE PLACEMENT MARKETS

Foreign issuers like HDII often find compliance with U.S. disclosure requirements in connection with a public offering impracticable and the costs associated with such an offering excessive. One of the difficulties of compliance with the disclosure requirements of the '33 Act is that the issuer's financial statements must be prepared in compliance with United States generally accepted accounting principles ("GAAP"). U.S. GAAP is problematic for foreign issuers because it may require restatement of financial statements prepared in accordance with local GAAP. There may also be a cultural barrier because managers and owners of non-U.S. corporations may not be accustomed to the amount of disclosure required to comply with U.S. GAAP.[50] Thus, the foreign issuer may be faced with

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47. CARY & EISENBERG, *supra* note 42, at 1407.

48. 15 U.S.C. § 77k (1996) (liability for false statements in the registration statement); 15 U.S.C. § 77a(1) (1996) (liability for fraud by sellers of securities); 15 U.S.C. § 77la(2) (1996) (liability for fraud by sellers to buyers of securities); 15 U.S.C. § 77q(a) (1996) (liability for fraud by sellers of securities using interstate commerce under the '33 Act).

49. *See* Escott v. Barchris Construction Corp., 273 F. Supp. 643 (S.D.N.Y. 1968).

50. *See The Securities and Exchange Commission Reauthorization Act of 1996:*

the need to maintain records complying with U.S. GAAP, as well as records prepared in accordance with locally accepted custom. It has been reported that the SEC has agreed to accept financial statements prepared in accordance with international accounting standards which have recently been developed to facilitate reporting by foreign issuers participating in international capital markets.[51]

If the barriers to compliance with the registration requirements of the '33 Act cannot be overcome, HDII may need to avail itself of one of the several exemptions to the registration requirements available under §4(2).[52] This article will limit itself to a discussion of those exemptions most likely to be attractive to a foreign issuer like HDII.[53]

If HDII wishes to raise capital in the United States markets without registering its offering, it must rely upon a so-called private placement exemption under §4(2) of the '33 Act. "Transactions by an issuer not involving any public offering"[54] are exempt from the registration process. These private placements may be offerings of a maximum dollar value of $5,000,000;[55] offerings made exclusively to accredited investors;[56] offerings limited to no more than 35 investors which are not accredited investors;[57] or offerings made exclusively to qualified institutional buyers.[58] The traditional or Regulation D private placement[59] has been available for years

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Hearing on H.R. 2972 Before the Subcomm. on Telecommunications and Finance of the House Comm. on Commerce, 104th Cong. 2d. Sess. 16 (1996) (testimony of Arthur Levitt, Chairman, SEC). International accounting standards have not been as rigorous as generally accepted accounting standards as developed by the Financial Accounting Standards Board. As a result, foreign issuers have difficulty complying with American accounting standards. There is an effort by the International Organization of Securities Commissions, through its International Accounting Standards Committee, to develop comprehensive international accounting standards. *See also* Floyd Norris, *Market Watch: Will U.S. Accounting Rules Be Irrelevant?* N.Y. TIMES, Dec. 29, 1996, § 3, at 1.

51. Norris, *supra* note 50, at 1.

52. *See* JENNINGS ET AL., *supra* note 4, at 322 for a discussion of exempt securities.

53. As a foreign issuer, HDII could not avail itself of the exemption for an intrastate offering. 15 U.S.C. § 77c(a)(11) (1996); 17 C.F.R. 230.147 (1996). *See also* JENNINGS ET AL., *supra* note 4, at 389.

54. 15 U.S.C. § 77d(2) (1996).

55. 17 C.F.R § 230.506 (1996).

56. Usually high net worth individuals or qualified institutional buyers. *See* 17 C.F.R. § 230.501(a) (1996); 17 C.F.R. § 230.144A (a)(1)(i) (1996).

57. 17 C.F.R. 230.505(ii) (1996).

58. 17 C.F.R. § 230.144A (1996).

59. *See* Securities Act Release No. 6389, (Mar. 8, 1982), explaining Regulation D, Rules 501 through 508, 17 C.F.R. § 230.501 through 15 U.S.C. § 508 (1996); *See also*

and has developed a niche in the marketplace because of the number of accredited investors. Accredited investors include large institutions like insurance companies and pension plan trusts.[60] Through its no-action letter mechanism, the SEC has permitted resales of private placements under certain conditions.[61] Although this exemption is not expressly mandated by statute, it has come to be called the §4(1 1/2) exemption because it draws upon elements of the exemption for sales by parties other than issuers, underwriters and dealers under §4(1) and the exemption for private sales by issuers under §4(2). However, such securities bear a restrictive legend, trade in physical form (i.e., cannot be deposited with a clearing entity such as the Depository Trust Company for ease of trading), and usually require extensive paperwork in connection with any resales. Thus such securities are highly illiquid, and investors charge issuers a premium as a result.

In April of 1990, Rule 144A was adopted, introducing a new private placement of eligible securities[62] exclusively to qualified institutional buyers[63] ("QIBs"). As with Regulation D private placements, these securities bear a restrictive legend limiting resales in the United States to exempt transactions for a period of time absent registration pursuant to the '33 Act.[64] QIBs must also agree not to distribute these securities to the public. Unlike traditional private placements, however, there is no effort to restrict the right of a QIB to resell Rule 144A securities to other QIBs. Rule 144A provided for the creation of a specific market whereby QIBs may freely trade Rule 144A securities with other QIBs under the PORTAL

JENNINGS ET AL., *supra* note 4, at 347 for a synopsis of Release No. 6389.

60. 17 C.F.R. § 230.501(a) (1996).

61. *See* MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 99 (1989).

62. *See* Exchange Act Release No.34-27956 (Apr. 27, 1990).

63. *See* 17 C.F.R. § 230.144A(a)(i) (1996), for those entities qualified to be "qualified institutional buyers" for purposes of Rule 144A. The Rule contemplates, for the most part, a discretionary investment level of $100M and institutional status such as an insurance company, 17 C.F.R. § 230.144A(i)(A) (1996), or an investment company, 17 C.F.R. § 230.144A(i)(B) (1996). For a comprehensive list, *see* 15 U.S.C. § 230.144A(i) (1996).

64. 17 C.F.R. § 230.144(d) (1996). (Generally for a period of one year).

system.[65] Despite the lack of acceptance of PORTAL, an active secondary market has developed for many Rule 144A securities.

Before concluding our consideration of private placements, however, it is worth mentioning that such offerings are exempt only from the registration requirements of § 5 of the '33 Act. Thus SEC review and approval of a registration statement and compliance with the requirements of § 5 such as U.S. GAAP reconciled financial statements can be avoided, but the antifraud provisions of both the '33 Act and the '34 Act are applicable to private placements. Although a misstatement or omission may be less likely to be material to a sophisticated institutional investor than a retail investor, liability for any such material misstatements or omissions exists in respect of private placements as well as public distributions.

VI. REGULATION S AND GLOBAL OFFERINGS

In April of 1990, simultaneous with the adoption of Rule 144A, the Commission approved Regulation S under the '33 Act ("Reg S").[66] Reg S confirms that the application of the '33 Act is limited under most circumstances to the territory of the United States, allowing certain offers and sales of securities outside the United States free from the requirement of registration or endorsement of a restrictive legend on the securities. Securities sold under Reg S may therefore be resold into the United States without restriction, subject to a holding period which may apply in certain cases.[67] Thus, HDII may sell unregistered securities to foreign investors

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65. Although the Rule 144A adopting release provided for creation of an NASD sponsored trading market for Rule 144A securities called PORTAL (Private Offerings, Resales and Trading Through Automated Linkages), in Resale of Restricted Securities: Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145; Resale of Restricted Securities SEC Release 33,6806, 17 C.F.R. § 230 (Oct. 25, 1988) 1988 SEC Lexis 2104 the market has not availed itself of this opportunity, relying instead on the trade by trade verification of compliance with the Rule and settling trades through the facilities of the Depository Trust Company, which settles most publicly traded securities in the United States.

66. 17 C.F.R. § 230.901-904 (1996).

67. JENNINGS ET AL., *supra* note 4, at 519. Regulation S has additional holding requirements depending on the status of the issuer. If there is no "substantial U.S. market interest" for a Reg S issue, then there is no additional holding period. If there is "substantial U.S. market interest, then there are "restricted periods," "offering restrictions" and "notice" requirements. *Id.* Since Reg S is non-exclusive, there is also a forty-day holding period under § 4(3) of the '33 Act for transactions involving a dealer. 15 U.S.C. § 77c (1996); JENNINGS ET AL., *supra* note 4, at 481.

who intend to hold them offshore in accordance with Reg S[68], which securities may later be sold by such investors in the United States free from the registration requirements of the '33 Act. If the volume of such securities traded in the United States becomes too great, however, HDII may become subject to the on-going reporting requirements of the '34 Act.[69]

Regulation S may create additional opportunities for a foreign issuer like HDII to access the U.S. market. It is reasonable to assume that there is a local market in which equity (and perhaps other securities) of HDII may be publicly traded, albeit thinly. It may even be reasonable to assume that some of those securities have been purchased in the secondary market by U.S. investors. It may therefore be possible for HDII to access the American capital markets through establishment of an American Depository Receipt ("ADR") facility.[70] ADRs may be registered with the SEC or privately placed like any other security. In either case, there will be a natural arbitrage between the local market and the ADR market since ADRs can usually be freely created by depositing local shares in the facility, and the shares can similarly be withdrawn from the facility for sale in the local market. This enhances the liquidity of both securities.

It may be possible to offer a Rule 144A ADR to QIBs in the United States, a Regulation S global depository receipt facility ("GDR") to investors outside of the U.S. and HDII's local market, and ordinary shares to investors in HDII's home market. Although the Rule 144A ADR will have a restrictive legend showing that it has not been registered pursuant to the '33 Act, there will be arbitrage between each facility and the local shares as described above. In addition, there may be arbitrage possible

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68. A sale under Reg S must come to rest abroad. A purchaser buying for the account of a U.S. person or with an intention to deliver the securities into the United States may not satisfy the requirements of Reg S. *See* 17 C.F.R. § 230.901 (1996); EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKET at 50-3 (3d ed. 1996). There have been abuses by U.S.companies seeking to circumvent the stringent requirements of the '33 Act. The SEC has proposed regulations that require exempt securities under Reg S issued by U.S. issuers to have a holding period of one year, instead of 40 days. *See also* SEC Release No. 33,7392, 34,38315, International Securities Release No. 1056, (Feb. 20, 1997).

69. The '34 Act requires quarterly and/or annual filings. 17 C.F.R. § 240.15d-13(a) (1996); 17 C.F.R. § 240.15d-1 (1996).

70. *See* JENNINGS ET AL., *supra* note 4, at 1578. An ADR facility may be created by an issuer or third party. A custodian bank is appointed in the local market to hold local shares for the benefit of a depository in the United States. The U.S. depository then issues receipts (ADRs) for those shares for trading in the U.S. Shares are quoted, trades settled and dividends and other amounts are paid to holders in U.S. dollars. *Id.*

between the ADRs and the GDRs. If a holder of ADRs sells those securities to a non-U.S. person under Regulation S[71], the purchaser can typically exchange the restricted ADRs for a like amount of unrestricted GDRs. It is therefore possible for HDII to enjoy enhanced liquidity for its equity securities without subjecting itself to the registration requirements of the '33 Act by offering fungible securities to local investors (common stock), international investors outside the United States (GDRs) and the largest institutional investors in the United States (Rule 144A ADRs).

VII. CONCLUSION

As HDII looks to finance its future growth, it needs to look beyond the capital starved domestic capital markets. Existing shareholders, suppliers and customers may be able to provide some additional capital, but are unlikely to meet HDII's needs if significant growth or recapitalization is contemplated. Creative alternatives such as receivable securitization or sale and leaseback financings allow the Company to leverage its balance sheet, but are limited to the amount of suitable assets owned by HDII. Strategic investment by a minority financial investor or establishment of a joint venture with an offshore partner may offer needed funds and lower cost access to essential technology and training. However, if HDII is to succeed, it will eventually need to tap the foreign capital markets.

If HDII decides to offer securities in the United States, it will need to comply with one of the most comprehensive and, to some, cumbersome regulatory and disclosure regimes in the world. Offers and sales of securities to the investing public must be made pursuant to a registration statement which has been filed with and approved by the SEC.[72] This procedure can be time consuming and expensive, but worth the effort if substantial sums are required and the disclosure requirements of the '33 Act can be satisfied. Alternatively, HDII may choose to access a limited number of United States investors through a private placement, including the recently adopted Rule 144A private placement to qualified institutional buyers.[73] In either case, the U.S. securities laws permit HDII to offer and sell securities outside of the United States without subjecting the Company

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71. 17 C.F.R. § 230.904 (Rule 904) (1996), allows secondary market sales of securities outside of the United States, including securities originally sold in a U.S. private placement and bearing a restrictive legend. In fact, the language of the typical legend contemplates such sales.

72. *See supra* note 31.

73. *See supra* note 63.

to the registration requirements of the '33 Act if the offering is conducted in accordance with Regulation S.[74]

We live in a world in which boundaries between capital markets are rapidly disappearing. There is growing demand for capital in the emerging markets and the capital markets of the United States continue to be one of the principal sources for such capital. Although significant regualtory hurdles continue to confront an emerging market issuer seeking to access the United States market, these hurdles can be overcome. Perhaps as more deals get done, the remaining barriers to free flow of capital will fall and issuers like HDII will have more ready access to capital necessary to finance their development.

74. *See* discussion *supra* part V.