

**AMENDMENTS TO REGULATION S:
NEW RESTRICTIONS ON OFFSHORE EQUITY OFFERINGS
BY U.S. ISSUERS**

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The U.S. Securities and Exchange Commission (the "SEC") has adopted amendments to Regulation S which, in effect, significantly restrict the ability of U.S. issuers to offer and sell equity securities outside the United States in reliance upon the Regulation.¹ The new restrictions do not apply, however, to foreign issuers, contrary to the SEC's initial proposals which had contemplated imposing additional restrictions on foreign issuers with their principal market in the United States.²

The amendments to Regulation S address SEC concerns that some U.S. issuers, including U.S. issuers that file periodic reports under the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), have sought to evade the registration requirements of the U.S. Securities Act of 1933, as amended (the "Securities Act"), by offering equity securities outside the United States purportedly in reliance upon Regulation S and then having such securities "flow back" into the U.S. securities markets immediately upon expiration of the generally 40-day restricted period. Put another way, the SEC believes that some U.S. issuers and other distribution participants have used the Regulation S issuer safe harbor to effect unregistered distributions of equity securities into the United States.

The amendments to Regulation S impose stringent procedures for offshore offerings of equity securities by all U.S. issuers. The new procedures also apply to equity equivalents, including convertible securities, exchangeable securities, warrants and other equity-related securities. The amendments move all offshore offerings by U.S. issuers of equity securities to Category 3 of Rule 903 and incorporate the following new requirements:

- *Longer Distribution Compliance Period.* The Regulation S "distribution compliance period" (formerly called the "restricted period") applicable to all offshore offerings of equity securities by U.S. issuers is set at one year. Regulation S previously imposed a one year distribution compliance period for non-reporting U.S. issuers and non-reporting foreign issuers for which the principal market for such securities is in the United States. Equity securities of reporting U.S. issuers, however, could

1. Release No. 33-7505 (dated February 17, 1998).

2. Release No. 33-7392 (dated February 20, 1997).

formerly often be resold in the U.S. securities markets commencing 40 days after the initial sale. As a result of amendments, equity securities of all U.S. issuers offered and sold in reliance on Regulation S cannot be resold in the United States for a one-year period absent registration or an exemption (e.g., Rule 144A or Rule 144).

- *Certifications and Agreements.* Purchasers of equity securities (other than distributors) are required to certify that they are not U.S. persons and are not acquiring such securities for the account or benefit of U.S. persons or that they are U.S. persons who purchased such securities in a transaction not requiring registration under the Securities Act. In addition, purchasers and distributors of equity securities are required to agree to resell such securities only in accordance with registration or exemptive provisions under the Securities Act or Regulation S and also, as discussed below, not to engage in hedging transactions except in compliance with the Securities Act. The amendments are unclear as to whether the certification/agreement applies to all resales during the one-year distribution compliance period or only to the initial sales to purchasers by issuers and distributors, although we believe that the SEC intended the former.
- *Legended Certificates.* All equity securities sold in reliance upon Regulation S are required to bear a restrictive legend to the effect that transfer of such securities, as well as hedging transactions in respect of such securities, are prohibited other than in accordance with the Securities Act.
- *Stop Transfer Instructions.* The issuer of equity securities sold in reliance upon Regulation S are required, by contract or charter or by-laws, to refuse to register any transfer of such securities unless made in accordance with the registration or exemptive provisions of the Securities Act or in accordance with Regulation S.³

Prior to the amendments, only purchasers and distributors of equity securities of non-reporting U.S. issuers were required to provide comparable certifications and agreements (without any reference to hedging transactions), and only such non-reporting issuers were required to comply with similar restrictive legend and stop transfer instruction procedures. As a result of the movement of all offshore offerings by U.S. issuers of equity securities to Category 3 of Rule 903, these requirements become applicable to reporting U.S. issuers as well.

The amendments to Regulation S impose additional requirements with respect to equity securities sold by U.S. issuers in reliance upon Regulation S, including the following:

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3. Under the amendments, where the securities are in bearer form or foreign law prevents the issuer of the securities from refusing to register securities transfers, other reasonable procedures (such as the legend referred to above) must be implemented to prevent transfers other than in accordance with Regulation S.

- *“Restricted Security” Status.* The SEC has adopted new Rule 905 within Regulation S which classifies equity securities sold in reliance upon Regulation S as “restricted securities” within the meaning of Rule 144. By so doing, the SEC believes that it would provide “clear guidance” as to when and how covered equity securities may be resold in the United States without registration. The SEC also believes that, by treating such equity securities as restricted securities, it has “harmonized” the resale restrictions for all securities sold without registration (i.e., both private domestic sales and unregistered offshore sales).

Rule 905 further provides that restricted equity securities of any U.S. issuer will remain restricted securities even after they are sold in an offshore transaction. The restricted security status of any covered equity security thus would not “wash off” as a result of a resale outside the United States such that any subsequent resale of such securities in the United States would require registration or an exemption therefrom (e.g., Rule 144A or Rule 144).

- *Sales to Non-resident Employees Subject to Restrictions.* Previously, equity securities sold to non-U.S. resident employees pursuant to employee benefit plans governed by foreign law have not been subject to holding period requirements, regardless of the domicile of the issuer or the level of U.S. market interest in the issuer’s securities. However, with the adoption of new Rule 905, equity securities sold by U.S. issuers to employees in reliance upon Regulation S will constitute restricted securities within the meaning of Rule 144. Because such securities will now be subject to the one or two year holding period requirement of Rule 144, U.S. reporting issuers wishing to give their employees immediate access to the markets will likely register equity securities sold to non-U.S. resident employees on Form S-8 as they have customarily done with respect to equity securities sold to U.S. resident employees.
- *Hedging Activities.* The SEC has been concerned, for some time, that hedging activities (whether in the form of short sales, swaps or derivative securities transactions) by purchasers of Regulation S securities may undermine the “offshore” status of the transactions involved. Indeed, the SEC has warned that a transaction might not be treated as offshore if a substantial portion of the economic risk is left in or returned to the U.S. markets during the restricted period. See, e.g., Release No. 33-7190 (June 27, 1995). The amendments would address these concerns by, first, requiring the above-mentioned purchaser agreements and restrictive legends prohibiting hedging “except in accordance with the Securities Act” and, second, treating covered equity securities as “restricted securities” for purposes of Rule 144. By adding the latter requirement, the SEC would impose the holding period requirement of Rule 144, which would, in effect, prohibit certain hedging activities during the one or two year holding period and instead force purchasers to maintain, if at all possible, hedges that extend beyond such longer restricted periods.

- *Prohibit Payments with Promissory Notes.* As proposed, the amendments would have prohibited the use of promissory notes or other executory obligations as payment for equity securities of U.S. issuers sold in reliance upon Regulation S. Recognizing the draconian nature of this prohibition and consistent with the SEC's efforts to harmonize the treatment of all restricted securities, the SEC has instead determined that the Rule 144 holding period will not commence unless and until the promissory note or other contract provides for full recourse against the purchaser of the equity securities and is secured by collateral (other than the securities purchased) having a fair market value at least equal to the purchase price for the securities. The SEC believes that this approach should forestall financing arrangements under which purchasers have financed purchases of Regulation S securities using promissory notes, have the resold such securities in the U.S. markets after the restricted period and have used the proceeds to repay such notes, arrangements which the SEC has viewed as being as the economic equivalent of raising funds in the U.S. public markets.

In conjunction with the amendments to Regulation S, the SEC has eliminated, for sales occurring after January 1, 1999, the recently implemented Form 8-K 15-day reporting requirement for sales by U.S. issuers of equity securities pursuant to Regulation S. U.S. issuers will be required to report Regulation S sales of equity securities only on a quarterly basis on Form 10-Q as currently required for other unregistered sales of such securities. The SEC believes that the longer restricted period applicable to sales of equity securities of U.S. issuers in reliance upon Regulation S obviates the need for more prompt reporting of such Regulation S sales.

The primary effect of the amendments to Regulation S should be to discourage use of Regulation S for offerings of equity securities by all U.S. issuers and instead compel such issuers to register under the Securities Act substantially all of such offerings (including the offshore tranches of multi-jurisdictional offerings). However, by excluding all foreign issuers from the scope of the amendments, the SEC has relented from imposing what could have been significant burdens upon a class of foreign issuers, burdens which would have otherwise been applicable to their ordinary course capital raising activities outside of the United States.⁴ Because the focus of the amendments on offerings of equity securities by U.S. issuers, the revisions to Regulation S should not affect the substantial majority of transactions structured, in whole or in part, in reliance on Regulation S—in particular, debt offerings by U.S. issuers and foreign issuers and most equity offerings by foreign issuers.

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4. A principal justification for the SEC's final determination to exclude foreign issuers from the scope of the new restrictions was their view that it was not evident that foreign issuers had been abusing Regulation S. The SEC has indicated, however, that it remains concerned regarding the potential for abuse and will monitor practices in this area and will revisit the issue as abuses occur.

Any questions relating to the proposed amendments to Regulation S or this memorandum should be addressed to John D. Lobrano (212-455-2890) jlobrano@stblaw.com or Glenn M. Reiter (212-455-3358) or to any of the following partners: D. Rhett Brandon (212-455-3615), Paul B. Ford, Jr. (212-455-2870) or Alan M. Klein (212-455-3188) of our New York office; Walter A. Looney, Jr., William R. Dougherty or Gregory W. Conway in our London office (011 44171-422-4000); Andrew R. Keller of our Hong Kong office (011-852-2514-7600); or David A. Sneider of our Tokyo office (011-81-3-5562-8601).

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