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Cross-Border M&A Guide

2021

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I.

Introduction

Cross-border merger and acquisition transactions are a significant part of the global M&A landscape, representing more than a third of all deal activity annually. Cross-border transactions reached $1.3 trillion in 2020, an increase in cross-border activity from 2019, which saw $1.2 trillion in transaction value. Consistent with the M&A market for 2020 generally, transaction volumes for the year were a tale of two halves. Both global M&A volumes and cross-border M&A volumes were down dramatically in the first half of 2020, reflecting the impact of the onset of the Covid-19 pandemic and the resulting market turmoil (first half global deal volumes declined 40% to just over $1.2 trillion in the first half of 2020, with a similar decrease in cross-border transactions). The second half of 2020, on the other hand, witnessed a remarkable return in M&A activity, with 34% more global M&A volume in the second half of 2020 than in the second half of 2019. The market for cross-border transactions followed this broader trend.

The first quarter of 2021 maintained the remarkable intensity of transaction volume seen in the second half of 2020, with over $1.4 trillion of M&A announced globally. Cross-border deals kept pace, with nearly $500 billion of cross-border transactions announced in the first quarter of 2021 (as compared to $210 billion in the first quarter of 2020). At the time of this writing, there are signs, both in the United States and internationally, that an emergence from the global Covid-19 pandemic is on the horizon, with vaccinations now widely available in many countries and companies around the world announcing plans to return employees to the office. We have every reason to believe that 2021 will be a record-breaking year for global M&A, including in the cross-border market, and are optimistic for an end to the pandemic.

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Cross-border M&A transactions can be among the most complex and challenging to execute, but can also provide substantial benefits to companies seeking to enhance their competitive position in the global marketplace. The purpose of this Guide is to discuss certain U.S. legal considerations relating to cross-border M&A transactions. In particular, the Guide focuses on two common types of transactions:

- acquisitions of U.S. companies by non-U.S. companies (or "inbound" M&A); and

- acquisitions of non-U.S. companies.

Note in this regard that the second type of transaction above is not limited to acquisitions of non-U.S. target companies with securities listed in the United States, nor is it limited to "outbound" cross-border transactions in which the acquiror is a U.S. company.

Even a transaction in which both parties are neither incorporated nor listed in the United States can implicate the U.S. federal securities laws. This illustrates a point that will become more evident throughout the Guide: The U.S. federal securities laws have expansive reach, more so than may be expected by transaction participants more accustomed to regulatory schemes outside of the United States, which often apply only to companies that are organized or listed in the relevant jurisdiction.

While the U.S. federal securities laws can have significant extraterritorial application, the U.S. Securities and Exchange Commission (the "SEC") has adopted rules that provide exemptions from certain U.S. federal securities law obligations. A core component of this system-wide relief for certain companies (or transactions involving them) is the concept of the "foreign private issuer," or FPI: a foreign company that can potentially qualify for these exemptions.

In addition to the U.S. federal securities laws and the related U.S. securities exchange listing rules, this Guide also discusses the U.S. antitrust regime under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), administered by the Federal Trade Commission and the Antitrust Division of the Department of Justice ("DOJ"), and the national security regime administered by the Committee on Foreign Investment in the United States ("CFIUS"). The Guide also touches on state corporate law matters in discussing inbound transactions, given that every U.S. company is incorporated under the laws of a particular state (frequently, Delaware). For a broader discussion of the legal, practical and tactical considerations for M&A involving U.S. target companies, please see the separate publication by our Firm, Takeover Law and Practice.

Section II summarizes the general framework for U.S. laws applicable to cross-border transactions (including federal securities laws, state laws, listing requirements and antitrust and national security considerations), as well as the considerations in the two types of cross-border M&A transactions mentioned above. It covers both those aspects that are applicable to the transaction itself and the post-transaction obligations that potentially can be imposed on foreign acquirors that issue securities as consideration in the transaction, and introduces the FPI concept, which is core to understanding the treatment of foreign companies under the U.S. federal securities laws. The remaining sections of the Guide address these topics in additional detail. Section III discusses inbound M&A transactions, with a focus on U.S. regulation of tender offers and other business combinations, the proxy rules, and the offering of securities in an M&A transaction. Section IV discusses the U.S. securities law aspects of acquisitions of non-U.S. companies. Section V discusses U.S. antitrust and national security laws and regulations. Section VI discusses certain practical and tactical considerations in negotiation, due diligence and integration in a cross-border context. Section VII discusses the key ongoing obligations that can be imposed on a non-U.S. company that lists or registers securities issued as consideration in a cross-border transaction. Finally, Section VIII discusses the principal sources of liability for non-U.S. companies under U.S. laws, as well as how these obligations are enforced in practice.

This edition of the Guide reflects developments through May 2021.

II.

Overview of U.S. Legal Considerations in Cross-Border Transactions

This Section II provides a general overview of U.S. legal considerations for cross-border transactions. These topics are discussed in greater detail in the subsequent sections of this Guide.

A. General Framework

1. The U.S. Federal Securities Acts and the SEC

The two principal U.S. federal securities law regimes are those under the U.S. Securities Act of 1933, as amended ("Securities Act"), and the U.S. Securities Exchange of 1934, as amended (the "Exchange Act"). The Securities Act and the Exchange Act, as well as other statutes, empower the SEC to make and enforce securities regulations that implement specific provisions of the statutes. The SEC has developed a complex body of rules and regulations under the U.S. federal securities laws that are designed to ensure full and fair disclosure to the market and the provision of sufficient information to investors to allow them to make informed investment decisions.

U.S. Securities Act of 1933

The Securities Act regulates offerings and sales of securities and establishes a disclosure system and rules of conduct for securities offerings. The regulations concerning offerings rest on a default rule that any issuer that wishes to offer or sell a security must either register the offer or sale with the SEC or find an exemption from such registration. The registration requirement applies to specific transactions in securities (not a whole class of securities), meaning additional registrations are required for future equity offerings and sales (although SEC rules do allow for a "shelf registration" that eases the process in certain circumstances).

U.S. Securities Exchange Act of 1934

The Exchange Act regulates the securities markets, including securities trading, business combinations and tender offers, and establishes ongoing reporting and other obligations on issuers with securities that are traded on a U.S. securities exchange or that are otherwise sufficiently widely held in the United States, as well as on their directors, officers and significant shareholders. Some of the regulatory regimes discussed below, including tender offer regulation, proxy regulation and beneficial ownership reporting, arise under the Exchange Act.

Antifraud Rules

The securities laws include several key antifraud rules that generally prohibit materially false or misleading statements. Most significantly, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder apply in connection with the purchase of any equity, debt or other security, regardless of whether it is registered under the Exchange Act

or is the subject of an offering registered under the Securities Act and whether the purchase occurs by direct acquisition, tender offer or otherwise. As discussed in more detail below, the principal limit on the applicability of Section 10(b) and Rule 10b-5 in connection with cross-border transactions is the extent to which they can be applied to transactions with an extraterritorial component.

In addition, the Securities Act includes antifraud provisions that apply in connection with registered offerings of securities, and, as noted below, certain antifraud rules specifically apply in connection with tender offers.

2. State Laws

In addition to the U.S. federal securities laws, parties to a transaction involving a U.S. target company must also consider the law of its state of incorporation. State corporate law statutes and judicial doctrines cover a variety of significant matters relevant to the acquisition of a U.S. company, such as the corporate form of the company, the basic rights of shareholders, the mechanics of acquiring the company and the fiduciary duties of its directors.

3. Listing Rules

The parties to a cross-border transaction involving a non-U.S. acquiror may agree that the securities issued in the transaction will be listed on a U.S. securities exchange. A non-U.S. company that meets the listing criteria imposed by a U.S. exchange may either list such securities directly or issue and list American Depositary Receipts ("ADRs"), which represent interests in the issuer's underlying securities. ADRs can facilitate trading in the non-U.S. company's securities by U.S. investors.

The listing criteria for the NYSE and Nasdaq, which are found in the NYSE Listed Company Manual and the Nasdaq Stock Market Rules, respectively, comprise a set of (i) quantitative standards concerning an issuer's financial situation and the market for the issuer's securities and (ii) qualitative standards, mostly regarding corporate governance.

4. Antitrust and National Security Considerations

Any cross-border transaction involving a U.S. company (or a non-U.S. company with a U.S. business) could be subject to U.S. laws on antitrust and national security. These laws could require additional filings and coordination between the transaction parties themselves and the U.S. government and could lead to delays in the consummation of a transaction.

The HSR Act requires parties to transactions above a certain dollar value threshold to file notifications with the FTC and the DOJ for certain transactions. These notifications trigger a subsequent waiting period, which could then be extended if the applicable government agency reviewing the transaction identifies competition concerns and requests additional information.

CFIUS is a federal interagency committee that reviews certain foreign investments in U.S. businesses for national security risks. CFIUS may conduct national security reviews of "covered transactions," defined as proposed or completed mergers, acquisitions or takeovers that could result in "control" of an existing U.S. business by a non-U.S. person. As has occurred with respect to comparable regulatory entities in other countries, the reach of CFIUS was recently extended. As a result of these reforms, CFIUS's jurisdiction now also covers non-passive, non-controlling foreign investments in "critical technology," "critical infrastructure" and certain sensitive personal data.

B. Acquisition of a U.S. Company

In the acquisition of a U.S. company, the particular U.S. laws and rules that will apply to the transaction will largely depend on three key factors: (1) whether the target company is a public company or a private company; (2) whether the acquisition will be effected by a merger or tender offer; and (3) whether the consideration to be provided in the acquisition will consist solely of cash or whether it will also include securities.

1. Public vs. Private Companies

An important distinction for understanding the methods of acquiring a U.S. company and related legal considerations is whether the U.S. company's common stock is registered under Section 12 of the Exchange Act. Several key aspects of the U.S. federal securities regulatory regime – including the proxy rules and the extent of applicable tender offer regulation – depend on whether the securities that are sought be acquired are registered under Section 12 of the Exchange Act.

A company is required to register its common stock under Section 12(b) of the Exchange Act if such common stock is listed on a U.S. securities exchange, such as the New York Stock Exchange (the "NYSE") or Nasdaq. A company generally also is required to register its common stock under Section 12(g) of the Exchange Act if: (a) the company has more than $10 million of total assets; and (2) such common stock is held of record by either 2,000 persons or 500 persons that are not accredited investors. This Guide generally refers to companies that have securities registered under Section 12 of the Exchange Act as "public" companies.

2. Merger vs. Tender Offer

As discussed in more detail below, different types of transactions may implicate different requirements under U.S. federal securities laws.

There are two principal methods for acquiring a public U.S. company: a merger, which requires a vote of the target's shareholders, and a two-step transaction in which a tender offer is followed by a merger to acquire all shares not purchased in the tender offer. A merger typically requires the approval of the shareholders of the target company, and the solicitation of such approval for a U.S. public company is regulated by the U.S. proxy rules contained in Section 14(a) of the Exchange Act and Regulation 14A thereunder.

A separate set of rules under the U.S. federal securities law applies to transactions involving a tender offer. The Williams Act, which is codified in Sections 14(d) and 14(e) of the Exchange Act, and the rules promulgated thereunder regulate the conduct of tender offers and require offerors to disclose material information concerning their offers and to provide procedural protections to allow subject company shareholders sufficient opportunity to consider the offer and to participate on a level playing field with other shareholders.

Section 14(d) of the Exchange Act and Regulation 14D apply to any tender offer for equity securities registered under Section 12 of the Exchange Act, the acquisition of which would result in beneficial ownership of more than 5% of such class of equity securities.[1] Regulation 14D primarily governs pre-commencement communications, tender offer documents, dissemination of tender offers to shareholders, equal treatment of shareholders, withdrawal rights, target board recommendations and communications to target shareholders and offer extensions.

Regulation 14E applies to any tender offer, without regard to whether the subject securities are registered under Section 12 of the Exchange Act, whether equity securities are the subject of the tender offer or the percentage of securities sought. Section 14(e) of the Exchange Act is a general antifraud provision that makes it unlawful for any person to make "any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation." Regulation 14E provides specific procedural obligations, notice requirements and restrictions on behavior with the objective of preventing such fraudulent practices prohibited by the Exchange Act. These rules impose requirements concerning minimum offer periods, prompt payments, notice of extensions, withdrawal rights, target responses to offers, purchases or sales using material information with respect to the offer, proration risk and purchases outside the offer.

3. Cash vs. Securities

The form of consideration to be paid to the target company's shareholders will also affect the set of U.S. rules that apply to the transaction. Acquisition of the target company's securities solely for cash will generally subject the acquiror to fewer obligations under the U.S. federal securities laws. If the acquiror intends to issue securities to the target company's shareholders for the acquisition, such issuance will potentially trigger obligations under the Securities Act, which governs offers and sales of securities.

The registration requirements under the Securities Act can be burdensome, particularly for new issuers. Unlike the securities law regimes of some jurisdictions, which register a class of securities as a whole, registration under the Securities Act generally applies to specific transactions in securities. Accordingly, subsequent transactions may require additional registrations, even if involving the same class of securities that was the subject of a prior Securities Act registration.

To register a transaction under the Securities Act, issuers must file a registration statement (of which there are several types, depending on the type of transaction and securities) with the SEC that discloses significant information about the issuer, including about the business, securities offered for sale, management team, financial condition and, in some cases, financial statements certified by public accountants. The SEC has the right to, and often does, review a registration statement and provides comments to the issuer, to which the issuer must respond to in writing and, in most cases, amend its registration statement with another filing to make changes identified by the SEC. Although there is no standard timetable for these reviews, they are likely to take at least two and up to four or more months.

C. Acquisition of a Non-U.S. Company

In the acquisition of a non-U.S. company, the particular U.S. laws and rules that will apply to the transaction will largely depend on three key factors: (1) whether the non-U.S. company qualifies as a "foreign private issuer" (or "FPI"); (2) whether the acquisition will be effected by a tender offer for the securities of the non-U.S. company (and, if so, whether the securities are registered under Section 12 of the Exchange Act, as well as the level of U.S. shareholder ownership of the securities); and (3) whether the consideration to be provided in the acquisition will consist solely of cash or if it will also include securities.

1. Foreign Private Issuers

The concept of the FPI is central to understanding the specific application of the U.S. federal securities laws to cross-border transactions and the companies that engage in them: first, an acquiror of an FPI may be able to take advantage of certain exemptions from the tender offer rules and the Securities Act registration requirements; and second, a non-U.S. acquiror of an FPI that would otherwise become subject to ongoing obligations under the U.S. federal securities laws and stock exchange listing rules as a result of the registration or listing of securities in connection with a cross-border transaction may benefit from exemptions available to FPIs from certain of those obligations.

To qualify as an FPI, an entity must be a "foreign issuer," meaning "any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country,"[2] other than a foreign government, for which either (a) more than 50% of its outstanding voting securities are directly or indirectly held of record by residents outside of the United States or (b) *all* of the following are true:

- the majority of the executive officers and directors of the foreign issuer are not U.S. citizens or residents;
- more than 50% of the assets of the foreign issuer are located outside of the United States; and
- the business of the foreign issuer is administered principally outside of the United States.[3]

Under this rule, a foreign issuer need only satisfy one of the two prongs. Thus, even if more than 50% of a foreign issuer's outstanding voting securities are held by U.S. residents, the foreign issuer would remain an FPI so long as it continued to satisfy each of the citizenship, asset and principal place of administration tests under prong (b).

To determine the percentage of a foreign issuer's outstanding voting shares held "of record" by residents outside the United States under prong (a), a foreign issuer must look through custodians and clearing houses to identify the accounts of customer residents held by brokers, dealers, bank or other nominees located in the United States, in the company's jurisdiction of incorporation, and in the jurisdiction that is the primary trading market for the company's voting securities, if different from its jurisdiction of incorporation.[4] Foreign issuers may rely in good faith on information as to the number of separate accounts supplied by all owners of the class of its securities that are supplied by brokers, dealers, banks or nominees of any of the foregoing. If after conducting a reasonable inquiry, a foreign issuer cannot obtain information on the shares represented by the separate accounts of customers resident in the United States, it may assume that the customers reside in the jurisdiction in which the nominee has its principal place of business.[5]

Under prong (b), a foreign issuer must calculate the citizenship and residency status of its executive officers and directors separately to satisfy the citizenship test. To identify the location of its assets pursuant to the asset test, a foreign issuer must either use geographical segment information used in the preparation of the issuer's financial statements or apply any other reasonable methodology. Lastly, the principal place of administration test requires a foreign issuer to "assess on a consolidated basis the location from which its officers . . . or managers primarily direct, control and coordinate" its activities. Certain SEC "no-action letters," through which SEC staff respond to requests for guidance on specific facts and circumstances, clarify how an issuer can measure the location of such administration, including obvious factors, like the location of the shareholders' meeting, the time executives spend in the U.S., the location of board meetings and the location of business division headquarters and less obvious factors, such as the percentage of revenues drawn from business activities outside the United States.

A foreign issuer registering with the SEC for the first time must evaluate its status as an FPI within 30 days prior to such new registrant's filing of its initial registration statement under either the Securities Act or Exchange Act. After being qualified as an FPI, the foreign issuer need only reassess its status, under the foregoing criteria, once per year as of the last business day of its second fiscal quarter. Upon qualification, an FPI is immediately able to use the forms and rules designated for FPIs, and may continue to do so until the first day of the fiscal year following the date on which a foreign issuer determines it fails to qualify as an FPI. In other words, even if a foreign issuer that was an FPI fails to requalify, it may still use the forms and rules for FPIs until the first day of the next fiscal year. Additionally, when a foreign issuer fails to qualify, it remains unqualified unless and until it again meets the requirements for FPI status as of the last business day of its second fiscal quarter.

2. Tender Offer for Securities of a Non-U.S. Company

If the acquisition of a non-U.S. company involves a tender offer, then the tender offer rules under the Williams Act will apply to the transaction. The precise set of tender offer rules that will apply depends on: (1) whether the non-U.S. company's common shares (or equivalent equity securities, such as ordinary shares) are registered under Section 12 of the Exchange Act; (2) whether the non-U.S. company is an FPI; and (3) the level of U.S. shareholder ownership of the securities.

If the non-U.S. company's common shares are registered under Section 12 of the Exchange Act, then Section 14(d) of the Exchange Act and Regulation 14D, discussed above in Section II.B.2, will generally apply to any tender offer for those securities, if the acquisition would result in beneficial ownership of more than 5% of such class of equity securities. Section 14(e) and Regulation 14E will apply to a tender offer for a non-U.S. company's securities regardless of whether its common shares are registered under Section 12 of the Exchange Act.

The SEC has adopted exemptions (referred to herein as the "Cross-Border Rules") to the tender offer rules applicable to tender offers for the securities of an FPI, depending on the level of the FPI's U.S. ownership:[6]

- *Tier I*. If, among other conditions, U.S. holders hold 10% or less of a subject FPI's securities, the "Tier I" exemptions apply, exempting the offeror from all of Section 14(d) and Regulation 14D and certain of the provisions of Regulation 14E.

- *Tier II*. If, among other conditions, U.S. holders hold more than 10% but not more than 40% of a subject target's securities, "Tier II" applies, providing targeted relief from Regulations 14D and 14E so as to limit the conflict between U.S. and non-U.S. tender offer rules.

If the acquisition of the non-U.S. company is to be accomplished other than through a tender offer, then the tender offer rules will not apply. In addition, FPIs are exempt from the proxy rules, and accordingly a vote by an FPI's shareholders to approve the transaction would not be subject to Section 14(a) of the Exchange Act or Regulation 14A thereunder.

3. Consideration Includes Securities

As with an acquisition of a U.S. public company as discussed above in Section II.B.3, the form of consideration to be paid to the target company's shareholders will also affect the set of U.S. rules that apply to the transaction. Acquisition of the target company's securities solely for cash will generally subject the acquiror to fewer obligations under the U.S. federal securities laws. If, however, the acquiror intends to issue securities to the target company's shareholders for the acquisition, such issuance will potentially trigger obligations under the Securities Act, unless an exemption is available for the registration.

In an acquisition of a non-U.S. company, the most commonly used exemptions from registration under the Securities Act are:

- Rule 802 under the Securities Act, which provides an exemption from registration similar to the Tier I exemptions from the tender offer rules, insofar as it applies when the target is an FPI and U.S. holders hold 10% or less of the subject FPI's securities; and

- Section 3(a)(10) under the Securities Act, which provides an exemption from registration to issuers for offers and sales of securities in exchange transaction schemes where certain conditions are met, including, among others, that only securities are exchanged and there is a governmental approval of the fairness of the exchange's terms. The Section 3(a)(10) exemption can sometimes be used in an acquisition of a non-U.S. company via a scheme of arrangement or similar court-approved transaction.

Depending on the circumstances, other exemptions or other means of avoiding registration, such as vendor placements or cashing out U.S. shareholders of the target, may be available.

4. Post-Transaction Securities Law Obligations

As noted above, the federal securities laws do not merely regulate transactions. They also can impose ongoing obligations on an FPI.

Incurring Ongoing Obligations

Generally speaking, an FPI can become subject to ongoing securities law obligations as a result of a cross-border transaction if it issues securities as consideration in the transaction and either (a) the securities are listed on a U.S. securities exchange (as may be the case if the acquiror issues listed ADRs to U.S. holders of the target's shares), triggering a registration obligation under Section 12(b) of the Exchange Act, or (b) the issuance is registered under the Securities Act (as may be the case if an exemption from registration is not available), triggering an obligation to file reports pursuant to Section 15(d) of the Exchange Act.

Moreover, if the FPI acquiror issues equity securities that are not listed on a U.S. securities exchange in a transaction that is not registered under the Securities Act, the acquiror may, as a technical matter, have to register the securities under Section 12(g) of the Exchange Act if the securities are held by a sufficient number of U.S. holders. However, under Exchange Act Rule 12g3-2(b), the equity securities would be exempt from registration under Section 12(g) so long as the primary market for the FPI's securities is on non-U.S. securities exchanges and the FPI makes certain information available in English in its primary trading market.

The Scope of Ongoing Obligations

An FPI that incurs obligations under Section 12—as well as its shareholders (including non-U.S. shareholders)—incurs a variety of obligations under the Exchange Act. The Exchange Act requires periodic disclosure of the company's operations quarterly and annually and disclosures of material events shortly after they occur. Financial

information, included audited financial statements, must also be periodically disclosed and accompanied by certifications from independent auditors and the company's management. U.S. federal securities laws and, if applicable, the listing rules of the national exchanges on which the FPI's securities are listed also mandate certain governance requirements, such as those involving the composition of board committees and compensation disclosure requirements for directors and officers. Section VII summarizes these requirements in detail.

The shareholder disclosure provisions of Sections 13(d) and 13(g) of the Exchange Act are intended to give notice of significant acquisitions and potential changes of control to securities markets and other holders of the issuer's securities. The reporting obligations turn on the percentage of the shareholder's beneficial ownership of the issuer's equity securities and are the shareholder's responsibility.

III.

Acquisition of a U.S. Company

This Section III describes in greater detail the principal legal considerations under the U.S. federal securities laws for accomplishing an acquisition of a U.S. company by a non-U.S. company.

A. Acquisition of a Private U.S. Company

Generally speaking, the acquisition of a private U.S. company – or more technically, as discussed above, a company that does not have a class of securities registered under Section 12(b) or 12(g) of the Exchange Act – is more straightforward from a U.S. securities law perspective than the acquisition of a public U.S. company. If the acquired company has only one or a handful of shareholders, it often can be accomplished by a direct purchase of the equity interests of the company, which implicates few federal securities law requirements other than the basic antifraud provisions of Exchange Act Section 10(b) and Rule 10b-5.

In some cases, the acquisition of a private company is effected by a merger, which is discussed in more detail below, rather than a direct purchase of equity interests. For example, the company may have a somewhat more dispersed shareholder base, but still is not "public" in the sense described above – such as a startup company that has grown through multiple investment rounds but has not yet had its initial public offering, or a private equity portfolio company in which management holds equity. Or, a merger may be preferable for tax or other reasons. In the case of an acquisition via merger, the target company's shareholders must approve the merger by a vote or written consent, either at a majority or supermajority level, depending on the relevant state law and the company's organizational documents. Because the company is private, the detailed process and disclosure requirements of the federal proxy rules would not apply. Instead, the process for obtaining shareholder approval of the merger would be governed by state law, which typically would involve only the minimal process requirements set forth in the state corporate law statute of the company's jurisdiction of incorporation and its governing documents, and any disclosure obligations would be limited to basic antifraud and fiduciary duty principles.

In rare cases, an acquisition of a private company with numerous shareholders may involve a tender offer. As discussed in more detail below, such a tender offer would have to comply with the requirements of Regulation 14E, but not the more detailed requirements of Regulation 14D.

If securities are being issued as consideration in connection with the transaction, it will be necessary to consider whether the offering needs to be registered under the Securities Act or if an exemption would be available for the offering. Notably, the fact that an acquiror is a foreign entity does not itself exempt the offering from registration, although, as discussed below, it would allow the acquiror to use a different set of Securities Act forms for registration if required.

B. Acquisition of a Public U.S. Company

Generally speaking, the acquisition of a public U.S. company – or more technically, a company that has a class of securities registered under Section 12(b) or 12(g) of the Exchange Act – implicates additional U.S. securities law obligations as compared to an acquisition of a private U.S. company. The particular set of obligations will depend on the manner of acquisition – specifically, merger versus tender offer – and whether the target shareholders will receive securities as part of the consideration.

1. Mergers

In the United States, public companies often are acquired via merger. A merger is a business combination transaction conducted pursuant to the corporate law statute of the state in which the target company is organized. A typical form of merger involves the target company merging with another entity (typically, but not always, a newly formed subsidiary of the buyer). As a result of the merger, the securities of the target company are converted into the consideration specified in the merger agreement. The merger will require approval of the target company's shareholders, usually by the holders of a majority of the outstanding shares, although some states require a higher threshold, and some companies provide for higher thresholds in their organizational documents. In certain cases, a vote may not be required; for example, Delaware permits a "short-form" merger without a vote if the acquiror owns at least 90% of the target company's shares.

In addition, some acquisitions are effected in a two-step process, in which the acquiror first completes a tender offer for the target's shares and then, assuming a sufficient percentage of the shares is acquired, then acquires the shares not tendered through a so-called "back-end" merger. In Delaware, such a back-end merger does not require a vote if the buyer acquires in the first-step tender offer, such percentage of the target company's shares that would be sufficient to approve a merger via shareholder vote.

From a U.S. securities law perspective, a merger is not treated as a tender offer and therefore is not subject to the tender offer rules discussed below (although in a two-step transaction, the first-step tender offer would be subject to those rules). The solicitation of the shareholder vote to approve a public company merger, however, must comply with the federal proxy rules. This involves the preparation and filing of a proxy statement that must comply with a series of specific disclosure requirements set forth in Schedule 14A under the Exchange Act. The SEC potentially may review a proxy statement, although it often does not—in recent years, the SEC has been declining to review all-cash merger proxy statements with increasing frequency. If the SEC chooses to review an all-cash merger proxy, the review process often can be completed more quickly than a review of a Securities Act registration statement, which is discussed in Section III.C.1.

Once SEC review of the proxy statement is complete (or if the SEC declines to review the proxy statement), the target company will mail the proxy statement to its shareholders in advance of a shareholder meeting at which the merger agreement will be presented for a vote. The proxy rules require that the proxy statement be mailed at least 20 business days before the shareholder meeting, subject to certain exceptions. In some cases,

the target's proxy solicitor may desire to have more than 20 business days in order to have adequate time to solicit votes in favor of the merger.

2. Tender Offers

If the acquisition is structured as a tender offer, and the target company's common shares (or equivalent equity security, such as ordinary shares) are registered under Section 12 of the Exchange Act, then Sections 14(d) of the Exchange Act and Regulation 14D will apply to the tender offer. In addition, Section 14(e) and Regulation 14E apply to all tender offers, whether or not they are made for equity securities registered under Section 12 of the Exchange Act.

The Williams Act and the rules promulgated thereunder require the offeror in a tender offer to disclose material information with respect to the offer and give shareholders procedural protections in deciding whether to tender their securities. The tender offer rules apply to third-party tender offers, as well as to tenders by a company or its affiliates for the company's equity securities, although this Guide will focus on third-party tender offers.[7]

The term "tender offer" is not defined in U.S. statutes and regulations. The term is typically defined by a multifactor test adopted by a decision of the Southern District of New York: (i) there is active and widespread solicitation of shareholders; (ii) a solicitation was made for a substantial percentage of the issuer's securities; (iii) an offer to purchase was made at a premium; (iv) the terms of the offer are firm rather than negotiable; (v) the offer is contingent on the tender of a fixed number of securities; (vi) the offer is open only for a limited period of time; (vii) the offerees are subjected to pressure to sell; and (viii) whether the public announcements of a purchasing program concerning the target precede or accompany rapid accumulation of large amounts of the target's securities.[8] Not all of these factors need to be present in order for a tender offer to be found. While in some circumstances there may be a question of whether a tender offer may be involved, a publicly made offer to shareholders of a public company to purchase any and all shares of the outstanding common stock of the company clearly is a tender offer. By contrast, a merger is not a tender offer.

a. Section 14(e) and Regulation 14E

Section 14(e) of the Exchange Act and Regulation 14E apply to any tender offer for any securities and, significantly, are not limited to equity securities or securities that are registered under Section 12 of the Exchange Act. Section 14(e) of the Exchange Act is a general antifraud provision applicable to tender offers. Regulation 14E provides specific procedural obligations, notice requirements and restrictions on behavior with the objective of preventing such fraudulent practices prohibited by the Exchange Act. The most significant requirements under Regulation 14E include:

- *Minimum Offer Period*. The tender offer must remain open for at least 20 U.S. business days from the date when such tender offer is first published or sent to shareholders.[9]

- *Prompt Payment*. Consideration must be paid or the target's securities must be returned to shareholders promptly (generally, within two to three business days) after termination of the offer or the withdrawal of tendered securities.[10]

- *Notice of Extensions*. The tender offer must remain open at least 10 U.S. business days after any announcement of material changes in the information published, sent or given to shareholders that could affect their investment decisions.[11] In addition, the SEC has stated, in an interpretive release, that a tender offer should remain open for at least 10 business days in response to a material change relating to the "price and share levels" and for at least five business days in respect of any other material change.[12]

- *Target's Response to the Offer*. Within 10 business days of the commencement of its offer, the target must publish or otherwise deliver to its shareholders a statement recommending acceptance or rejection of the offer (or expressing neutrality or inability to take a position with respect to the offer). If there is any material change in the target's recommendation after this publication, the target must promptly provide an update to its shareholders.[13]

- *Purchases or Sales Using Material Information with Respect to the Tender Offer*. Regulation 14E classifies the purchase or sale of the subject securities (or any securities convertible into the subject securities) as a fraudulent, deceptive or manipulative act or practice under the Exchange Act if such transaction is undertaken by a person with material information relating to the tender offer that was obtained from the offeror, the target or an insider of either.[14] Similarly, insiders are prohibited from disclosing such material information with respect to the tender, except when doing so in good faith.[15]

- *Proration Risk*. Shareholders are prohibited from hedging against the risk that not all the securities that the shareholders tenders in the tender offer will be accepted by the offeror by tendering more securities than such shareholders actually owns. Shareholders are also prohibited from selling tendered securities before the proration deadline to another party that could then tender such sold securities.[16]

- *Purchases Outside the Tender Offer*. In the case of tender offers for equity securities, after the commencement of its offer, the offeror, its agents and any parties acting in concert may not purchase any target securities shares except pursuant to the offer, subject to expressly identified exceptions.[17]

Regulation 14E does not require any filings to be made with the SEC, nor does it include specific requirements as to the content of the offer documents or other communications disseminated by the offeror or the target to the shareholders (although such communications would be subject to the general antifraud rules of the Exchange Act).

b. Section 14(d) and Regulation 14D

Section 14(d) of the Exchange Act and Regulation 14D apply to all tender offers for equity securities registered under Section 12 of the Exchange Act, the acquisition of which would result in beneficial ownership of more than 5% of such class of equity securities. If the target's equity securities are not registered under Section 12 of the Exchange Act, Regulation 14D does not apply. Furthermore, even if Regulation 14D is applicable, the Cross-Border Rules provide for exemptions, discussed below, that can separately provide relief from certain requirements of Regulation 14D.

The most significant requirements under Section 14(d) of the Exchange Act and Regulation 14D include:

- *Pre-Commencement Communications*. The bidder is required to file all communications prior to the commencement of a formal tender offer (which is 12:01 am on the date when the offeror has first published, sent or given the means to tender to security holders) with the SEC.[18]

- *Tender Offer Documents*. The offeror is required to file specified tender offer documents in a prescribed form, "Schedule TO," with the SEC. Schedule TO requires disclosure regarding the terms and conditions of the offer, the background of the transaction, the terms of offeror financing and other items.[19]

- *Dissemination of Tender Offers to Shareholders*. Depending on the type of consideration offered by the offeror in the tender offer, the offeror is required to communicate certain details with respect to the tender offer to subject shareholders by publication or dissemination.[20]

- *Equal Treatment*. The offeror is required to make the tender offer open to all target shareholders and to pay each shareholder the highest consideration paid to any other shareholder in the offer.[21]

- *Withdrawal Rights*. The offeror is required to grant certain rights to shareholders who have tendered securities pursuant to a tender offer to withdraw any such securities during the period such offer remains open.[22] In addition, Section 14(d)(5) of the Exchange Act requires the offeror to allow tendered shares to be withdrawn by shareholders (i) at any time prior to the expiration of seven days after the time that copies of the offering documents are first published or sent or (ii) at any time after the 60th day following commencement of the offer (the latter are sometimes referred to as "back-end withdrawal rights").

- *Target Board Recommendation and Communications to Target Shareholders*. Within 10 business days of the commencement of the offer by the offeror, the target is required to file a "Schedule 14D-9," which must include the recommendation of the target's board of directors to its

shareholders regarding the offer (including the reasons therefor), with the SEC.[23]

- *Offer Extensions*. The offeror may elect to provide a subsequent offering period of at least three business days during which tenders will be accepted, so long as certain requirements are met.[24]

In some cases, the SEC may issue comments on tender offer materials filed by the offeror or target pursuant to Regulation 14D. If such comments are received, the parties would typically respond to the SEC's comments by amending the tender offer materials or explaining to the SEC why they believe that amendments are not warranted. The SEC review process begins only after the offer is commenced (*i.e.*, there is no requirement to complete SEC review before launching the offer), and the SEC will often endeavor to provide comments in a timely fashion so as not to delay the consummation of the offer. As discussed below, this SEC review process differs from transactions that are subject to the proxy rules, in that the SEC must first be given the opportunity to review a proxy statement before it is mailed to target shareholders.

3. Choice of Merger vs. Tender Offer

A tender offer followed by a back-end merger can potentially be completed in less than five weeks after entering into a definitive transaction agreement. In contrast, it typically takes at least two to three months to receive shareholder approval of a voted merger under similar circumstances. In a situation in which the parties expect regulatory approval and the satisfaction of other conditions in a short timeframe, a tender offer therefore can significantly shorten the period between signing and closing. On the other hand, some transactions entail a long regulatory approval process. If the regulatory process is expected to take a substantial amount of time, a tender offer would need to remain open until regulatory approval has been received. In a one-step merger structure, however, the parties could obtain shareholder approval during the pendency of the regulatory process and then close the transaction promptly following receipt of regulatory approval. In this circumstance, acquirors often prefer the one-step merger structure because a target's ability to accept an alternative proposal (or change its recommendation to shareholders) in a merger agreement typically terminates upon shareholder approval, while a tender offer remains subject to interloper risk so long as it remains open.

C. Acquisition of a U.S. Company with Stock Consideration

The inclusion of stock consideration in a cross-border transaction introduces significant additional requirements under the Securities Act. If the acquisition is accomplished via an exchange offer—*i.e.*, a tender offer in which the consideration includes securities—the transaction would be subject to the same tender offer rules of the Williams Act as apply to all-cash tender offers, as well as the requirements of the Securities Act.

1. Registration Requirements

Under Section 5 of the Securities Act, the offer or sale of securities must either be registered with the SEC or qualify for an exemption from registration. Securities offered pursuant to an exchange offer as well as other statutory business combination transactions are deemed to involve offers for this purpose.[25] Therefore, absent an exemption under Section 5, any company, U.S. or non-U.S., that seeks to offer its securities as all or part of the consideration in an exchange offer or business combination, whether consensual or hostile, to investors in the U.S. must first file a registration statement with the SEC under the Securities Act.

To register a class of securities under the Securities Act pursuant to an exchange offer or business combination, an issuer must file a Form S-4 (for U.S. issuers) or F-4 (for FPIs) registration statement with the SEC. Forms S-4 and F-4 each comprise two parts: Part I is a proxy statement or prospectus, written in narrative form, that contains information regarding the acquiror, the target, the business combination or exchange offer and, as applicable, certain information incorporated by reference from the parties' reports under the Exchange Act. Part II includes supplemental information not required to be in the prospectus concerning the indemnification of officers and directors of the issuer, exhibits, and certain undertakings. Only Part I must be delivered to target shareholders, but both parts become public when filed with the SEC.

Forms S-4 and F-4 include, among other items, disclosure with respect to the following matters:

- summaries of the parties, their business, their financial conditions, as well as the transaction, including its structure, information with respect to voting and other information;

- a letter from the chief executive officer or chairman of the target (and also the acquiror if the acquiror is required to vote or otherwise elects to do so) providing a brief description of the transaction, the consideration payable and the target board's (and, if applicable, the acquiror board's) recommendation, as well as encouraging the shareholders to vote;

- questions and answers regarding the fundamental questions that target (and, as applicable, acquiror) shareholders may have about the contemplated transaction, including what proposals will be voted on at the special meeting, what will happen as a result of the transaction, what consideration will be payable in the transaction and what shareholders need to do now, among others;

- notice of the meeting required to approve the transaction, including the date, time, and location of the special meeting, as well as the purpose of the meeting and the key matters to be voted on;

- voting information concerning all the proposals submitted for a shareholder vote at the meeting, including the votes required for approval and determination of the votes, including how the votes are counted and the effect abstentions have on such count;

- risk factors associated with the parties, the transaction, the combined company, and the securities being offered in the transaction;

- descriptions of the transaction and the parties to the transaction, including background to, and material terms of, the transaction, sufficient for shareholders to make informed investment decisions, and the parties' businesses, operations, and financial conditions;

- a description of important merger agreement provisions;

- selected financial information, including financial statements for the previous five fiscal years and pro forma financial statements that give effect to the business combination (in general, financial statements must be prepared in accordance with U.S. GAAP, IFRS as issued by the IASB or local GAAP/non-IASB IFRS reconciled to U.S. GAAP, and may be presented in any currency);

- management's discussion and analysis of financial condition and results of operations for each party; and

- comparison of rights of common shareholders, describing differences in the rights of the shareholders of the acquiror and the target.

Part II includes information on the indemnification of directors and officers, exhibits, including the merger agreement, organizational documents of both parties, legal opinions, powers of attorney and the consents of experts, certain undertakings, such as incorporating, as applicable, annual and quarterly reports and subsequent Exchange Act reports by reference and warrants and rights offerings and the signatures of the parties to the transaction.

The registration statements that issuers file on Forms S-4 and F-4 are subject to review by the SEC. Although there is no standard timetable for these reviews, they are likely to take at least two and up to four or more months. The SEC typically takes approximately 30 days to provide comments on the initial filing of the first version of a registration statement. The SEC comments are in the form of a letter, which references parts of a registration statement and identifies deficiencies or asks questions with respect to the content of the filing. Once comments are received from the SEC, it may take as long as two to four weeks for the parties to implement the changes required by the SEC to a registration statement or to research and respond to SEC inquiries. If the SEC comments relate to accounting matters, auditors and other advisors will need to be involved in addition to counsel, adding time and cost to the response period. When a prospective registrant has addressed the substance of the SEC comments, and, if necessary, after communication with

the SEC, an amendment to a registration statement is filed, along with a written response to the SEC's initial comments. Thereafter, the process begins again with SEC review of and comment on the amendment to the registration statement. SEC comments on amendments to a registration statement often are returned in approximately 10 days, although it may take more or less time depending on the nature of the outstanding comments. Only after the SEC comments are exhausted, and any other applicable timing criteria are met, can a party request that the registration statement be declared effective and the securities eligible for offer or sale.

2. Listing of Securities Issued in an Acquisition

In some cases, the parties to a cross-border transaction involving a foreign acquiror may wish to list the securities being offered to target securityholders on a U.S. securities exchange. For example, the board of a U.S. target company may be unwilling to proceed with the transaction unless the foreign acquiror agrees to list the securities being offered to U.S. holders in the United States. A U.S. listing provides additional liquidity for U.S. shareholders, and may be a prerequisite for certain institutional investors to invest in a company's securities. Listing can therefore enhance the attractiveness of a non-U.S. company's shares in the U.S. capital market.

American Depositary Receipts

An acquiror may agree to issue listed ADRs to target securityholders. ADRs are negotiable certificates that evidence ownership interests in American Depository Shares ("ADSs"), which themselves represent interests in the underlying equity securities of a non-U.S. issuer held by a U.S. depository bank. ADRs allow U.S. investors to easily invest in non-U.S. issuers, and allow non-U.S. issuers to raise capital and establish a trading presences in the U.S. ADRs trade in U.S. dollars and clear via U.S. settlement systems, which allows U.S. investors to avoid trading in non-U.S. currencies and the related risks. An ADR can represent any number of underlying securities of a non-U.S. issuer; that is, an ADR can represent a fraction of an underlying share or multiple underlying shares. There are approximately 2,000 ADRs trading today on U.S. securities exchanges representing equity securities of issuers across more than 70 countries.

ADRs are created when a non-U.S. issuer or an investor deposits the non-U.S. issuer's securities that will underlie the ADRs in a U.S. depository bank. After receipt of the securities, the bank will bundle the securities into an ADS and issue the ADRs to the depositor. The depositor may then trade the ADRs, either on a U.S. securities exchange or over the counter. ADRs can be traded, settled and held as if they were regular securities of a U.S. issuer. Holders of ADRs may also remove the securities underlying the ADSs from the ADR program, at a conversion rate equal to the number of securities included in the ADS represented by the ADR.

ADRs are either "sponsored" or "unsponsored." Sponsored ADRs result when a non-U.S. issuer enters into an agreement with a U.S. depository bank to hold the deposited ADRs and manage all aspects of such deposit, including, among others, recordkeeping, forwarding shareholder communications and paying dividends. Unsponsored ADRs result

when an ADR is created without the assistance (or the consent) of the applicable non-U.S. issuer – the principal depositary banks will create unsponsored ADR programs in response to market demand for the underlying securities, for the purpose of establishing a U.S. trading market for the non-U.S. issuer's securities. A depository bank may create an unsponsored ADR program only if the non-U.S. issuer is either subject to the reporting requirements under the Exchange Act or exempt from such requirements pursuant to Rule 12g3-2.

ADRs must be registered under the Securities Act with the SEC on a Form F-6. The disclosures required on Form F-6 include the contractual terms of deposit under the deposit agreement, including copies of the agreements, a form of ADR certificate and legal opinions. No information about the non-U.S. issuer is disclosed. To raise capital in the U.S., a non-U.S. issuer would need to file a separate registration statement under the Securities Act on Form F-1, F-3 or F-4, depending on the circumstances of the transaction. To list its ADRs on a U.S. securities exchange, the non-U.S. issuer must file a separate registration statement under the Exchange Act with the SEC on Form 20-F. Unlike Form F-6, the Form 20-F registration statement used to raise capital and list securities requires significant disclosures about the non-U.S. issuer, its business, its financial condition and, if applicable, the transaction in connection with the capital raise.

Additionally, ADRs are generally split into three "levels," which depend on the degree to which the non-U.S. issuer has accessed U.S. markets:

- *Level 1 ADRs*. Level 1 ADRs establish a trading presence in the U.S. but may not be used to raise capital. Only Level 1 ADRs may be unsponsored and therefore may only be traded on U.S. over the counter markets. Only a Form F-6 need be filed, and, as a result, no information about the non-U.S. issuer need be disclosed. No information about the non-U.S. issuer will be available on EDGAR. Importantly, the consent of the non-U.S. issuer of the securities underlying an unsponsored Level 1 ADR program is *not* required.

- *Level 2 ADRs*. Level 2 ADRs establish a trading presence in the U.S., generally through the listing of ADRs representing preexisting securities on a U.S. exchange. Like Level 1 ADRs, Level 2 ADRs may not be used to raise capital. The sponsoring bank and non-U.S. issuer must file Form F-6 and a registration statement on Form 20-F with the SEC, and, pursuant to such registration, the non-U.S. issuer becomes subject to the ongoing reporting requirements of the Exchange Act, which include the requirement to file annual reports on Form 20-F.

- *Level 3 ADRs*. Level 3 ADRs establish a trading presence in the U.S. and allow the non-U.S. issuer to raise capital. Level 3 ADRs, like Level 2 ADRs, must be sponsored and therefore may be traded on either U.S. securities exchanges or U.S. over the counter markets. The sponsoring bank and non-U.S. issuer must file Form F-6 and a registration statement on Form F-1, Form F-3 or Form F-4 with the SEC, and, pursuant to such

registration, the non-U.S. issuer becomes subject to the ongoing reporting requirements of the Exchange Act, which include the requirement to file annual reports on Form 20-F.

An FPI that lists its Level 2 or Level 3 ADRs on a U.S. securities exchange is required to register under Section 12(b) of the Exchange Act. And, even if an FPI does not list its ADRs, an FPI may still be required to register pursuant to Section 12(g) of the Exchange Act if it surpasses certain asset and shareholder thresholds, or may have obligations under Section 15(d) of the Securities Act, if it files a registration statement under the Securities Act in a public offering. When an FPI lists and registers under Section 12(b) of the Exchange Act, it must comply with the reporting and other requirements of the Exchange Act and Sarbanes-Oxley as long as it has listed ADRs, and thereafter until it can suspend or terminate its reporting obligations. When an FPI registers under Section 12(g) or has obligations under Section 15(d), it must similarly comply with the Exchange Act and Sarbanes-Oxley (excluding sections of Sarbanes-Oxley pertaining only to listed issuers) until it is no longer subject to Section 12(g) (by, for example, meeting the requirements of Section 12g3-2(b), as discussed in Section VII.A) or Section 15(d).

The Listing Process

In order to list a class of securities (or ADRs) directly on a U.S. securities exchange, an issuer must apply for listing to the applicable exchange and comply with that exchange's listing criteria. In a direct listing, an issuer lists its securities directly on an exchange, creating a public market for its securities. An issuer applies for a direct listing with an exchange's staff and is required to provide certain supporting information, including organizational documents, financial statements, governance undertakings and other information about the issuer. The timeline for approval generally ranges from one to three months.

The NYSE provides two sets of listing criteria, the first of which must be met by all prospective issuers and the second of which applies only to FPIs. The first set includes the following standards:

- An issuer must meet *one* of the following financial standards:
    - *Earnings Test*. The issuer's aggregate adjusted pretax income for the last three fiscal years is $10 million, the issuer's adjusted pretax income for each of the two most recent fiscal years is $2 million and the issuer's aggregate adjusted pretax income for each of the prior three fiscal years is greater than $0.
    - *Global Market Capitalization Test*. The issuer has a global market capitalization of $200 million or greater.
    - An FPI must also meet *all* of the following distribution standards: 400 round lot shareholders; 1.1 million publically held shares; $40 million market value of publically held shares; and $4.0 minimum share price.

The second set of standards, only for FPIs, includes the following standards:

- An FPI must meet one of the following financial standards:
    - *Earnings Test*. The issuer's aggregate adjusted pretax income for the last three fiscal years is $100 million and the issuer's adjusted pretax income for each of the two most recent fiscal years is $25 million.
    - *Valuation/Revenue with Cash Flow Test*. Aggregate adjusted cash flows for the last three fiscal years is $100 million and adjusted cash flows for each of the two most recent fiscal years is $25 million; the issuer's global market capitalization is $500 million; and the issuer's revenues in the most recent 12-month period were $100 million.
    - *Pure Valuation/Revenue Test*. The issuer's global market capitalization is $750 million and the issuer's revenues in the most recent 12-month period were $75 million.
    - *Affiliated Company Test*. The issuer's global market capitalization is $500 million and the issuer's operating history is 12 months.
- An FPI must also meet *all* of the following distribution standards: 5,000 worldwide round lot shareholders; 2.5 million worldwide publically held shares; $100 million worldwide market value of publically held shares; and $4.0 minimum per share price.

Nasdaq provides three sets of standards, one for each of its three markets, Nasdaq Capital Market, Nasdaq Global Select and Nasdaq Global Market. An FPI may apply to be listed on any of Nasdaq's three markets, although Nasdaq Capital Market is a frequent choice given that it has the most lax criteria of the three. Nasdaq Capital Market, for example, includes the following standards:

- An issuer must meet *one* of the following financial standards:
    - *Stockholders' Equity*. The issuer's stockholders' equity is $5 million; the issuer's publicly held shares have a market value of $15 million; and the issuer has an operating history of at least two years.
    - *Market Value*. The issuer's stockholders' equity is at least $4 million; the issuer's publicly held shares have a market value of at least $15 million; and the issuer's listed securities have a market value of $50 million.
    - *Net Income Standard*. The issuer's stockholders' equity is at least $4 million; the issuer's net income is at least $750,000 in either the last fiscal year or two of the last three fiscal years; the issuer's publicly held shares have a market value of at least $5 million.

- An issuer must also meet *all* of the following distribution standards: at least 300 round lot holders; at least one million publically held shares; $4.0 minimum per share price (or as low as $2.0 in certain situations); and at least three registered and active market makers.

If an issuer, U.S. or non-U.S., is listed directly by either the NYSE or Nasdaq, they must also comply with certain enumerated quantitative maintenance standards or risk suspension or delisting from the exchange. These standards require issuers to maintain, among other requirements, a certain number of shareholders, publically held shares, average closing price over a 30-day trading period, global market capitalization and stockholders' equity.

Registration under Exchange Act Section 12(b)

Securities listed on a national securities exchange in the United States are required to be registered under Section 12(b) of the Exchange Act. Such registration of the securities of an FPI is typically accomplished by filing a registration statement on Form 20-F. If the offering of the securities was registered under the Securities Act (which will often be the case when listed securities are offered), certain content of the Form 20-F can generally be incorporated by reference or copied from the Securities Act registration statement.[26] After the listing is approved, the securities are admitted for trading once the exchange certifies the listing with the SEC and the issuer's registration of the securities under Section 12(b) of the Exchange Act becomes effective.

Note that ADRs can either be listed or unlisted. If they are unlisted, they do not have to be registered under Section 12(b) of the Exchange Act, although they may potentially have to be registered under Section 12(g) of the Exchange Act, unless an exemption (such as that afforded by Rule 12g3-2(b)) applies.

3. Post-Registration Obligations

A critical consideration in determining whether to issue securities in the acquisition of a U.S. public company is that, if the securities are listed on a U.S. securities exchange (or if the securities offering is registered under the Securities Act), the issuer of the securities will have certain post-transaction securities law obligations following the transaction, including those concerning periodic reporting requirements, the preparation of financial statements and corporate governance. FPIs enjoy certain exemptions from such obligations.

Additional information on the registration process, exemptions and post-transaction obligations is provided in Section VII.

IV.

Acquisition of a Non-U.S. Company

This Section IV describes in greater detail the principal legal considerations under the U.S. federal securities laws for accomplishing an acquisition of a non-U.S. company. As noted above, the particular U.S. rules that will apply to an acquisition of a non-U.S. company will depend on whether: (1) the non-U.S. company qualifies as an FPI; (2) the transaction is structured as a tender offer for the securities of the non-U.S. company (and, if so, whether the securities are registered under Section 12 of the Exchange Act, as well as the level of U.S. shareholder ownership of the securities); and (3) whether securities will be included as part of the consideration to be offered to the target company's shareholders. This Section IV discusses the rules that would apply if the non-U.S. target company qualifies as an FPI.

A. Acquisition of a Non-U.S. Company through a Tender Offer

1. Tender Offers and the Cross-Border Rules

If the acquisition is structured as a tender offer to acquire the non-U.S. company's securities, then the set of U.S. rules that will apply to the transaction will depend on whether the non-U.S. company's securities are registered under Section 12 of the Exchange Act. As described in Section III.B.2, Section 14(d) and Regulation 14D apply if the tender offer is for securities registered under Section 12 of the Exchange Act, and Sections 14(e) of the Exchange Act and Regulation 14E apply to all tender offers regardless of whether the subject securities are registered under Section 12.

In response to the potential for conflicts between the U.S. tender offer rules and local legal requirements and concerned that bidders were intentionally excluding U.S. holders from participation in cross-border transactions to avoid compliance with U.S. federal securities laws, the SEC has promulgated a set of exemptions that can provide relief to certain of the tender offer rules in the context of a tender offer for securities of an FPI. The SEC codified prior guidance by adopting regulations under the Securities Act and the Exchange Act to address conflicts between U.S. and non-U.S. regulations in 1999.[27] In 2008, the SEC revised these rules in part to address ongoing conflicts of law and facilitate participation by U.S. persons in the global capital markets.[28] The resulting Cross-Border Rules provide for certain exemptions from compliance with the above tender offer rules. While the requirements for the exemptions are specific and detailed, the applicability of the rules is based generally on the level of U.S. interest in a transaction, measured by (i) the percentage of U.S. holders of the subject security in such transaction or (ii) where the acquiror cannot determine the residency of shareholders, a substitute test for ownership based on trading volume.

The Cross-Border Rules create a two-tier system of U.S. ownership applicable to U.S. tender offer rules. The Tier I exemptions apply where U.S. holders hold no more than 10% of an FPI target's common shares. The Tier II exemptions apply where U.S. ownership is above 10% but not more than 40% of an FPI target's common shares. If U.S.

ownership is above 40%, neither the Tier I nor Tier II exemptions apply, meaning the full set of tender offer rules are applicable.

a. Determining U.S. Ownership

Determining U.S. ownership of the subject securities requires evaluating the residency of security holders of the target to determine the percentage resident in the United States. The calculation requires specific analysis of the following:

- *Timing*. To determine the percentage of outstanding securities held by U.S. holders, the offeror must calculate the U.S. ownership as of a date no more than 60 days before and no more than 30 days after public announcement of the tender offer. If the offeror is unable to calculate ownership as of a date within this range, the calculation may be made as of the most recent practicable date before public announcement, but in no event earlier than 120 days before announcement.

- *Securities Counted*. The securities that underlie ADRs convertible into the subject securities, but not other convertible securities such as warrants and options, should be counted in both the U.S. holder and total securities figures. Securities held by the offeror are excluded.

- *Residency Determination.* In determining whether a shareholder is a U.S. resident, the offeror should use the method of calculating record ownership in Rule 12g3-2(a), which is the rule used for calculating the number of holders for assessing FPI status, with some modification. The inquiry for determining U.S. holders under the Cross-Border Rules requires that an offeror "look through" record owner accounts (like brokers, dealers and banks) and attempt, by reasonable inquiry, to establish the residency of the customers behind those intermediary record owners or their nominees. The obligation to look through applies to securities held of record by intermediaries in the United States, the subject company's jurisdiction of incorporation or the jurisdiction of each participant in a business combination and (if different than the subject company's jurisdiction of incorporation) the jurisdiction that is the primary trading market for the subject securities. If, after reasonable inquiry, the bidder is unable to obtain information about the amount of securities represented by accounts of customers resident in the United States, the bidder may assume, for purposes of this definition, that the customers are residents of the jurisdiction in which the nominee has its principal place of business.

Depending on how a target's home jurisdiction requires companies and intermediaries to record, and publish, residency data for the holders of the target's securities, the look-through analysis may be difficult or impossible in some circumstances. At minimum, the offeror must review public filings and other information provided to the offeror. The determination can include extensive cooperation between target and acquiror (who share an interest in the applicability of an exemption under the Cross-Border Rules).

This need for cooperation presents complications to ascertaining which, if any, exemptions apply in an unsolicited or hostile offer. Where the acquiror cannot determine the residency of shareholders pursuant to the instructions described above, the acquiror may presume that the percentage of shares held by U.S. holders is less than the 10% or 40% threshold level, as applicable, so long as there is a primary trading market for the shares outside the United States, unless one of several conditions exists:

- average daily trading volume of the shares in the United States for a recent twelve-month period ending on a date no more than 60 days before the public announcement of the offer exceeds the applicable threshold percentage of the average daily trading volume of that class of shares on a worldwide basis for the same period;

- the most recent annual report or annual information filed or submitted by the issuer with regulators of the home jurisdiction or with the SEC or any jurisdiction in which the shares trade before the public announcement of the offer indicates that U.S. holders hold more than the applicable threshold percentage of the outstanding subject class of shares; or

- the acquiror knows or has reason to know, before the public announcement of the offer, that the level of U.S. ownership exceeds the applicable threshold percentage (such as from the target, from a reasonably reliable source or through public filings with the SEC or any regulatory body in the target's jurisdiction of incorporation or jurisdiction in which the primary trading market for the subject securities is located).

b. Tier I Exemptions

The Tier I exemptions, applicable where U.S. ownership of the target company is not more than 10%, provide the broadest relief from the U.S. tender offer rules, including exempting the offeror from nearly all of Regulation 14D and most of Regulation 14E, but the exemptions apply only in limited circumstances. To qualify, the tender offer must be for the securities of an FPI but not be an investment company registered or required to be registered under the Investment Company Act of 1940, as amended.[29] In general, the offeror must permit U.S. holders of the subject securities to participate in the offer on terms at least as favorable as those offered to any other holder of the same class of securities that is the subject of the tender offer, although there are narrow exceptions to the equal treatment requirement.[30] The offeror must also comply with applicable requirements to disseminate documents to U.S. holders (in English), including any document published in its home jurisdiction.

If an offer qualifies for the Tier I exemptions, it will be exempt as follows:

- *Minimum Offer Period*. A Tier I offer need not remain open for 20 business days from the date such tender offer is first published or sent to security holders.

- *Notice of Extensions*. A Tier I offer need not comply with the requirement to extend the tender offer in certain circumstances.

- *Purchases Outside of the Tender Offer*. Purchases by the offeror, its affiliates or its financial advisors outside the offer are not prohibited.

- *Equal Treatment*. A tender offer need not be open to all target shareholders and holders are not all required to be offered the same consideration. However, U.S. security holders must be permitted to participate in the offer on terms at least as favorable as those offered to other security holders, subject to certain exceptions, such as substantially equivalent cash offers in lieu of stock.

- *Withdrawal Rights*. Withdrawal rights pursuant to Regulation 14D and Section 14(d)(5) of the Exchange Act, including back-end withdrawal rights, do not need to be extended to securities tendered in Tier I offers.

- *Filing Requirements*. There is no requirement to file a Schedule TO in Tier I offers, but English-language informational documents must be provided to U.S. shareholders on a basis comparable to that provided to shareholders in the subject FPI's home jurisdiction.

- *Response of the Target Company*. Target companies need not give shareholders their positions with respect to Tier I offers.

- *Prompt Payment of Consideration/Return of Securities*. There are no prompt payment or return requirements in Tier I offers.

c. Tier II Exemptions

If U.S. holders hold more than 10% but not more than 40% of the subject FPI's securities, the "Tier II" exemptions from the tender offer rules will apply. The rules subject to Tier II offers include the following:

- *Equal Treatment; Separate U.S. and Non-U.S. Offers*. The Tier II exemptions permit an offeror to separate a tender offer into multiple parts: the offeror may make one offer to U.S. holders, including all ADR holders, and one or more offers to all non-U.S. holders. The U.S. offer must be made on terms at least as favorable as those offered any other holder of the same class of securities that is the subject of the tender offers. U.S. holders may be included in the non-U.S. offer(s) only where the laws of the jurisdiction governing such non-U.S. offer(s) expressly preclude the exclusion of U.S. holders from the non-U.S. offer(s) and where the offer materials distributed to U.S. holders fully and adequately disclose the risks of participating in the non-U.S. offer(s).

- *Notice of Extensions*. Notice of extensions made in accordance with the requirements of a subject FPI's home jurisdiction law or practice will satisfy the requirements of the tender offer rules, as opposed to being required to announce the extension no later than 9:00 a.m. Eastern time on the next business day after the scheduled expiration of the offer.

- *Prompt Payment*. Payment made in accordance with the requirements of a subject FPI's home jurisdiction law or practice will satisfy the requirements of the tender offer rules. If payment is not made on a more expedited basis under such home jurisdiction law or practice, payment for securities tendered during any subsequent offering period within 20 business days (in the target's jurisdiction) of the date of tender will satisfy the prompt payment requirements.

- *Subsequent Offering Period and Withdrawal Rights*. An offeror may institute a subsequent offering period, even if it is unable to announce the results of the initial offering period by 9:00 a.m. New York City time on the U.S. business day following expiration of the initial offering period and promptly pay for securities tendered thereafter, as long as:

  - the offeror announces the results of the offer and pays for tendered securities in accordance with the requirements of the law or practice of the subject FPI's home jurisdiction; and

  - the subsequent offering period commences immediately thereafter.

  If these conditions are satisfied, the offeror also does not need to extend withdrawal rights during the period from the closing of an initial offering period to commencement of the subsequent offering period, as could otherwise be required under Section 14(d)(5) of the Exchange Act.

- *Payment of Interest on Securities Tendered During Subsequent Offering Period*. The offeror may pay interest on securities tendered during a subsequent offering period, if required under applicable non-U.S. law.

- *Suspension of Withdrawal Rights During Counting of Tendered Securities*. Mandatory "back-end" withdrawal rights may interfere with an offeror's ability to count tendered shares (*i.e.*, centralize and tally definitively tenders received in accordance with non-U.S. law and practice) if such counting process takes place at the time when back-end withdrawal rights arise. To avoid this problem, in Tier II offers, an offeror may suspend withdrawal rights at the expiration of its offer and during the period that tendered securities are being counted, provided that:

  - the offer has been open (including withdrawal rights) for at least 20 U.S. business days;

- all conditions to the offer are satisfied or waived at the time of suspension; and

- withdrawal rights are suspended only during the period when tendered securities are being counted and are reinstated immediately thereafter.

- *Early Termination of an Initial Offering Period*. An offeror may terminate an initial offering period, including a voluntary extension of that period, if at the time the initial offering period and withdrawal rights terminate:

  - the initial offering period has been open for at least 20 U.S. business days;

  - the offeror has adequately discussed the possibility and impact of the early termination in the original offer materials;

  - the offeror provides a subsequent offering period after the termination of the initial offering period;

  - all offer conditions are satisfied as of the time the initial offering period ends; and

  - the offeror does not terminate the initial offering period or any extension of that period during any mandatory extension required under U.S. tender offer rules.

- *Purchases Outside of the Tender Offer*. The offeror, its affiliates and affiliates of its financial advisor may purchase or arrange to purchase subject company securities in compliance with the laws of the subject FPI's home jurisdiction if certain conditions are satisfied.

2. Avoiding U.S. Jurisdictional Means

While the U.S. federal securities laws can extend to transactions with significant foreign involvement, their reach is not unlimited. As the SEC has stated:

> "Whether U.S. tender offer rules apply in the context of a cross-border tender offer depends on whether the bidder triggers U.S. jurisdictional means in making a tender offer…. We have recognized that bidders who are not U.S. persons may structure a tender offer to avoid the use of the means or instrumentalities of interstate commerce or any facility of a national securities exchange in making its offer and thus avoid triggering application of our rules. A bidder making a tender offer for target securities of a foreign private issuer may exclude U.S. target security holders if the offer is conducted outside the United States and U.S. jurisdictional means are not implicated. However, a bidder may implicate U.S. jurisdictional means if it fails to take adequate measures to prevent tenders by U.S. target holders while purporting to exclude them."[31]

There are no bright-line rules—and no assurances for acquirors—as to how to successfully avoid U.S. jurisdictional means. The relevant principles have been developed through market practices informed by a limited number of court decisions and occasional SEC guidance, but have not been codified by regulation. Following the adoption of the Cross-Border Rules, the SEC stated that there would be fewer circumstances warranting exclusionary offers because the Cross-Border Rules would make it easier for acquirors to balance the regulatory requirements of foreign and U.S. rules.[32] In particular, the SEC stated that it would view with skepticism exclusionary offers with a close nexus between the target securities and the United States, including where the target securities are registered under Section 12 of the Exchange Act, listed on a U.S. exchange or held by a large number of U.S. holders, particularly where the participation of U.S. holders is necessary to meet the minimum acceptance condition in the offer.[33] The SEC has, however, recognized the need for exclusion in transactions where U.S. holders hold only a small percentage of target securities.[34]

In the context of a tender offer for securities of a non-U.S. company, an acquiror may seek to avoid the territorial scope of the U.S. federal securities laws, including the tender offer rules under the Exchange Act, by "taking reasonable measures to keep the offer out of the United States."[35] In practice, this requires implementing controls to ensure that (i) offer materials include a legend stating that the offer is not being made into the United States, (ii) offer materials are not distributed in the United States, (iii) tenders are not accepted from, nor securities issued (in the case of an exchange offer) to, U.S. holders, which may require the acquiror to obtain adequate information, such as representations, to identify U.S. holders, and (iv) U.S. holders do not receive the offer consideration.[36]

The same general principles apply with respect to tender offer materials posted on the Internet. The SEC has said that such materials will not result in an offer taking place in the United States where such offer is "reasonably designed to ensure that [it is] not targeted to persons in the United States or to U.S. persons."[37] In the case of a non-U.S. acquiror, a reasonably designed offer would include prominent disclaimers on any website related to the offer that clearly state that no securities are being offered to any persons in the United States or any U.S. persons, and controls reasonably designed to guard against sales of securities to any U.S. persons.[38] In the case of a U.S. acquiror, due to existing contacts with the United States, the acquiror would also need to implement password-type controls reasonably designed to ensure that only non-U.S. persons can access the offer.[39]

In some cases, it may be difficult to successfully avoid the use of jurisdictional means—where, for example, applicable foreign law prohibits the exclusion of any target security holders in a tender offer for all outstanding securities of a subject class. In addition, avoiding the use of jurisdictional means in the context of mergers and other business combinations where equity is automatically converted into transaction consideration or that require the dissemination of transaction documentation to or the solicitation of votes from all shareholders presents additional complexities. This could pose an issue for acquirors that must complete a second-step merger or other business combination to consummate a transaction. The ability to avoid U.S. jurisdictional means by excluding U.S. holders must therefore be examined on a case-by-case basis, including

with respect to whether the intended actions are achievable and permissible under local laws and market practices.

B. Acquisition of a Non-U.S. Company by Means Other Than a Tender Offer

It may be possible to acquire a non-U.S. company by means other than a tender offer. If the target is an FPI, the methods of acquiring the company will depend on the laws of its jurisdiction of incorporation. Although mergers are less common outside of the United States, many jurisdictions provide for similar business combination transaction structures, such as an amalgamation or a scheme of arrangement. Such a transaction not involving a tender offer would not be subject to the tender offer rules, and any target shareholder vote would not be subject to the proxy rules because FPIs are exempt from the proxy rules.

C. Acquisition of Non-U.S. Companies with Stock Consideration

The U.S. securities law rules governing the acquisition of a non-U.S. company for stock consideration are largely the same as the rules applicable in the acquisition of a U.S. company for stock consideration described in Section III.C. Namely, the issuance of the stock to the target company's shareholders will need to be registered under the Securities Act unless an exemption from registration is available. The principal exemptions for the acquisition of a non-U.S. company are discussed below.[40]

1. Securities Act Registration

a. Rule 802

A key exemption from the registration requirements of the Securities Act is found in Rule 802 of the Securities Act, promulgated by the SEC as a part of the Cross-Border Rules. Like the Tier I exemptions to the tender offer rules, Rule 802 applies where U.S. holders hold no more than 10% of the subject securities of an FPI. Specifically, Rule 802 provides an exemption from registration, if certain conditions are met, for offers and sales in:

- any exchange offer for a class of securities of an FPI; or
- any exchange of securities for the securities of an FPI in any business combination.

The Rule 802 exemption is available to any issuer in such a transaction, whether it is a U.S. issuer or a non-U.S. issuer.

Rule 802 defines "exchange offer" as a tender offer in which securities are issued as consideration[41] and "business combination" as a statutory amalgamation, merger, arrangement or other reorganization requiring the vote of security holders of one or more of the participating companies, including statutory short-form mergers that do not require such a vote.[42] In a business combination in which the securities are to be issued by a successor registrant, U.S. holders may hold no more than 10% of the class of securities of

the successor registrant, as if measured immediately after completion of the business combination. The percentage of U.S. holders is determined in the same way as such holders are determined in connection with the calculations for determining Tier I and Tier II relief under the Williams Act, as described in Section IV.A.1.

The issuer must permit U.S. holders to participate in the transaction on terms at least as favorable as those offered any other holder of the subject securities. The issuer need not either extend the offer to shareholders in jurisdictions that require registration or qualification or extend the same consideration to all shareholders. The issuer may, for example, offer shareholders in such jurisdictions cash consideration instead of stock consideration in the exchange offer or business combination. If, however, the issuer offers shareholders in such jurisdictions cash consideration, the offeror must offer the same cash alternative to all shareholders.

Although there is no specific disclosure requirement under Rule 802, if the issuer disseminates any information document to holders of subject securities, it must furnish such information document in English to the SEC on Form CB. Form CB submissions are not considered to be information filed with the SEC, but must be submitted no later than the first business day after such dissemination. If the issuer is a non-U.S. company, it must also file a Form F-X to appoint an agent for service of process in the U.S. The issuer must disseminate the information documents to U.S. holders, in English, on a comparable basis as the offeror furnishes the documents to holders in the FPI's home jurisdiction, including by publication. Significantly, financial statements submitted on Form CB are exempt from the general requirement for reconciliation with U.S. GAAP.

Lastly, Rule 802 also requires a legend, in clear, plain language, to be displayed prominently on the informational document disseminated to U.S. holders notifying them that the exchange offer or business combination is made for the securities of a foreign company, that the offer is subject to different disclosure requirements than those of the United States and that any financial statements may not be comparable to those of United States companies.

b. Section 3(a)(10)

Section 3(a)(10) of the Securities Act provides an exemption from registration under the Securities Act. This section applies to both U.S. issuers and non-U.S. issuers for offers and sales of securities in certain exchange transactions without any action on the part of the SEC. An issuer must meet the following conditions to be eligible for an exemption under Section 3(a)(10):

- the securities must be exchanged for "securities, claims or property interests, or partly in such exchange and partly for cash";[43]
- the fairness of the exchange's terms and conditions must be approved by a court or authorized government entity;

- the court or authorized government entity must, before the hearing: (i) find that the exchange's terms and conditions are fair to those who will be issued securities and (ii) be advised that the issuer will rely on this exemption so long as it receives approval from the court or authorized government entity;

- the court or authorized government entity must hold a hearing before approving the fairness of the exchange's terms and conditions;[44]

- if a government entity holds the hearing as opposed to a court, the entity must be expressly authorized by law to hold the hearing, even though the law need not require a hearing;

- the hearing must be open to everyone who will be issued securities;

- adequate notice must be given to all such people; and

- there must be no improper impediments to such people's attendance at the hearing.[45]

Securities issued in a scheme of arrangement, which is a common means of acquisition in jurisdictions such as the U.K., Ireland, the Cayman Islands, Bermuda and elsewhere, typically can qualify for the Section 3(a)(10) exemption.

Note that an acquisition of an FPI pursuant to a scheme of arrangement where Section 3(a)(10) applies generally would not require either a registration statement or a proxy statement in the United States for either the acquiror (unless the acquiror is listed on a U.S. securities exchange, is issuing 20% or more of its outstanding shares in the transaction and is not itself an FPI, in which case a vote under securities exchange listing rules[46] and an associated proxy statement would be required) or the target.

c. Vendor Placements

Another potential means of avoiding Securities Act registration in certain cross-border exchange offers is a vendor placement. As described by the SEC, "[a] vendor placement in a cross-border exchange offer occurs when a bidder offers securities to foreign target holders in an offer, but establishes an arrangement whereby securities that would be issued to tendering U.S. target holders are sold offshore by third parties. The bidder (or the third party) remits the proceeds of the sale (minus expenses) to tendering U.S. target holders."

The SEC has stated that, "unless the market for the bidder's securities to be sold through the vendor placement process is highly liquid and robust and the number of bidder securities to be issued for the benefit of U.S. target holders relatively small compared to the total number of bidder securities outstanding, a vendor placement arrangement in a cross-border exchange offer would in our view be subject to Securities Act registration."[47]

d. Cashing Out U.S. Shareholders of Target

In other cases, an acquiror may avoid the registration requirements under the Securities Act by cashing out U.S. shareholders of the target company. For example, an exchange offer, merger or other transaction in which acquiror securities comprise some or all of the consideration may by its terms provide that all U.S. holders will receive cash rather than acquiror securities. The ability to cash out target shareholders, however, depends on the law of the non-U.S. company's jurisdiction. For example, some jurisdictions require that all target shareholders be treated equally, in which case it may be more difficult to issue securities solely to the non-U.S. shareholders of the target company.

2. Listing of Securities Issued in an Acquisition

As with "inbound" M&A transactions, the acquisition of a non-U.S. company may involve the listing by a foreign acquiror of the securities being offered to target securityholders on a U.S. securities exchange (for example, because the target has a broadly held ADR program). The listing process is discussed above in Section III.C.2.

3. Post-Registration Obligations

As with the acquisition a U.S. company, a critical consideration in determining whether to issue securities in the acquisition of a non-U.S. company is the post-transaction securities law obligations that the acquiror will incur if the securities are listed or the offering is registered under the Securities Act, including those concerning periodic reporting requirements, the preparation of financial statements and corporate governance. FPIs enjoy certain exemptions from such obligations.

Additional information on the registration process, exemptions and post-transaction obligations is provided in Section VII.

V.

Antitrust and National Security Considerations

Any cross-border transaction could be subject to U.S. laws on antitrust and national security. These laws could require additional filings and coordination between the transaction parties themselves and the U.S. government, and sometimes more importantly could lead to delays in the consummation of a transaction.

A. Antitrust Considerations and the Hart-Scott-Rodino Act

The HSR Act requires parties to file notifications with the FTC and the DOJ for certain transactions and to observe certain statutory waiting periods before consummating the transactions. The purpose of the HSR Act is to give the FTC and the DOJ an opportunity to investigate whether the contemplated transaction would substantially lessen competition in violation of Section 7 of the Clayton Antitrust Act of 1914, as amended, and, if so, challenge the transaction in federal court. The transactions that fall under the HSR Act include all acquisitions of voting securities or assets that meet both the (i) "size-of-transaction" threshold of $92 million, which is generally calculated as the greater of the purchase price or fair market value of the securities or assets being acquired, and the (ii) "size-of-person" threshold, which is satisfied when one person to the transaction has at least $184 million in total assets or revenues and the other person has at least $18.4 million in total assets or revenues. There are two exceptions to these thresholds. First, where the size of the transaction is $368 million or greater, the "size-of-person" threshold is irrelevant and the parties will have to file, unless an exemption applies. And second, if a buyer has at least $184 million in assets or revenues and the target is a non-manufacturer, then the target's revenues are irrelevant to the threshold, and so the second threshold is met only when the target has at least $18.4 million in total *assets*.

Additionally, certain acquisitions of non-U.S. targets, including in some cases acquisitions by non-U.S. acquirors, may require notification under the HSR Act. In general, and subject to several exceptions, an acquisition of non-U.S. assets will not require notification unless the sales in or into the U.S. generated by such assets exceed $92 million during the acquired person's last fiscal year.

The specifics of the waiting periods under the HSR Act depend on the type of transaction involved. For most transactions, the waiting period begins when both the FTC and the DOJ receive complete HSR filings from both the target and acquiror; for tender offers and other nonconsensual transactions, the waiting period begins when the agencies receive complete HSR filings from the buyer (although both parties must comply with the process outside of a cash tender offer). The waiting period is generally 30 days, except for cash tender offers and acquisitions in bankruptcies under 11 U.S.C. § 363, where the period is 15 days. The first day of the waiting period is the day following the day on which the agencies receive the complete filings. If the last day of the waiting period does not fall on a business day, then the waiting period ends on the next business day. The parties may also once withdraw and refile their filings without paying an additional filing fee, before

the waiting period elapses, which triggers a new 30-day waiting period (or a 15-day waiting period for cash tender offers and 11 U.S.C. § 363 bankruptcies).

If the waiting period elapses without either agency issuing a request for additional information and documents (known as a "Second Request"), the parties have met their obligations under the HSR Act and may consummate their transaction. The parties may request early termination of the waiting period before the period has elapsed, which both agencies must agree to grant.[48] When early termination is available, the agencies will generally grant it within two to three weeks of the initial filing when there are no issues, in which case the parties have also met their obligations and may consummate the transaction. But note that the agencies publish the names of the parties who are granted an early termination publicly. When a Second Request is issued, it extends the waiting period until both parties substantially comply with the request. The waiting period will then end 30 days after the parties submit valid certifications of substantial compliance with the Second Request (or 10 days for cash tender offers and 11 U.S.C. § 363 bankruptcies). HSR filings are generally valid for one year after the final waiting period expires.

The agencies' merger guidelines set forth the primary analytical techniques and types of evidence used to assess the anticompetitive effects of a transaction.[49] The agencies focus on the definition of the market(s) involved in the transaction, including both product and geographic market definitions; market participants, market shares and market concentration; specific anticompetitive effects, including price discrimination, pricing of differentiated products, reduced innovation and product variety, coordinated effects and powerful buyers; and new entry and expansion into said markets. Further, the key pieces of evidence on which the agencies rely include, among others:

- the actual anticompetitive effects observed in consummated mergers;
- the historical, "natural experiments" that are informative regarding the competitive effects of the merger, including in recent mergers, entries, expansions, or exits, in the relevant market(s);
- the parties' market share in the relevant market(s), the level of their respective concentrations and the change in such concentrations caused by the transactions;
- the existence of head-to-head competition, in the present or future (absent the transactions) between the parties; and
- the disruptive role of a merging party (*i.e.*, where the merger of a "maverick" firm would lessen competition).

If there are no issues, the HSR clearance process takes about six weeks to complete, and, if the parties receive a Second Request, then it could take six months to a year, or more than a year in the event of litigation. Of note, where parties in a transaction do not file for review because the transaction is not reportable, the agencies may still review the

transaction, before or after closing, if they believe the transaction may have anticompetitive effects, and in such cases the agencies are not bound by HSR time limitations.

B. National Security Considerations and the Committee on Foreign Investment in the United States

CFIUS is a federal interagency committee that reviews certain transactions for national security risks. CFIUS operates pursuant to Section 721 of the Defense Production Act of 1950 and several other federal regulations. CFIUS membership is composed of the heads of nine federal agencies, including the departments of Treasury (chair), Justice, Homeland Security, Commerce, Defense, State and Energy and the offices of the U.S. Trade Representative and Science & Technology Policy, and has additional observer and non-voting, ex-officio members.

CFIUS may conduct national security reviews of "covered control transactions," defined as proposed or completed mergers, acquisitions or takeovers with a non-U.S. person that could result in "control" of an existing U.S. business by a non-U.S. person, as well as "covered investments," defined as non-controlling investments in U.S. businesses that develop critical technology, perform certain functions with respect to critical infrastructure, or handle sensitive personal data of specified types and volumes ("TID Businesses") that confer certain governance rights to a foreign investor. Covered transactions generally include all transactions with the characteristics of an equity investment. Parties must therefore consider whether their transactions, including debt and hybrid investments, exhibit characteristics that are equity-like in nature (*i.e.*, acquisition of an interest in a U.S. business, acquisition of the right to appoint board members or other equity-like financial or governance rights).[50] In August 2018, the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") became law, which represents the most significant changes in the last 10 years to the U.S. framework for reviewing foreign investment transactions in the United States, including an expansion of the scope of covered transactions.[51] FIRRMA extends the reach of CFIUS by adding four new types of covered transactions:

- Non-controlling investments involving critical technologies, critical infrastructure or sensitive personal data of U.S. citizens that afford a non-U.S. person access to material nonpublic technical information in the possession of the U.S. business, membership on the board of directors or other decision-making rights, other than through voting of shares;

- a purchase, lease or concession by or to a non-U.S. person of real estate located in proximity to sensitive government facilities;

- any change in a non-U.S. investor's rights resulting in non-U.S. control of a U.S. business or "other investment" in certain U.S. businesses; and

- any other transaction, transfer, agreement or arrangement designed to circumvent the jurisdiction of CFIUS.

Some provisions of FIRRMA took effect upon enactment, while others required formal rulemaking by CFIUS. In October 2018, the Treasury Department issued interim regulations to implement some of FIRRMA's changes, and in September 2019, it released proposed rules to implement most of the remaining provisions. The new rules were finalized in January 2020 and became effective on February 13, 2020. Among other things, the rules introduce a mandatory filing requirement for certain investments resulting in foreign-government controlled entities obtaining 25% or more of the voting power in a U.S. business involved in critical technology or infrastructure or sensitive personal data. The new regulations also identify several categories of businesses involving "critical technology," including the sorts of military- and defense-related items with which CFIUS has traditionally been associated, as well as certain technologies subject to export control and "emerging and foundational technologies" used in industries such as computer storage, semiconductors and telecommunications equipment. Businesses involving "critical infrastructure" are identified by reference to a list of 28 subsectors. With respect to businesses involving "sensitive personal data," the new regulations include any business that maintains or collects genetic information or other "identifiable data" such as financial, health-related, biometric or insurance data for more than one million individuals. The rules also implement the real estate provisions of FIRRMA by expanding CFIUS's jurisdiction to capture the purchase, lease or concession of certain U.S. real estate to a foreign person.

Rather than the more traditional indicia such as protection of defense facilities and infrastructure, government contracts, etc., FIRRMA mandates that CFIUS view national security through a wider lens and acknowledges that the capability to develop emerging technologies, both digital and otherwise, is critical to ensuring long-term U.S. national security. While the full implications of the new law will largely depend on the implementation and application of the rules that became effective in February 2020, the changes are expected to increase the number of CFIUS filings and result in longer overall review periods for many transactions, thus further increasing the potential impact of CFIUS in cross-border deals.

The CFIUS review process generally starts with the filing of a notice or declaration, at which point CFIUS will initiate its review process. While filings for most transactions are voluntary, as noted above FIRRMA introduced mandatory filing requirements for certain investments by foreign-government controlled entities as well as investments in U.S. businesses involved in critical technology. When CFIUS clears a covered transaction, the parties receive a "safe harbor" before closing, which allows "the transaction [to] proceed without possibility of subsequent suspension or prohibition under section 721."[52] If, however, CFIUS does not clear a covered transaction that it believes presents national security issues before closing, it may do so after closing, which could lead to the imposition of mitigation measures, including potentially burdensome divestitures, after the closing of the transaction.[53]

In addition, FIRRMA provides for mandatory filers or voluntary filers to use an abbreviated "declaration" containing basic information in lieu of a full-length notice. A declaration must be submitted at least 45 days before closing of the applicable transaction, and within 30 days of filing, CFIUS must decide whether to clear the transaction or request submission of a full-length notice, which would commence a full review period. It remains

to be seen whether the abbreviated "declaration" will present an attractive option for foreign investors, given that to date CFIUS has rarely cleared transactions on the basis of a declaration, and has often requested submission of a full notice at the end of the 30-day review period. FIRRMA also lengthened CFIUS's initial review period upon the filing of a full-length notice from 30 days to 45 days, and allowed for investigations to be extended for an additional 15 days (from 45 to 60 days) in extraordinary circumstances. In practice, this extended timeline is unlikely to have a significant effect on sensitive transactions, as parties to such transactions typically engage in protracted "pre-notification" discussions with CFIUS and are often asked to withdraw and refile their notice, restarting the applicable review period.

In circumstances in which a mandatory filing is not required, it is often still prudent to make a voluntary filing with CFIUS if control of a U.S. business is to be acquired by a non-U.S. acquiror and the likelihood of an investigation is reasonably high or if competing bidders are likely to take advantage of the uncertainty of a potential investigation. If there is significant likelihood of an investigation, it may be advantageous for the parties to forego the opportunity to file a short-form "declaration" and instead move straight to filing a long-form notice, so as to avoid an additional 30-day delay while CFIUS evaluates the "declaration," only to then require a full-length notice and full investigation. Similar considerations with respect to the use of a "declaration" or the full-length notice will apply for transactions where a mandatory filing is required as a result of the FIRRMA changes. Filings typically are preceded by discussions with U.S. Treasury officials and other relevant agencies, and companies should consider suggesting methods of mitigation early in the review process in order to help shape any remedial measures and avoid delay or potential disapproval. In some cases, it may even be prudent to make the initial contact prior to the public announcement of the transaction. Given the higher volume of filings that have occurred in the last few years, such discussions can be instrumental in minimizing the review period. In circumstances where no filing is required and the risk of review is low, but the parties still want assurances that CFIUS or the U.S. President will not take action on their own initiative, the short-form "declaration" provided for by FIRRMA will be a useful tool to streamline the CFIUS process and remove lingering uncertainty.

Additionally, although practice varies, an increasing number of cross-border transactions in recent years have sought to mitigate CFIUS-related nonconsummation risk by including reverse break fees specifically tied to the CFIUS review process. In some of these transactions, U.S. sellers have sought to secure the payment of the reverse break fee by requiring the acquiror to deposit the amount of the reverse break fee into a U.S. escrow account in U.S. dollars, either at signing or in installments over a period of time following signing. While still an evolving product, some insurers have also begun offering insurance coverage for CFIUS-related nonconsummation risk, covering payment of the reverse break fee in the event a transaction does not close due to CFIUS review, at a cost of approximately 10%–15% of the reverse break fee.

The CFIUS review process involves several steps. The parties submit a draft notice to CFIUS, which then initiates a national security review and, if necessary, a national security investigation. CFIUS investigates a transaction when it determines in its review that it may impair national security. In the review and investigation, CFIUS examines the

transaction to identify and address any potential national security concerns that may arise as a result of the transaction. Lastly, CFIUS makes its recommendations to the President to approve, either unconditionally or with certain conditions (*e.g.*, divestitures, forfeitures of contracts, appointments of compliance personnel or appointments of proxy board composed solely of U.S. persons), suspend or prohibit the transaction. FIRRMA makes certain changes to this process, including by extending the review period from 30 days to 45 days and allowing an investigation to be extended for an additional 15 days under extraordinary circumstances, which could increase the average review period from 75 days up to 105 days.

CFIUS considers all relevant facts and circumstances with respect to a covered transaction, regardless of industry, that have potential national security implications. CFIUS generally considers in its review: with regard to the nature of a U.S. business, (i) the existence of government contracts, (ii) whether the U.S. business has operations relevant to national security, and (iii) whether the U.S. business deals in certain advanced technologies or goods and services controlled for export; and, with regard to the identity of a non-U.S. person, (iv) the nationality of the buyer, (v) the track record of the non-U.S. person acquiring control of the U.S. business and (vi) the nonproliferation record of the non-U.S. person's country of origin.[54] Additionally, non-U.S. government control constitutes a national security consideration, although certain circumstances may lessen its significance in a transaction, and, in rare cases, corporate reorganizations may also raise national security concerns.

While it is too early to tell how the current administration will approach CFIUS, parties to cross-border transactions must continue to give the process due consideration. In recent years, CFIUS has loomed particularly large over cross-border deals, especially those involving investors from China or other non-allied countries. For example, in September 2017, President Trump issued an executive order blocking Lattice Semiconductor's $1.3 billion acquisition by a Chinese government-backed private equity fund, Canyon Bridge Capital Partners, based on CFIUS concerns.[55] In early January 2018, MoneyGram and Alibaba affiliate Ant Financial terminated their proposed $1.2 billion deal, following failure to gain CFIUS approval over concerns about protection of personal data. And in what was likely the most high-profile CFIUS-related action, in March 2018 CFIUS ordered Qualcomm to postpone its annual shareholder meeting, at which Broadcom had nominated a slate of directors who would constitute a majority of the Qualcomm board; shortly thereafter, President Trump ordered Broadcom to cease pursuit of its hostile bid for Qualcomm, ending what would have been one of the largest technology transactions in history. In 2019, CFIUS continued to use its authority to block or cause parties to abandon transactions, including forcing post-consummation divestitures, as was the case with two Chinese companies' investments in technology startups Grindr and PatientsLikeMe, allegedly due to concerns regarding cybersecurity or access to sensitive personal data. In 2020, CFIUS blocked a Chinese entity from acquiring a fertility clinic in San Diego, highlighting the increasing concerns over sensitive data collection and retention of U.S. persons by foreign entities, and forced several post-consummation divestitures on national security grounds, including Beijing Shiji's interest in StayNTouch, which provides property management software for hotels and guests, and Beijing ByteDance's interest in TikTok.

While the Biden administration is expected to remain open to foreign investments in the U.S., particularly from traditional allies, investors should expect that it will maintain a robust CFIUS review process. In particular, investments from countries that are viewed by the U.S. government as strategic competitors will continue to face close scrutiny. In addition, the Covid-19 pandemic has brought supply chain issues to the fore, with many U.S. businesses struggling to obtain medical and personal protective equipment from foreign suppliers. The supply chain vulnerabilities exposed by the pandemic may result in heightened CFIUS scrutiny of transactions that may affect supply chains of U.S. industries critical to the economy and public health.

VI.

Negotiation, Diligence and Integration Considerations

Practical and tactical considerations with respect to structuring and executing a cross-border transaction are as important to understand as related U.S. legal considerations. A complex combination of local laws and custom may guide the parties not only in transaction structure and consideration, but also in the negotiation, due diligence and integration phases of the cross-border deal.

A. Negotiation

When negotiating a potential cross-border transaction, understanding the custom and practice of M&A in the target's jurisdiction is essential. Successful execution is as much art as science, and will benefit from early involvement by experienced local advisors. For example, understanding when to respect—and when to challenge—a target's sale "process" may be critical. Knowing how and at what price level to enter the discussions will often determine the success or failure of a proposal. In some situations, it is prudent to start with an offer on the low side, while in other situations, offering a full price at the outset may be essential to achieving a negotiated deal and discouraging competitors, including those who might raise political or regulatory issues. Decisions as to pricing can also fundamentally impact the timeline for a transaction—offering a full price at the outset avoids the need for multiple rounds of negotiation. In strategically or politically sensitive transactions, hostile maneuvers may be imprudent; in other cases, unsolicited pressure may be the only way to force a transaction. Similarly, understanding in advance the roles of arbitrageurs, hedge funds, institutional investors, private equity funds, proxy voting advisors and other important market players in the target's market—and their likely views of the anticipated acquisition attempt as well as when they appear and disappear from the scene—can be pivotal to the outcome of the contemplated transaction.

Where the target is a U.S. public company, the customs and formalities surrounding participation by the board of directors in the M&A process, including the participation of legal and financial advisors, fairness opinion practice and the inquiry and analysis surrounding the activities of the board and the financial advisors, can be unfamiliar and potentially confusing to non-U.S. transaction participants and can lead to misunderstandings that threaten to upset delicate transaction negotiations. Non-U.S. participants must be well-advised as to the role of U.S. public company boards and the legal, regulatory and litigation framework and risks that can constrain or prescribe board action. In particular, the litigation framework should be kept in mind as shareholder litigation often accompanies M&A transactions involving U.S. public companies. The acquiror, its directors, shareholders and other offshore stakeholders should be conditioned in advance (to the extent possible) to expect litigation and not to necessarily view it as a sign of trouble. In addition, it is important to understand that the U.S. discovery process in litigation is different, and in some contexts more intrusive, than the process in other jurisdictions. Moreover, the choice of governing law and the choice of forum to govern any potential dispute between the parties about the terms or enforceability of the agreement may have a substantial effect on the outcome of any such dispute, or even be outcome

determinative. Parties entering into cross-border transactions should consider with care whether to specify the remedies available for breach of the transaction documents and the mechanisms for obtaining or resisting such remedies.

The litigation risk and the other factors mentioned above can impact both tactics and timing of M&A processes and the nature of communications with the target company. Additionally, on top of the U.S. securities law considerations discussed above in Section II.C.2, local takeover regulations often differ from those in the acquiror's home jurisdiction. For example, the mandatory offer concept common in Europe, India and other countries—in which an acquisition of a certain percentage of securities requires the bidder to make an offer for either the balance of the outstanding shares or for an additional percentage—is very different from U.S. practice, as is a regulator-supervised auction. Permissible deal-protection structures, pricing requirements and defensive measures available to targets also differ. Sensitivity also must be given to the contours of the target board's fiduciary duties and decision-making obligations in home jurisdictions, particularly with respect to consideration of stakeholder interests other than those of shareholders and nonfinancial criteria.

In addition to these customs and formalities, participants in a cross-border transaction should focus attention on the practical considerations of dealing with a counterparty that is subject to a foreign legal regime. For example, acknowledging the potential practical constraints around enforcing a remedy in a foreign jurisdiction can significantly change negotiating dynamics and result in alternative deal structures. Escrow deposit structures or letters of credit from U.S. banks have been used a number of times to reduce enforceability risk in transactions with Chinese acquirors and may be instructive in other contexts where enforceability is not assured.

The multifaceted overlay of foreign takeover laws and the legal and tactical considerations they present can be particularly complex when a bid for a non-U.S. company may be unwelcome. Careful planning and coordination with foreign counsel are critical in hostile and unsolicited transactions, on both the bidder and target sides. For example, Italy's "passivity" rule, which limits defensive measures a target can take without shareholder approval, is suspended unless the hostile bidder is itself subject to equivalent rules. A French company's organizational documents can provide for a similar rule, and France's Florange Act contains default provisions that a French company's long-term shareholders are granted double voting rights, which would reduce the influence of toehold acquisitions or merger arbitrageurs. Dutch law and practice allow for the target's use of an independent "foundation," or *stichting*, to at least temporarily defend against hostile offers through the issuance of voting shares. The foundation, which is controlled by independent directors appointed by the target and has a broad defensive mandate, is issued high-vote preferred shares at a nominal cost, which allow it to control the voting outcome of any matter put to target shareholders.

Disclosure obligations may also vary across jurisdictions. How and when an acquiror's interest in the target is publicly disclosed should be carefully controlled to the extent possible, keeping in mind the various ownership thresholds or other triggers for mandatory disclosure under the law of the jurisdiction of the company being acquired.

Treatment of derivative securities and other pecuniary interests in a target other than equity holdings also vary by jurisdiction and have received heightened regulatory focus in recent periods.

B. Integration Planning and Due Diligence

Integration planning and due diligence warrant special attention in the context of a cross-border transaction. Regardless of jurisdiction, wholesale application of the acquiror's domestic due diligence standards to the target can cause delay, wasted time and resources, or result in the parties missing key transaction issues.

Due diligence methods must take account of the target jurisdiction's legal regime and local norms, including what steps a publicly traded company can take with respect to disclosing material non-public information to potential bidders and implications for disclosure obligations. Many due diligence requests are best funneled through legal or financial intermediaries as opposed to being made directly to the target company. For a U.S. company acquiring a non-U.S. company, due diligence relating to compliance with the sanction regulations overseen by the Treasury Department's Office of Foreign Assets Control is essential. Similarly, due diligence with respect to risks related to the Foreign Corrupt Practices Act of 1977 (the "FCPA")—and understanding the DOJ's guidance for minimizing the risk of inheriting FCPA liability—is critical for a U.S. company acquiring a company with non-U.S. business activities; even acquisitions of foreign companies that do business in the United States may be scrutinized with respect to FCPA compliance. In 2018, the DOJ established guidance expanding its FCPA Corporate Enforcement Policy to M&A transactions. As a result, when an acquiring company identifies misconduct through pre-transaction due diligence or post-transaction integration, and then self-reports the relevant conduct, the DOJ is now more likely to decline to prosecute if the company fully cooperates, remediates in a complete and timely fashion and disgorges any ill-gotten gains. This presumption of declination was further broadened by the DOJ's 2019 revisions to the policy, which provide that an acquiring company may still be eligible for a declination even if the target it acquired presented aggravating circumstances—for example, if the target's management was complicit in the corruption, the presumption of declination could still apply if the acquiror timely discovered and removed such members of management. This guidance further underscores the importance of careful pre-acquisition due diligence and effective post-closing compliance integration, which will place acquiring companies in the best position to take advantage of the DOJ's enforcement approach in appropriate cases where misconduct is uncovered.

Cross-border transactions sometimes fail due to poor post-acquisition integration where multiple cultures, languages, historic business methods and distance may create friction. If possible, the executives and consultants who will be responsible for integration should be involved in the early stages of the deal so that they can help formulate and "own" the plans that they will be expected to execute. Too often, a separation between the deal team and the integration/execution teams invites slippage in execution of a plan that in hindsight is labeled by the new team as unrealistic or overly ambitious. However, integration planning needs to be carefully phased in, as implementation cannot occur prior

to the time most regulatory approvals are obtained, and merging parties must exercise care not to engage in conduct that antitrust agencies perceive as a premature transfer of beneficial ownership or conspiracy in restraint of trade. Investigations into potential "gun-jumping" present costly and delaying distractions during substantive merger review.

VII.

Post-Transaction Obligations of an FPI That Lists or Registers Securities

A critical consideration for an non-U.S. company that is evaluating whether to issue securities as consideration in the transaction is the potential post-transaction securities law obligations that may be imposed as a result of the issuance. The listing of securities on a U.S. securities exchange, or registration of an offering under the Securities Act, can impose post-transaction obligations, including those concerning periodic reporting requirements, the preparation of financial statements and corporate governance. FPIs enjoy certain exemptions from such obligations. This section summarizes these obligations and the exemptions that are afforded to FPIs.

It is important to keep in mind that a non-U.S. company would lose the benefit the various exemptions available to FPIs if it ceases to qualify as an FPI. In that circumstance, the company would become subject to the full panoply of federal securities laws applicable to U.S. companies. See Section II.C.1 for a description of FPIs and the requirements for annual evaluation of a non-U.S. company's status as an FPI.

A. Registration Requirements

Sources of Exchange Act Obligations

The registration requirements under the Exchange Act set forth the three ways by which an issuer becomes a "reporting company," and thereby must register with the SEC and comply with the periodic reporting requirements of Sections 13(a) or 15(d) and other obligations. Specifically, an issuer becomes a reporting company when it:

- lists a class of securities on a national securities exchange, requiring it to register the securities under Section 12(b) of the Exchange Act;[56]

- has assets in excess of $10 million and its shares are held of record by (i) 2,000 or more persons or (ii) 500 or more persons who are not accredited investors, excluding persons who received unregistered securities pursuant to an employee compensation plan, requiring it to register its securities under Section 12(g) of the Exchange Act;[57] and/or

- files a registration statement for a class of securities under the Securities Act in a public offering, and, as a result, incurs ongoing reporting obligations under Section 15(d) of the Exchange Act, which would continue for at least the fiscal year in which the registration statement became effective.[58]

The Rule 12g3-2 Exemptions

Unlike Sections 12(b) and 15(d), which an FPI can avoid by not listing its securities on a U.S. securities exchange and not conducting an offering registered under the Securities

Act, an FPI may be unable to avoid meeting the numerical shareholder tests of Section 12(g). However, Exchange Act Rule 12g3-2 provides two important exemptions from Section 12(g).

Rule 12g3-2(a) exempts an FPI from having to register under Section 12(g) if it has fewer than 300 holders of record in the U.S. For this purpose, issuers must count all beneficial U.S. holders and not only record holders. To do so, an issuer must (i) "look through" the record ownership of the brokers, dealers, banks and nominees holding the issuer's securities for the accounts of their customers to identify all beneficial U.S. holders and (ii) consider beneficial ownership reports and other similar documentation with U.S. holder information. This exemption continues until the next fiscal year end at which the FPI has a class of equity securities held by 300 or more persons resident in the U.S.

To qualify for the exemption under Rule 12g3-2(b), an FPI must meet the following requirements: (1) not currently be required to file or furnish Exchange Act reports (due to being listed on a U.S. securities exchange or having had a Securities Act registration statement become effective); (2) be listed on a non-U.S. exchange that is its "primary trading market"[59] as of its most recently completed fiscal year; and (3) publish in English certain home country disclosure documents on its website or through an electronic information delivery system. This exemption continues until the FPI no longer satisfies the electronic publication condition; no longer maintains a listing of the subject class of securities on one or more exchanges in a primary trading market; registers a class of securities under Section 12 of the Exchange Act; or incurs reporting obligations under section 15(d) of the Exchange Act.

B. Periodic Reporting Obligations

1. Periodic Reports

An FPI with reporting obligations must file an annual report on Form 20-F with the SEC within four months after the FPI's fiscal year-end.[60] FPIs thus enjoy a benefit relative to U.S. issuers, which must file their annual reports on Form 10-K within 60 to 90 days after the end of their fiscal years. Form 20-F is also used to register outstanding securities to be listed on the NYSE or Nasdaq. Form 20-F provides investors with comprehensive information about an FPI's business, management and operational and financial status during a fiscal year. Among other items, Form 20-F must include:

- a description of the issuer's business;
- selected financial data;
- a discussion of material risk factors;
- management's discussion and analysis of financial condition and results of operations ("MD&A");[61]
- disclosures concerning directors, management and employees;[62]

- information about related-party transactions (including transactions and agreements with major shareholders);
- a summary of material litigation;
- a description of any changes to the rights of security holders;
- reports and attestations assessing the effectiveness of the company's internal controls over financial reporting;
- disclosures related to accountants, including fees and changes in the certifying accountant;
- full annual audited financial statements prepared in accordance with one of (i) U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), (ii) International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"); or (iii) GAAP of a foreign country, together with a U.S. GAAP-reconciliation disclosure;
- CEO and CFO certifications as required by Sarbanes-Oxley; and
- key documents filed as exhibits, including (i) charters and bylaws as currently in effect and any amendments to either; (ii) all certificates, instruments and agreements defining the rights of shareholders; (iii) all instruments and documents defining the rights of holders of long-term debt issued (with some exceptions); (iv) any voting trust agreements and any amendments to them; (v) material contracts; (vi) management contracts or compensatory plans (with some exceptions); (vii) a list of subsidiaries; and (viii) an explanation of earnings per share calculations.

SEC regulations issued under the Exchange Act pursuant to Sarbanes-Oxley further require a U.S. issuer's annual report to contain a report on internal controls that states management's responsibility for maintaining an adequate internal control structure and procedures for financial reporting and to include an assessment of the effectiveness of such controls as of the end of the reporting period.[63] An issuer's independent auditor is required to attest to management's assessment in accordance with standards adopted by the U.S. Public Company Accounting Oversight Board ("PCAOB").[64] These requirements apply to FPIs, although a new reporting company is not required to comply with them until it has been required to file, or has filed, an annual report for the prior fiscal year.[65]

As with Forms 10-K, the SEC does not routinely review annual reports on Form 20-F when filed. Yet the SEC may elect at any time to review all or part of an annual report after it has been filed, and the SEC is required to review disclosures made by issuers in their annual reports (including their financial statements) at least once every three years. If the SEC reviews a report, it may issue a comment letter that includes questions based on a disclosure and/or requests that the company revise the disclosure on the basis of its interpretation of its regulations and the information contained in the report. If the company

receives comments from the SEC, it must respond to each comment and make revisions to its report as necessary.[66] SEC comment letters and company response letters are made public.

Unlike U.S. issuers, which are required to file quarterly reports with the SEC, FPIs are exempt from quarterly reporting on Form 10-Q and need not file any other report on a quarterly basis. Both Nasdaq and NYSE require listed FPIs to submit semi-annual financial information to the SEC on Form 6-K.[67] If, however, an FPI is required to file or make public periodic reports under the laws of its home jurisdiction, it must disclose those reports under Form 6-K, in accordance with the criteria discussed below.

An FPI must furnish to the SEC material information it makes public in its home country or elsewhere under cover of Form 6-K. Unlike a U.S. issuer, which must make disclosures upon the occurrence of any of the specific events itemized on Form 8-K, an FPI must furnish information that it (i) makes or is required to make public pursuant to the laws of the jurisdiction of its domicile or the laws in the jurisdiction in which it is incorporated or organized, (ii) files or is required to file with a securities exchange on which its securities are traded and which was made public by that securities exchange or (iii) distributes or is required to distribute to its shareholders.[68] This information generally includes: changes in business; changes in management or control; acquisitions or dispositions of assets; bankruptcy or receivership; changes in registrant's certifying accountants; the issuer's financial condition and results of operations; material legal proceedings; changes in securities; defaults upon senior securities; material increases or decreases in the amount outstanding of securities or indebtedness; the results of shareholder votes; transactions with directors, officers or principal shareholders; the granting of options or payment of other compensation to directors or officers; and any other information that the registrant deems of material importance to shareholders.

Form 6-K consists of a copy of the relevant information, as well as cover and signature pages, and must be furnished "promptly" after the information required to be included has been made public, filed or distributed, although there is no precise deadline. U.S. issuers, by comparison, are generally required to file a Form 8-K within four business days of the event that triggers the filing obligation.

2. Forward-Looking Statements

When an issuer makes forward-looking statements in its periodic reports and public statements, it can avail itself of a safe harbor from securities fraud liability in the event the statements turn out to be incorrect.[69] A forward-looking statement is a statement that discusses future plans or performance, including revenue projections. The safe harbor provides for three separate tests, any one of which, if met, limits liability.

Under the first test, a forward-looking statement is protected if it is identified as a forward-looking statement and is "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." Guidance on what constitute "meaningful cautionary statements" can be found in case law.[70] In particular, such case law suggests that (i) the

cautionary language must be tailored to the forward-looking information; (ii) risk disclosure should convey the magnitude of the risk (not just that it exists); (iii) the warnings should be prominent; and (iv) if the forward-looking statement is based on specific assumptions, those assumptions should be disclosed. In the case of oral communications, the safe harbor provides more flexibility. Companies relying on the safe harbor for oral statements must still identify the statement as forward-looking, but may reference other "readily available" documents for the required disclosure of factors that could cause actual results to vary. This eliminates the need to take the awkward step of including lengthy oral risk factor recitations in every analyst conference call or offering road show. Under the second test, the statement is protected if it is immaterial. Under the third test, it is protected if the plaintiff is not able to prove that the statement was made with actual knowledge that it was false. If the forward-looking statement is accompanied by meaningful cautionary statements, then the first test applies and a defendant's state of mind is irrelevant.

3. Director and Officer Compensation Disclosures

FPIs must disclose in their annual reports on Form 20-F the aggregate amount of compensation given to directors and officers, including benefits in kind, deferred compensation accrued in the relevant fiscal year and stock option grants. Disclosure of compensation on an individual basis is required only if the FPI's home jurisdiction requires it or if the FPI otherwise makes that information publicly available in its home country. Additionally, an FPI must file as exhibits to its public filings individual management contracts and compensatory plans if required by its home-jurisdiction requirements or if it previously disclosed such documents.[71]

4. Regulation FD

Regulation FD under the Exchange Act prohibits selective disclosure of information by public U.S. issuers by requiring public companies that disclose, whether orally or in writing, material nonpublic information to securities analysts and shareholders to also disclose that information to the public.[72] Regulation FD applies to all issuers with a class of securities registered under Section 12 of the Exchange Act or that are required to file reports under Section 15(d) of the Exchange Act. The timing requirements of the public disclosure turns on intentionality: where disclosure is intentional, an issuer must make a public disclosure "simultaneously"; where it is unintentional, it must make it "promptly." Required public disclosures can be made on Form 8-K or through another method reasonably designed to provide broad, non-exclusionary distribution of the information to the public.

FPIs are not subject to Regulation FD. Nonetheless, most FPIs voluntarily comply with the rule or look to it for guidance in adopting policies that are designed to prevent selective disclosure because Regulation FD addresses a circumstance that can give rise to liability under Rule 10b-5 and is similar to the policies that underlie the prohibition on insider trading that applies to all public companies. Restrictions on public disclosure in an FPI's home jurisdictions may overlap Regulation FD requirements.

5. Conflict Minerals Disclosures

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") added Section 13(p) to the Exchange Act, and the SEC later adopted Rule 13p-1, requiring all reporting companies, including FPIs, that have "conflict minerals that are necessary to the functionality or production of a product manufactured or contracted by that registrant" to disclose that fact on Form SD. Conflict minerals, as defined in Form SD, include "Columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives, which are limited to tantalum, tin, and tungsten, unless the Secretary of State determines that additional derivatives are financing conflict in the Democratic Republic of the Congo or an adjoining country."[73]

Form SD requires companies to file either a short Conflict Minerals Disclosure or a longer Conflict Minerals Report, which also requires an "independent private sector audit."[74] The Conflicts Mineral Disclosure is filed as an exhibit to Form SD when the issuer reasonably determines that the conflict minerals in its supply chain did not originate in the Democratic Republic of Congo or an adjoining country or did come from recycled or scrap sources. The latter is filed as an exhibit to Form SD when the issuer reasonably determines that the conflict minerals in its supply chain originated in the Democratic Republic of Congo or an adjoining country. Form SD is due on May 31 following the end of an issuer's most recent fiscal year.

C. Section 13(d) and 13(g) Obligations of Shareholders

The shareholders (including non-U.S. shareholders) of an FPI with voting equity securities registered under Section 12 of the Exchange Act are subject to the reporting obligations under Sections 13(d) and 13(g) of the Exchange Act. These provisions are intended to give notice of significant acquisitions and potential changes of control to securities markets and other holders of the issuer's securities. The reporting obligations thus turn on the percentage of beneficial ownership of equity securities, and each shareholder or group of shareholders is responsible for complying with these provisions.

Rule 13d-1(a) under the Exchange Act mandates that a person or group that acquires, directly or indirectly, beneficial ownership of more than 5% of a class of registered equity securities must file a statement containing the information required by Schedule 13D with the SEC within 10 business days of the triggering event.[75] A shareholder who has filed a Schedule 13D must promptly amend it whenever a material change occurs concerning the facts set forth in the filing. Any increase or decrease of 1% or more in such a shareholder's ownership of the company's equity securities constitutes a material change sufficient to warrant an amended Schedule 13D.[76] Schedule 13D requires, among other things:

- a description of the identity and background of each filing person and each of its controlling persons and their respective directors and officers, including as to their occupations and criminal convictions or judgments in civil proceedings involving violations of securities laws;

- the purpose of the transaction and the plans that the acquiror may have for the subject company or for accumulating additional subject company securities;

- the source(s) and amount of funds used to acquire the securities;

- the percentage of the class of securities acquired (by the filing persons as well as by their controlling persons and their respective directors and officers);

- details about transactions in the subject company's securities in the preceding 60 calendar days by the filing persons as well as by their controlling persons and their respective directors and officers (including the date of each transaction, the amount of securities involved, the price per share and where and how the transaction was effected); and

- the nature of any arrangements to which the acquiror is a party relating to the subject company's securities.

In addition, ownership of derivative securities (such as options) may in certain circumstances constitute beneficial ownership of the securities upon which the derivatives are based, or otherwise require disclosure in the 13D. Even cash-settled instruments may raise 13D concerns. Accordingly, if it is contemplated that a company will enter into any derivative transactions referenced to its shares at any time before or during the proposal or transaction process it should be carefully discussed and the disclosure and other implications determined.

A person who would otherwise be required to file a Schedule 13D may in some cases file a Schedule 13G. Schedule 13G follows a similar format to Schedule 13D but requires the filer to provide less detailed information. There are three general types of 13G filers. First, a shareholder may qualify as a "passive investor" under Rule 13d-1(c) where that person (i) has not acquired the securities with any purpose of, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect, including any transaction subject to Rule 13d-3(b) and (ii) is not directly or indirectly the beneficial owner of 20% or more of the class of security that is the subject of the Schedule.[77] Such a person must file a Schedule 13G with the SEC within 10 business days after becoming a 5% beneficial holder and must amend its Schedule 13G annually, and at times more frequently, upon certain changes to its beneficial ownership.[78]

Second, a person may qualify as a "qualified institutional investor" under Rule 13d-1(b) where that person (i) acquired such securities in the ordinary course of its business and not with the purpose nor with the effect of changing or influencing the control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect, including any transaction subject to Rule 13d-3(b), (ii) is one of the qualified institutional investors enumerated in the rule and (iii) promptly notified any other person (or group within the meaning of Section 13(d)(3) of the Exchange Act) on whose behalf it

holds securities exceeding 5% of the class, of any acquisition or transaction on behalf of such other person which might be reportable by that person under Section 13(d). This person must file Schedule 13G with the SEC within 45 business days after the end of the calendar year in which the person became obligated to report under this rule, and must amend its Schedule 13G annually, and at times more frequently, although less frequently than a Rule 13d-1(c) passive investor, upon certain changes to its beneficial ownership.[79]

Third, a person may qualify as an "exempt investor" under Rule 13d-1(d) where that person beneficially owned 5% or more of a class of an issuer's equity securities before the securities were registered under the Exchange Act. At the time the class of securities is registered, the person must file a Schedule 13G with the SEC within 45 days after the end of the calendar year in which the issuer's shares were registered.[80] Thereafter, the person must amend its Schedule G annually upon certain changes to its beneficial ownership.[81] In the event the person acquires additional equity securities after the registration of the issuer's securities, it must report its entire holdings on Schedule 13D if the most recent acquisition, when added to all other acquisitions of securities of the same class within the prior 12-month period, aggregates to more than 2% of the class of such securities.[82]

Separate from the Section 13(d) and (g) requirements discussed above, Section 16(b) of the Exchange Act imposes reporting obligations on 10% shareholders (as well as directors and officers) of certain U.S. issuers, and also provides for disgorgement by such persons of so-called "short-swing" profits. Rule 3a12-3 of the Exchange Act exempts FPIs from the entirety of Section 16.

In addition, shareholders of FPIs that are required to report under Section 15(d), as opposed to Sections 12(b) or 12(g), are not subject to the beneficial ownership reporting requirements of Sections 13(d) and 13(g).[83]

D. Financial Statements

1. Accounting Standards

U.S. issuers are required to report audited financial statements prepared in accordance with U.S. GAAP. As noted, however, the Exchange Act affords FPIs an important accommodation with respect to their audited financial statements on Form 20-F: FPIs generally have the option of reporting audited financial statements prepared in accordance with (i) U.S. GAAP, (ii) IFRS as issued by the IASB (in which case no reconciliation with U.S. GAAP is required) or (iii) home-jurisdiction generally accepted accounting principles accompanied with U.S. GAAP reconciliation disclosure.[84] Reconciliation comprises both disclosure of the material variations between local accounting principles/non-IASB IFRS, on the one hand, and U.S. GAAP, on the other hand, as well as a numerical quantification of those variations.[85] An FPI registering for the first time must reconcile only the two most recently completed fiscal years (and any interim period).[86]

Pursuant to Sarbanes-Oxley, the SEC implemented Regulation G and amended Item 10(e) of Regulation S-K, which require a company releasing a non-GAAP financial

measure to provide the most comparable GAAP measure and a quantitative reconciliation of the non-GAAP measure with the comparable GAAP measure.[87] For FPIs with financial statements prepared in accordance with non-U.S. GAAP, GAAP refers to the specific accounting principles of the country under which the financial statements are prepared. A non-GAAP financial measure that triggers the application of the rules is one that excludes amounts that would otherwise be included, or includes amounts that would otherwise be excluded, from the most directly comparable GAAP measure.[88] Regulation G applies to any public disclosure of material information, whether in writing or orally, while Regulation S-K Item 10(e) is limited to SEC filings.

Exceptions exist for each of the two rules. An FPI is exempt from Regulation G if (i) its securities are listed or quoted on a foreign stock exchange, (ii) the non-GAAP financial measure is not derived from a measure presented in accordance with U.S. GAAP and (iii) the disclosure was made outside the United States.[89] The SEC has confirmed that the exception is available for information released simultaneously within and outside the U.S., including by means of the filing of a Form 6-K in the U.S.[90]

Regulation S-K permits an FPI to use a non-GAAP financial measure in its SEC filings, without complying with the requirements of Item 10(e), if (i) the measure relates to the home-jurisdiction GAAP used for the issuer's primary financial statements, (ii) is required or expressly permitted by the entity responsible for setting home-jurisdiction GAAP, and (iii) is included in the annual report the issuer uses in its home country or distributes to non-U.S. security holders.[91] The SEC has stated that a measure is "expressly permitted" if "the particular measure is clearly and specifically identified as an acceptable measure by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission."[92]

2. Independent Audit

U.S. issuers and FPIs must have their financial statements and internal controls audited by an "independent" auditor under SEC rules. As a general matter, the SEC will not recognize an auditor as independent vis-à-vis an audit client if the auditor is not capable of exercising objective and impartial judgment on all issues encompassed within the auditor's engagement. In determining whether or not this standard has been met, the SEC will consider all relevant circumstances, including all relationships between the accountant and the audit client, focusing on whether any such relationship: creates a mutual or conflicting interest between an auditor and the audit client, places an auditor in the position of auditing its own work, results in an auditor acting as management or as an employee of the audit client or places an auditor in a position of being an advocate of an audit client.

Audit committees, discussed in Sections VII.D.3 and VII.F.2, should be aware of and ensure that they or management have implemented appropriate policies and procedures to identify and evaluate such relationships and potential conflicts of interest.[93] As part of the inquiry concerning an auditor's independence, an audit committee should examine carefully the scope of work that the independent auditor has undertaken for the company and the value of that work to the auditor, including any related fees. An independent auditor also should be vetted carefully for any relationships that might be perceived as

affecting its independence, such as the presence of its former employees, or relatives of its employees, on a company's board or audit committee or among a company's management or senior financial staff, as well as any financial or other business relationships between an independent auditor and a company or its officers, directors or substantial shareholders.

In addition to SEC rules concerning auditor independence, the PCAOB has adopted ethics and independence rules that require an audit firm to disclose in writing to the audit committee all relationships between the auditor and the company that, in the auditor's professional judgment, may reasonably be thought to bear on its independence and to affirm to the audit committee that the auditor is independent.[94]

Under Section 303 of Sarbanes-Oxley and SEC rules,[95] directors and officers are prohibited from taking any action, direct or indirect, to coerce, manipulate, mislead or "fraudulently influence" any public accountant engaged in an audit of a company's financial statements if they know or should have known that their action, if successful, could render the company's financial statements false or materially misleading.

3. Internal Controls

In accordance with Sarbanes-Oxley, all public companies in the U.S. must have adequate internal controls over financial reporting: a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with proper accounting standards. This requirement aims to require an issuer to identify material weaknesses that have a reasonable possibility of leading to a material misstatement in the issuer's financial statements.

Management is primarily responsible for designing and implementing internal controls. This includes establishing and maintaining adequate internal control structures and procedures for financial reporting, evaluating the effectiveness of internal controls at least annually, identifying in a timely manner weaknesses and deficiencies in internal controls, taking appropriate corrective actions where deficiencies or weaknesses exist and notifying the independent auditor and audit committee of significant internal control deficiencies and any acts of fraud.

Reflecting the importance of effective internal controls, Section 404 of Sarbanes Oxley and the SEC rules promulgated thereunder, applicable to both U.S. issuers and FPIs, require public companies to include in their annual reports both an assessment by management of the company's internal control over financial reporting, and an independent auditor's attestation report on the company's internal controls and financial reporting. Sarbanes-Oxley made clear that an independent auditor's attestation under Section 404(b) must be based on the independent auditor's own audit of the company's internal controls. PCAOB AS 2201 prescribes the standards by which an independent auditor must conduct the Section 404(b) audit of a company's internal control over financial reporting.

The audit committee should review the adequacy and effectiveness of a company's internal controls over financial reporting, the process for monitoring compliance with applicable regulations and laws and any other legal matters that could have a significant

impact on a company's financial reports. In overseeing compliance with applicable laws and regulations and the integrity of the financial statements, the committee is encouraged to pay close attention to the compliance and internal controls environment generally. The U.S. Sentencing Commission, as well as the SEC, the DOJ and the PCAOB, have stressed the singular importance in this area of management's setting the right "tone at the top" and creating an organizational culture that encourages a commitment to compliance with law.

a. Reports on Internal Controls

Section 404 of Sarbanes-Oxley and the SEC rules adopted thereunder require management to disclose on Form 10-K or, in the case of an FPI, Form 20-F, management's involvement in and opinion regarding the effectiveness of the issuer's internal control procedures, as well as a report and attestation by the issuer's auditors. Also, if there will be disclosure that there have been material changes to internal controls over financial reporting during a quarter, the audit committee should inquire whether any significant deficiencies or material weaknesses underlying such changes are proposed to be specially disclosed, and, if it is determined that they will not be, ensure that this has been a properly considered decision and that there is a firm and reasonable basis for the decision not to disclose.

b. Disclosure Controls

In addition to financial accounting controls, issuers must assess their disclosure controls and procedures more generally, including procedures for good business and legal disclosure. While the SEC has not mandated any particular procedures, it recommends that issuers create a committee with responsibility for considering the materiality of information and determining disclosure obligations on a timely basis. The SEC has suggested that such a committee should include the principal accounting officer or controller, general counsel or other senior legal officer with responsibility for disclosure matters, principal risk management officer, chief investment relations officer and other officers or employees, including individuals associated with the issuer's business units.[96]

c. Disclosure Certifications by the CEO and CFO

In addition to internal controls disclosure, Sarbanes-Oxley requires certifications from an issuer's CEO and CFO under Sections 302 and 906. Section 302 of Sarbanes-Oxley, filed as exhibits to the relevant periodic report, requires a company's CEO and CFO to certify in each quarterly and annual report or, in the case of an FPI, Form 20-F that, among other things:

- based on their knowledge, the report is not misleading;
- based on their knowledge, the financial statements and other financial information included in the report fairly present, in all material respects, the financial condition and results of operations of the company;

- they are responsible for establishing and maintaining, and have performed certain specified tasks with respect to, the company's internal controls and disclosure controls and procedures; and

- they have disclosed to the audit committee and auditors all significant deficiencies and material weaknesses in the design or operation of internal controls, as well as any fraud that involves management or other employees with a significant role in the company's internal controls.

The certification required by Section 906 of Sarbanes-Oxley requires that each periodic report containing financial statements be accompanied by a statement by the company's CEO and CFO that (i) the report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act *and* (ii) that the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company.[97] The "fairly presents" standard, since it excludes reference to any accounting standard, encompasses the selection and proper application of accounting principles, the disclosure of financial information that is informative and reasonably reflects the underlying events and the inclusion of other information necessary to give investors a materially complete picture of a company's financial condition, results of operations and cash flows.[98] The CEO, CFO and all other company employees making accounting or disclosure judgments must therefore base their decisions not only on the accounting principles applicable to the company but also on the "fairly presents" standard.

The audit committee should take appropriate steps to satisfy itself that the company's CEO and CFO are meeting their obligations to the audit committee, the independent auditor and the public under the certification requirements established by the SEC, the company's securities market and Sarbanes-Oxley.

E. Proxy Rules

Rule 3a12-3 under the Exchange Act exempts FPIs with registered securities from the SEC's proxy rules. An FPI may thus prepare and distribute proxy statements in accordance with the law of its home jurisdiction rather than Schedule 14A. An FPI that distributes its proxy statement to shareholders in accordance with home-jurisdiction rules, however, may be required to furnish it under cover of Form 6-K.

F. Corporate Governance Obligations

Federal law and regulations, including the federal securities laws, Sarbanes-Oxley and Dodd-Frank, and the rules of the U.S. securities exchanges, establish corporate governance requirements. FPIs that trade on a U.S. securities exchange may receive exemptions from these requirements in certain circumstances, particularly with regard to director obligations and liabilities. Additionally, FPIs may be permitted to follow certain corporate governance practices in accordance with their home-jurisdiction rules and regulations.

1. Director Obligations and Liabilities

a. Transactions and Conflicts of Interests Involving Directors

Sarbanes-Oxley Section 402(a) added Section 13(k) to the Exchange Act, which makes it unlawful for any issuer, including an FPI, directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit or to renew an extension of credit in the form of a personal loan to or for any of its directors or executive officers. Loans that are not prohibited include travel advances, cash advances and issuer-sponsored credit cards provided they are used only in the ordinary course of business, and, with respect to credit cards, the terms are not more favorable than the terms the issuer offers to the public. In addition, the prohibition has been interpreted as not applying to the advancement by the issuer of legal expenses to its directors and officers.

FPIs must disclose on Form 20-F any transactions or loans between the company and key management personnel, meaning those persons having authority and responsibility for planning, directing and controlling the activities of the company, including directors and senior management and members of such individuals' close families.[99] They also have to disclose any arrangement or understanding with major shareholders, customers, suppliers or others, pursuant to which any director or senior manager was selected as a director or member of senior management. In addition, FPIs must disclose any directors' shareholdings in the FPI on Form 20-F.[100]

b. Directors' Dealings in Securities

The federal securities laws in the United States generally do not restrict a director's ability to purchase or sell securities of a company that is publicly traded (whether a U.S. issuer or an FPI), other than the following:

- *Restrictions in relation to insider trading*. A director cannot trade in the company's shares if he or she possesses material nonpublic information about the company.[101]

- *Blackout Trading Restrictions* ("Regulation BTR"). Section 306 of Sarbanes-Oxley prohibits directors and executive officers from acquiring or transferring company equity securities during pension fund "blackout periods"[102] imposed by the company itself or by a fiduciary of the company's pension fund. Under Regulation BTR, if a director or officer is subject to such a blackout trading restriction, the issuer must timely notify each director or officer and the SEC of the blackout period and disclose the reasons for the blackout period.[103]

- *Restrictions on public resale of securities that are considered "restricted" or "control" securities*. Restricted securities are securities acquired in unregistered, private sales from the issuer or from an affiliate of the issuer. Directors typically receive restricted securities through private placement offerings, Regulation D offerings or as compensation for professional services. Control securities are any securities held by an "affiliate" of the

issuer (including directors, policymaking executive officers and potentially significant shareholders) – even if those securities are acquired on the public market. Public resale of restricted and control securities by directors is permitted only if certain conditions are met, including with respect to holding periods, volume limitations and manner of sale, among other conditions.[104]

2. Sarbanes-Oxley

Sarbanes-Oxley was a significant revision to U.S. securities laws, focused on enhancing public disclosure, improving the quality and transparency of financial reporting and auditing and strengthening penalties for violations of securities laws. Sarbanes-Oxley provides that any violation of its provisions is considered a violation of the Exchange Act, thus availing the SEC of its full range of powers, remedies and penalties under the Exchange Act. Sarbanes-Oxley applies to all issuers, including FPIs, that have registered securities under Section 12 of the Exchange Act, that are required to file reports under Section 15(d) of the Exchange Act and that have filed a registration statement under the Securities Act that has not yet become effective or been withdrawn.

There are, however, exemptions from some Sarbanes-Oxley requirements for FPIs. Further, some Sarbanes-Oxley rules apply only to issuers with securities listed in the United States. The principal Sarbanes-Oxley requirements that apply to FPIs include the requirements set forth in Section VII.F.1 and the following:

- FPIs must generally include in their annual reports management's report on internal controls, and an independent auditor must attest to, and report on, management's assessment of internal controls.

- FPIs' CEOs and CFOs must provide certifications on financial statements and internal controls in annual reports.

- FPIs must disclose "off-balance sheet arrangements," a table of certain contractual obligations and a table of certain contingent liabilities and commitments in its SEC filings.

- FPIs' CEOs and CFOs are subject to potential clawbacks of bonus, incentive-based compensation or equity-based compensation in the event of an accounting restatement due to material noncompliance with any financial reporting requirements due to misconduct, as well as any profits that the CEO or CFO realized based on the sale of the company's securities during the previous twelve months.

- FPIs must disclose in their Form 20-F filings whether they have adopted a code of ethics that applies to certain of its executive officers, and, if not, must explain why they have not done so.

- Sarbanes-Oxley creates a series of requirements relating to the work of an FPI's external auditors, *e.g.*, that the auditor must be "independent," requires disclosure of fees paid to such auditor, generally requires auditor registration in the United States, and forbids the provision of certain non-audit services by the auditor.

- FPIs must disclose that their boards of directors have determined whether or not they have one audit committee "financial expert," and, if not, state why, and must disclose the name of the audit committee "financial expert" and whether such person is independent from management.

- FPIs with securities listed on an exchange must comply with certain audit committee standards, as discussed below. FPIs must generally maintain an audit committee composed solely of independent directors, although FPIs are granted certain exemptions from the "independence" requirements as well as a general exemption under Rule 10A-3(c). The audit committee must be granted certain responsibilities and authorities, such as oversight of auditors.

a. Audit Committee Requirement and Exemptions for FPIs

The audit committee of an issuer's board of directors plays a central role in the issuer's corporate governance, which includes supervising management, overseeing the internal audit and ensuring adequate disclosure. Rule 10A-3, which implemented Section 301 of Sarbanes-Oxley, and which applies to issuers that are listed on the U.S. securities exchanges, requires each audit committee member to be a member of the listed issuer's board and to otherwise meet certain independence requirements. Pursuant to the rule, the audit committee requirements include the following:

- *Independence*. All members of the audit committee must be independent from the issuer, which means, among other things, that they may not accept consulting, advisory or other compensatory fees from the issuer or any affiliate, or be an affiliate. Under the NYSE Listed Company Manual, a director does not qualify as independent unless the board affirmatively determines that the director has no material relationship with the company.[105] Similarly, under Nasdaq rules, the board of directors must make a determination of which members or nominees are independent.[106]

- *Responsibilities relating to registered public accounting firms*. The audit committee is responsible for the appointment, compensation, retention and oversight of external auditors and must have the authority to resolve disagreements between management and external auditors regarding financial reporting.

- *Complaints*. The audit committee must set up procedures for receipt, retention and treatment of complaints regarding accounting, internal

accounting controls and auditing matters, including for confidential submissions by employees of the company.

- *Authority to engage advisers*. The audit committee must have the authority to engage independent counsel and advisers as it deems necessary.

- *Funding*. The audit committee must have adequate funding to compensate external auditors and advisers as well as to cover administrative expenses.

Rule 10A-3 grants FPIs limited exemptions from the independence requirement. The members of the audit committee may be exempt from such requirement in certain circumstances, including non-executive employee representation on the committee, two-tiered board systems, common in certain foreign jurisdictions, in which the committee is drawn from members of the supervisor/non-management board, representation of a controlling shareholder that owns more than 50% of the FPI's voting securities and affiliated persons with only observer status and foreign government representation.[107]

An FPI can therefore comply with the audit committee requirements by either:

- Forming an audit committee in full compliance with the standard requirements with at least three independent board members. The board of directors must approve the creation of the committee, the delegation of powers to the committee (to the extent permitted by the law of the home jurisdiction) and the committee's charter, internal policies and procedures; or

- Under the general exemption for FPIs provided in Rule 10A-3(c)(3), using an existing board of auditors or similar body to perform the role of an audit committee, to the extent permitted by the law of the home jurisdiction. This exemption is available to FPIs provided that:[108]

    - the FPI has a board of auditors (or similar body), or statutory auditors, set up or selected under a law or listing requirement of the home jurisdiction that expressly requires or permits such a board or body;

    - the board of auditors is either (i) separate from the board of directors or (ii) composed of one or more members of the board of directors and one or more members who are not members of the board of directors;

    - the board of auditors is not elected by management and no executive officer of the FPI is a member of it;

    - local law stipulates standards for the board of auditors' independence from management;

    - the board of auditors is responsible, to the extent permitted by local jurisdiction law, for the appointment, retention and oversight of the FPI's independent auditors; and

- the remaining requirements of an audit committee (*i.e.*, complaint procedures, authority to engage advisers and funding) are complied with to the extent permitted by the laws of the local jurisdiction.

An FPI relying on Rule 10A-3's exemption from independence, or the general exemption under Rule 10A-3(c), will need to disclose on Form 20-F its reliance on the exemptions and an assessment of whether this reliance will materially adversely affect the audit committee's ability to act independently and to satisfy any of the other requirements of Rule 10A-3.[109] Moreover, while NYSE and Nasdaq rules applicable to U.S. issuers requiring at least one member of the audit committee to be a financial expert do not apply to an FPI, it is obligated to disclose on Forms 20-F whether it has at least one financial expert serving on its audit committees and, if so, the name(s) of the expert(s).[110]

3. Dodd-Frank

Signed into law in 2010 in response to the financial crisis, Dodd-Frank reformed numerous areas of U.S. securities regulation that affect public companies in the U.S. It applies to both U.S. issuers and, in some cases, to FPIs, and contains several key provisions affecting the corporate governance of such companies, including compensation committee disclosures, incentive-based compensation clawbacks and, as discussed in VII.B.5, conflict mineral disclosures.

a. Independent Compensation Committee

Rule 10C-1 of the Exchange Act, added pursuant to Section 10C of the Exchange Act and Section 952 of Dodd-Frank, directs U.S. securities exchanges to require (i) that each member of the compensation committee of a U.S. listed company be a member of the board and otherwise independent, (ii) that the compensation committee be given adequate funding and authority to retain compensation consultants, independent legal counsel, and other compensation advisors and (iii) compliance with independence considerations for all such advisors. In determining independence, Section 10(c)(a) requires the U.S. securities exchanges to consider certain factors, including the source of the director's compensation (such as any consulting, advisory or other compensatory fees paid by the company) and whether the director is affiliated with the company or its subsidiary or affiliate. FPIs that disclose annually the reasons why they do not have an independent compensation committee in place are not subject to the independence requirements.[111]

Further, Form 20-F requires FPIs to disclose information about their compensation committee, including the names of the committee members and a summary of the terms under which the committee operates. Both the NYSE and Nasdaq permit an FPI to follow home-jurisdiction practices with respect to its compensation committee so long as the FPI discloses annually the differences between its home-jurisdiction practices and the applicable exchange requirements as well as, for Nasdaq, the reasons why it does not have an independent compensation committee in place.

b. Incentive-Based Compensation Clawback

Section 10D of the Exchange Act, added pursuant to Section 954 of Dodd-Frank, requires that the SEC direct U.S. securities exchanges to require listed issuers to develop and implement policies providing for the "clawback" of incentive-based compensation paid to current or former executive officers following a restatement due to the company's material noncompliance with financial reporting requirements. Such policies must apply to incentive-based compensation (including stock options) paid during the three-year period preceding the restatement and provide for recovery of the amount in excess of what otherwise would have been paid to the officer.[112]

Dodd-Frank, and Section 10D, furthers a trend in which compensation can be clawed back even though the officers in question were not directly involved in the actions that gave rise to the restatement. The SEC, for example, announced in 2011 a settlement in which it "clawed back" incentive based compensation from a former CEO who was not accused of any wrongdoing.[113] In that instance, the court rejected the notion that the misconduct-triggering clawback must be the officer's own and focused instead on the misconduct of the company, acting through the efforts of its officers and employees.

It is unclear whether the SEC can, or will, exclude FPIs from the clawback remedy requirement. A proposed rule from 2015 would require companies listed on national security exchanges to allow for clawback remedies and does not allow the national exchanges to exempt FPIs from such requirement. It does, however, allow FPIs to forego recovery if (among other requirements) recovery would violate the FPI's home country law, if supported by an opinion of counsel, or if recovery is impracticable because the expense of doing so exceeds the amount to be recovered.[114] Restatements are less common for FPIs than for U.S. issuers because IFRS and other foreign accounting principles often provide for adjustments of accounting errors in current periods under circumstances in which U.S. GAAP would require restatements, and the laws of some jurisdictions limit restatements.

4. Code of Ethics

An FPI must disclose on Form 20-F whether it has adopted a written code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions. The FPI must also describe the nature of any amendment to, or waiver of, any provision of the code. If the company discloses that it has not adopted such a code, it must explain why it has not done so.[115]

5. NYSE and Nasdaq Corporate Governance Listing Standards

The NYSE and Nasdaq impose rules and regulations governing audit committee composition and disclosures for companies that list on their exchanges, in addition to those under law. These rules apply to listed U.S. issuers and FPIs, although the securities exchanges offer certain accommodations for FPIs that allow them to follow home-jurisdiction corporate governance practices. Generally, FPIs must comply with the corporate governance standards of the relevant U.S. securities exchange or explain their

departures from those standards. Under NYSE and Nasdaq "comply or explain" rules, and in response to certain SEC amendments to Form 20-F, FPIs must provide a concise summary of any significant ways in which their corporate governance practices differ from those followed by U.S. issuers under the relevant exchange rules.

a. NYSE Corporate Governance Requirements

The NYSE has granted substantial flexibility to listed FPIs by allowing them to follow their home-jurisdiction corporate governance practices rather than its standard corporate governance requirements as set forth in Rule 303A of the NYSE Listed Company Manual. There are exceptions to this accommodation, however, as FPIs must comply with the following:

- *Audit Committee*. Listed FPIs must have an audit committee that satisfies the requirements of Exchange Act Rule 10A-3, described in Section VII.D.3.

- *Differences in Corporate Governance Practices*. Listed FPIs must disclose any significant ways in which their corporate governance practices differ from those followed by U.S. issuers under the NYSE listing standards.

- *Annual Certification Relating to Observance of Corporate Governance Standards*. The CEO of a listed FPI must certify to the NYSE each year that he or she is not aware of any violation of the NYSE corporate governance listing standards, qualifying the certification to the extent necessary. This certification must be disclosed in the FPI's annual report to shareholders or, if the company does not prepare an annual report to shareholders, in the company's annual report on Form 20-F filed with the SEC. In addition, the CEO of a listed FPI must promptly notify the NYSE in writing after any executive officer becomes aware of any material noncompliance with the applicable NYSE corporate governance standards.

b. Nasdaq Corporate Governance Requirements

The Nasdaq corporate governance rules also permit FPIs to follow home-jurisdiction practices (except for notification of noncompliance pursuant to Listing Rule 5625, the voting rights requirement pursuant to Listing Rule 5640, and the audit committee rules under Listing Rule 5605(c)(3)) in lieu of certain Nasdaq corporate governance requirements, but only if the issuer promptly informs Nasdaq of such departure, as necessary, and provides a letter from outside counsel in the FPI's home country certifying that the FPI's practices are not prohibited by any home-jurisdiction law. Each Nasdaq requirement that an FPI does not follow must also be disclosed in the FPI's annual report on Form 20-F, along with a description of the alternative corporate governance practices followed by the issuer. As with NYSE-listed companies, all Nasdaq-listed companies must comply with the audit committee requirements of Exchange Act Rule 10A-3.

c. NYSE and Nasdaq Shareholder Approval Requirements

The NYSE's rules do not expressly exempt FPIs from its 20% shareholder vote rule, which, subject to certain exceptions, requires an issuer to obtain shareholder approval prior to issuances where the issued common stock equals 20% or more of the number of shares of common stock or voting power outstanding before such issuance. The NYSE, however, will orally confirm to an FPI upon request at the time of a contemplated issuance that it is not required to comply with the rule so long as the FPI provided as part of its original listing application an opinion from local counsel certifying that a shareholder vote is not required under the laws of its home jurisdiction for such an issuance.

Nasdaq allows FPIs to follow their home-jurisdiction rules instead of its own 20% rule where they promptly inform Nasdaq, provide Nasdaq with an opinion from local counsel certifying that their practices do not violate the laws of their home jurisdictions, state in the annual Form 20-F that they are not complying with the 20% rule and explain the home-jurisdiction practices with which they are complying.

G. Delisting and Deregistering Securities

As with U.S. companies, FPIs that wish to cease having reporting and other obligations under the Exchange Act—that is, to "go dark"—may delist their securities from a U.S. securities exchange, if previously listed, and deregister their securities under the Exchange Act. Once this happens, an issuer is no longer subject to the applicable U.S. securities exchange's rules or the Exchange Act obligations, including the obligations under Sarbanes-Oxley.

As described in Section VII.A, a company, including an FPI, incurs obligations under the Exchange Act in any of the following three ways: by listing securities on a U.S. securities exchange under Section 12(b) of the Exchange Act; by surpassing a specific asset size and shareholder count under Section 12(g) of the Exchange Act (unless it is then exempt under Rule 12g3-2); or by registering an offering under the Securities Act, under Section 15(d) of the Exchange Act. In order to "go dark," the registrant must terminate or suspend its obligations under each applicable Exchange Act section.

1. Delisting and Deregistration under Section 12(b)

To delist and deregister under Section 12(b) of the Exchange Act, an issuer must first delist from each U.S. securities exchange on which it is listed and file a Form 25 with the SEC.[116] At least 10 days before filing a Form 25, an issuer must notify each such exchange in writing of its intent to file a Form 25 and issue a press release, also posted to the issuer's website, that it intends to delist and deregister, including its reasons therefor. Form 25 is automatically effective, as is the issuer's delisting, 10 days after Form 25 is filed; the issuer's deregistration is effective 90 days after filing. When a Form 25 becomes effective, the issuer's reporting obligations under Section 13(a) are suspended, meaning the issuer need not file current or periodic reports due on or after such effectiveness, unless the issuer is required to continue reporting pursuant to Sections 12(g) or 15(d).

Certain obligations, however, continue to apply to the FPI until its deregistration is effective (specifically, for FPIs, the tender offer rules and Sections 13(d) and 13(g)).

2. Termination of Obligations under Sections 12(g) and 15(d)

When an issuer delists and deregisters under Section 12(b), it may still have obligations under Sections 12(g) or 15(d) of the Exchange Act. FPIs have two main paths for addressing these obligations:

- terminate obligations under both sections pursuant to Rule 12h-6; or
- (a) terminate obligations under Section 12(g) pursuant to Rule 12g-4 and (b) suspend obligations under Section 15(d) either pursuant to Rule 12h-3 or pursuant to Section 15(d) itself.

These paths are discussed in turn below.

a. Rule 12h-6

The SEC adopted Rule 12h-6 in 2007 in order to facilitate Exchange Act deregistration by FPIs. An FPI would be able to terminate its obligations under Sections 12(g) and 15(d) by filing a Form 15F if it meets the following conditions:

- the FPI has had reporting obligations under the Exchange Act for at least 12 months preceding the Form 15F filing, and has filed at least one annual report on Form 20-F;
- the FPI's securities have not been sold in the U.S. in a registered offering during the 12 months preceding the Form 15F filing, subject to certain exceptions; and
- the FPI has maintained a listing of its securities on one or more non-U.S. exchanges that, either singly or together with the trading in another jurisdiction, constitutes a "primary trading market," as defined above, for the securities.

In addition to the three requirements above, the FPI must also certify that it passes at least one of the following two tests:

- *The trading volume test*. During the 12 months prior to the Form 15F filing, the average U.S. daily trading volume of its securities was less than or equal to 5% of the average daily trading volume of its securities worldwide; or
- *The record holder test*. On a date within 120 days before the Form 15F filing, there were fewer than 300 holders of record of the securities (either worldwide or in the U.S.).

An FPI must wait at least 12 months to file Form 15F in reliance on the Trading Volume Test (as opposed to the Record Holder Test) if it has delisted a class of equity securities from a U.S. securities exchange or terminated a sponsored ADR facility and at the time of delisting or termination the U.S. average daily trading volume of the applicable securities exceeded 5% of the worldwide average daily trading volume for the preceding 12 months. In addition, for purposes of the Record Holder Test, U.S. holders are counted using the method in Rule 12g3-2(a) (described above in Section VII.A), except that the obligation to look-through record ownership of the brokers, dealers, banks and nominees is limited to those in the U.S. and certain foreign jurisdiction.

Upon filing of the Form 15F, the FPI's duty to file reports is suspended. Termination of registration under Section 12(g) and of the duty to file reports under Section 15(d) is effective 90 days after filing.

b. Termination of Section 12(g) Obligations Pursuant to Rule 12g-4

If Rule 12h-6 is unavailable, an FPI may seek to rely on Rule 12g-4, which is available to all issuers (both U.S. issuers and FPIs). In order to terminate registration under Section 12(g) pursuant to Rule 12g-4, the FPI must file a Form 15 certifying that its securities are held of record by fewer than 300 holders (or 500 holders if the Company's total assets have not exceeded $10 million as of the last day of its last three fiscal years). Unlike Rules 12g3-2(a) and 12h-6, for purposes of Rule 12g-4, securities held in street name by a broker-dealer are held of record only by the broker-dealer.[117]

An issuer cannot file a Form 15 after delisting and deregistering under Section 12(b) until the Form 25 is effective (*i.e.*, 10 days after the Form 25 is filed). Upon filing of the Form 15, the issuer's duty to file reports is suspended. Termination of registration under Section 12(g) is effective 90 days after filing.

An FPI that terminates its registration under Section 12(g) pursuant to Rule 12g-4 may then need to claim the exemption under Rule 12g3-2(b), in case the number of record holders of its securities later rises above the applicable threshold.

c. Suspension of Section 15(d) Obligations

If Rule 12h-6 is not available to terminate Section 15(d) obligations, there are two avenues for suspension of Section 15(d) reporting obligations, which are generally available for all issuers (both U.S. issuers and FPIs):

- the first is automatic—the issuer's reporting obligations are suspended for any fiscal year if its securities are held by fewer than 300 record holders at the beginning of that fiscal year;

- the second is available at any time, but requires the issuer to file a Form 15 pursuant to Rule 12h-3 (making the same certifications described above in the discussion of Rule 12g-4 with respect to the number of shareholders). As with deregistration under Section 12(g), the issuer's reporting

obligations under Section 15(d) would be suspended immediately upon filing the Form 15. Unlike deregistration under Section 12(g), however, a condition to filing a Form 15 to suspend Section 15(d) reporting obligations is that the issuer be current in all of its Section 13(a) reporting obligations.

Note that reporting obligations under Section 15(d) may only be suspended, not terminated, because they automatically retake effect with respect to a given fiscal year if there are more than 300 holders of record on the first day of that fiscal year. The number of record holders is counted in the same manner as for purposes of Rule 12g-4, discussed above.

VIII.

Sources of Liability

The Securities Act and the Exchange Act each impose liability on issuers, including FPIs, that run afoul of U.S. federal securities laws. The key provisions of these laws that create potential liability are Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which create liability for intentionally false and misleading statements that impact trading in securities, and Sections 11, 12 and 17 of the Securities Act, which create liability for issuers and others in connection with public offerings. The SEC and, in certain cases, private parties and the DOJ, may bring actions against parties who violate these provisions of the U.S. securities laws.

These liability provisions adopt the general disclosure philosophy of the U.S. federal securities laws: with few exceptions, each provision requires only fair disclosure.[118] Accordingly, while affirmative misrepresentations may lead to liability, "[s]ilence, absent a duty to disclose, is not misleading" under the U.S. federal securities laws.[119] Liability based on the omission of information remains possible, however, if a duty to disclose exists under applicable law (such as an SEC disclosure regulation), or if a party makes voluntary, but incomplete, statements regarding a particular subject.[120]

The U.S. federal securities laws limit liability to material misrepresentation or disclosure. A fact is material if there is "a substantial likelihood" that it would be "viewed by the reasonable investor" as "significantly alter[ing] the 'total mix' of information made available."[121] Although questions of materiality are typically decided on a case-by-case basis, based on a thorough factual record, courts have developed some general principles that allow the materiality question to be resolved as a matter of law. For example, statements in a corporate code of business conduct have been found to be "'inherently aspirational,'" "not capable of objective verification," and therefore not actionable under the U.S. securities laws, in part because "[a] contrary interpretation . . . could turn all corporate wrongdoing into securities fraud."[122]

In addition to the provisions in the Securities Act and the Exchange Act, the FCPA imposes anti-bribery and other obligations on issuers, with substantial potential penalties for noncompliance, and other federal legislation, including Sarbanes-Oxley and Dodd-Frank, has imposed additional obligations on issuers, increased potential penalties for violations and expanded enforcement authorities of federal agencies.

A. SEC Actions and Private Litigation

The SEC enforces the U.S. federal securities laws through either civil proceedings in U.S. courts or administrative proceedings before administrative law judges ("ALJs"). The SEC's Division of Enforcement (the "Division") conducts investigations and recommends that the SEC bring charges, as appropriate. The Division also prosecutes cases on behalf of the SEC and works with U.S. and non-U.S. law enforcement agencies with regard to criminal proceedings. The Division's investigations involve informal inquiries, interviews with witnesses and reviews of brokerage records and trading data,

among other methods. When it obtains a formal order of investigation, the Division may subpoena witnesses to testify and produce books, records and other documentation. When an investigation is complete, the Division presents its findings to the SEC, which can authorize the Division to file a case, either in federal district court or before an administrative judge, settle the matter before trial or take no action.

Civil actions and administrative proceedings differ both in process and possible sanctions or remedies. In civil actions in U.S. courts, the SEC files a complaint with a district court and asks the court for specific sanctions or remedies, which often include injunctions to prevent further acts or practices that violate the U.S. federal securities laws, civil money penalties, disgorgement of profits and/or barring an individual from serving as a corporate officer or director for a certain period of time. In administrative proceedings, ALJs preside over hearings at which the SEC and the charged individual(s) present evidence. These judges issue initial decisions, which include findings of fact, legal conclusions and sanctions or remedies. Any party may appeal such initial decisions by ALJs to the SEC, which may affirm, reverse or remand the decision for additional hearings, and final orders from the SEC are subject to a further appeal to a U.S. appellate court. Sanctions and remedies available in administrative hearings include cease-and-desist orders, suspension or revocation of broker-dealer and investment advisor registrations, censures, bars from association with the securities industry, bars from serving as an officer or director of a public company, civil money penalties and/or disgorgement of profits.

Any violation of a provision of the U.S. securities laws can give rise to criminal liability if the facts and circumstances are sufficiently egregious. The SEC may refer such violations to the DOJ for criminal prosecution, and the DOJ also opens investigations at its own initiative. Any person who willfully violates the Securities Act or any of the rules promulgated thereunder can be sentenced to up to five years in prison and fined up to $10,000. Willful violations of the Exchange Act or the rules thereunder carry sentences of up to 20 years in prison and fines of up to $5 million. Companies that violate the Exchange Act may be subject to a $25 million criminal penalty. Companies can also face civil monetary penalties of similar magnitude in SEC enforcement actions.

Private parties may also be able to bring actions in U.S. courts for violations of the securities laws. As the Supreme Court has explained, there are in total "eight express liability provisions" in the Securities Act and the Exchange Act: Sections 9, 16, 18, 20 and 20A of the Exchange Act and Sections 11, 12 and 15 of the Securities Act.[123] Other private rights of action have been implied by the courts. For example, although the Exchange Act is silent as to whether private parties can sue for violation of Section 10(b) of the Exchange Act, courts have long recognized a private right of action under Rule 10b-5. In 1983, the Supreme Court, acceding to the significant extent of case law that developed over the years in the lower courts, recognized a private right of action under the Rule 10b-5.[124]

B. The Liability Provisions of the Securities Act and Exchange Act

1. Section 10(b) and Rule 10b-5 of the Exchange Act

Among the most significant provisions of the U.S. federal securities laws are Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. Section 10(b)

forbids the use of any "manipulative or deceptive device or contrivance" in contravention of rules prescribed by the SEC "in connection with the purchase or sale" of any security. Rule 10b-5, in turn, prohibits using "any device, scheme or artifice to defraud," making material misstatements or omissions or engaging in "any act, practice or course of business" that would "operate as a fraud or deceit upon any person" "in connection with the purchase or sale of any security." Establishing a violation of Rule 10b-5 requires proof of scienter: that the defendant acted with an "intent to deceive, manipulate, or defraud."[125] In general, to prevail on a Rule 10b-5 claim, a plaintiff must prove that the defendant (i) made a false statement or an omission of material fact, (ii) with scienter, (iii) in connection with the purchase or sale of a security, (iv) upon which the plaintiff justifiably relied and (v) which proximately caused (vi) the plaintiff's economic loss.[126]

Under Rule 10b-5, therefore, an issuer and its employees may be liable for disseminating false or misleading information or suppressing material information about the issuer that was required to be disclosed, whether or not the issuer or any of its employees purchased or sold any securities; rather, it is enough that their conduct occurred "in connection with" purchases or sales of securities by others. Rule 10b-5 liability can be based on information filed in a registration statement or in a report filed with the SEC (including on Form 6-K), or upon public statements issued by the company. Another Exchange Act provision, Rule 12b-20, requires that public filings contain such "material information . . . as may be necessary to make the required statements, in light of the circumstances under which they are made not misleading," and does not require the SEC to prove that the issuer engaged in fraud or recklessness tantamount to fraud as would be required under Rule 10b-5.[127] All issuers should therefore carefully review their press releases and other public information prior to release.

Liability may also arise under Rule 10b-5 from "insider" trading in securities while material information remains undisclosed. Insiders should not trade when a material event (including a proposed financing or acquisition) is developing but is not yet ripe for disclosure. A corporate insider also may be held liable on an insider trading theory for the actions of persons to whom he or she discloses material nonpublic information and who then trade on that information, even though the insider has not personally profited.[128] FPIs should thus avoid selective disclosure of material nonpublic information out of concern for potential liability under Rule 10b-5.

As noted, issuers, including FPIs, that violate Rule 10b-5 may be liable to private parties and subject to federal enforcement action and, where such violation is willful, criminal liability. Investors can sue issuers, as well as their directors and officers, in federal court under Rule 10b-5 to recover losses sustained as a result of the issuer's materially misleading statements or omissions made with scienter. U.S. courts allow investors to bring class-action claims under Rule 10b-5, which means that an issuer can be liable to thousands of investors for a single misstatement or omission. In the majority of cases that advance beyond the pleadings stage, issuers ultimately reach a settlement with class-action plaintiffs' attorneys instead of taking a case to trial. From 2009 to 2018, the median size across all 537 class-action settlements in Rule 10b-5-only cases in the United States was $8.2 million.[129] Settlements in several notable cases, however, have been significantly

higher, including Tyco International Ltd. ($3.7 billion), AOL Time Warner, Inc. ($2.7 billion), Nortel Networks ($2.3 billion) and Royal Ahold ($1.1 billion).

Of particular importance to FPIs, in 2010, the U.S. Supreme Court handed down a ruling in *Morrison* v. *National Australia Bank Ltd.* that limited the liability of FPIs under Rule 10b-5.[130] According to *Morrison*, non-U.S. investors who purchased securities on a non-U.S. exchange cannot obtain damages from FPIs, or their directors or officers, under Rule 10b-5. Since 2010, lower courts have held that U.S. investors who purchased shares on a non-U.S. exchange also cannot recover damages under Rule 10b-5.[131] An FPI, however, may still be liable to investors who acquired its ADRs. Dodd-Frank was intended to partly overrule *Morrison* by allowing the SEC and the Justice Department to bring actions under Rule 10b-5 (as well as other antifraud provisions of the U.S. securities laws) against FPIs, even when an issuer's shares are not listed on a U.S. securities exchange, but whether that statute successfully did so remains an open question.[132]

Rule 10b-5 can be enforced by the SEC in injunctive and civil penalty actions, brought pursuant to Section 21(d) of the Exchange Act, and by the Justice Department in actions brought pursuant to Section 32(a) of the Exchange Act, for willful violations of that Act. Similarly, remedies available in private actions under Rule 10b-5 include injunctive relief as well as damages.[133] The Supreme Court has stated that the correct measure of damages under Rule 10b-5 for a defrauded seller or purchaser is the "out-of-pocket" measure, which is the difference between the price paid or received and the true value at the time of purchase (in the absence of fraudulent conduct).[134] It is universally accepted that punitive damages may not be awarded under Rule 10b-5.[135] The Private Securities Litigation Reform Act of 1995 (the "PSLRA") adopted a further cap on damages in an attempt to account for any "bounce-back" in a security's price after full or corrective disclosure is made.

2. Sections 11 and 12 of the Securities Act

Sections 11 and 12 are the basic private liability provisions of the Securities Act. In contrast with Rule 10b-5 under the Exchange Act, neither Section 11 nor Section 12 requires a plaintiff to prove scienter. In fact, as discussed below, both provisions impose strict liability on issuers who make material misstatements or omit material information that was required to be disclosed.

In keeping with the general scheme of the Securities Act, Sections 11 and 12 protect only buyers and not sellers. The difference between the two sections is this: Section 11 makes those responsible for a false or misleading registration statement liable in damages to any and all purchasers regardless of from whom they bought (provided that the purchaser can trace his shares to the defective registration statement), while Section 12 allows a purchaser to rescind his purchase of securities, or to get damages from his seller if he no longer holds the securities, if the seller used a false or misleading prospectus or false or misleading oral statements in making the sale. Section 11 deals with the "manufacturers" and "wholesalers" of securities (*i.e.*, issuers, underwriters and experts who aid them in preparing registration statements), has no privity requirement and provides a remedy in damages. Section 12, on the other hand, deals with "retailers" of securities (*i.e.*, the

securities dealers who sell to the general public), requires privity (except for issuers in primary offerings selling through underwriters) and provides primarily for a rescission remedy.

A purchaser may not rescind or recover damages from a seller under Section 12 *and* recover damages from an issuer, underwriter or their advisors under Section 11. Yet nothing prevents a litigant from pursuing actions under both Sections 11 and 12 to judgment and then electing his remedy.

a. Section 11 of the Securities Act

Section 11 provides that any person who purchases a security covered by a registration statement has a private right of action, if at the time the registration statement became effective it contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading. The potential defendants under Section 11 include (i) the issuer, (ii) every person who signed the registration statement (*i.e.*, the directors and certain executive officers of the registrant), (iii) every person named, with their consent, in the registration statement as being or about to become a director, (iv) every expert, such as an accountant, engineer or appraiser, who has with his consent been named as having prepared or certified any part of the registration statement and (v) every underwriter of the security. All of the above, except experts, are responsible for all misstatements and omissions in the registration statement. Experts are responsible for misstatements and omissions only in those parts of the registration statement they are named as having prepared or certified.[136]

As noted above, unlike under Rule 10b-5, a plaintiff under Section 11 need not establish a defendant's scienter, or even negligence, to prove his or her case.[137] Section 11 imposes strict liability: it generally is enough if the registration statement is shown to have contained material misstatements or omissions.[138] Moreover, a purchaser who wishes to bring an action under Section 11 need not have purchased the securities in question in the initial offering. So long as the purchaser can trace the securities to a registration that contained a material misstatement or omission when it went effective, and is within the statute of limitations, the purchaser may sue.

Moreover, Section 11(a) provides that a person who purchases securities after an earning statement covering a period of at least 12 months beginning after the effective date of the registration statement has been made available must prove that he acquired the securities in reliance on a materially false or misleading statement in the registration statement in order to have a right of recovery under Section 11. Yet such person need not show that he or she read the registration statement in order to prove reliance on it. A Form 20-F may constitute an "earnings statement" for purposes of this provision.[139]

Under Section 11, the issuer is absolutely liable for material deficiencies in the registration statement irrespective of good faith or the exercise of due diligence. By contrast, the standard of liability imposed upon directors, officers and underwriters is somewhat less stringent, as a "due diligence" defense is available to all non-issuer defendants. A non-issuer defendant who is not designated as an expert may establish this

defense by proving (i) with regard to parts of the registration statement based either on official reports or statements or on the reports or statements of experts (such as financial statements to the extent certified by independent public accountants), that he had no reason to believe that such statements or reports were false or misleading or were inaccurately represented in the registration statement and (ii) with regard to other parts of the registration statement, that he conducted a reasonable investigation, and that, after such investigation, he had reasonable grounds for believing, and did believe, that the registration statement was neither false nor misleading.[140] Section 11(c) sets the standard of reasonableness for non-experts as that required of a prudent man in the management of his own property.

Thus, officers, directors and underwriters must exercise due diligence with respect to the preparation of the registration statement. They may not avoid liability by relying solely upon counsel or some other person to prepare the registration statement. If the issuer has made provision for the indemnification of its officers and directors, these arrangements must be disclosed in the registration statement. Any indemnification by the issuer of the underwriters or their controlling persons against liability under the securities laws must also be disclosed in the prospectus.[141]

The primary remedy under Section 11 is money damages. Section 11(e) provides that the plaintiff may recover damages representing the decline in value of the plaintiff's securities, measured as the difference between the amount paid for the securities (not exceeding the price at which the securities were offered to the public) and (i) the value thereof as of the time such suit was brought, (ii) the price at which such securities were sold in the market before suit or (iii) the price at which such securities were sold after suit but before judgment if such damages were less than the damages representing the difference between the amount paid for the securities (not exceeding the price at which the securities were offered to the public) and the value thereof as of the time such suit was brought. Notwithstanding the above, Section 11 provides a "reverse loss causation" affirmative defense: damages are reduced to the extent that the defendant can prove that the plaintiff's losses were caused by something other than the defect in the registration statement. As with claims under Rule 10b-5, U.S. courts permit Section 11 plaintiffs to bring class actions on behalf of thousands of investors at the same time. Section 11 has resulted in few reported awards of damages, although Section 11 cases that survive the defendants' motion to dismiss are regularly settled before trial.

b. Section 12 of the Securities Act

Section 12(a)(2) provides that the purchaser of a security has a right of action for rescission or damages against the person who offered or sold the security to him or her by means of any prospectus or oral communication containing a material misstatement or omission (unless the purchaser was aware of the misstatement or omission). Liability can be based on a prospectus other than that required under Section 5 of the Securities Act: any offering circular will do.[142] And unlike Section 11, which applies only to securities subject to the requirements of Section 5 of the Securities Act, Section 12(a)(2) applies to all securities except those exempted from the Securities Act by Section 3(a)(2).

The Supreme Court has held that Section 12(a)(2) does not apply to a private contract for a secondary market sale of securities.[143] That decision left unclear the applicability of Section 12(a)(2) to private placement offerings, but a number of courts have subsequently held that the section does not apply to offerings made by means of a private placement memorandum.[144] Moreover, the Second Circuit has held that a Section 12(a)(2) action cannot be maintained by a plaintiff who acquires securities through a private transaction even where the marketing of the securities relied on a prospectus prepared for a public offering.[145]

As noted, Section 12(a)(2) does not require the plaintiff to prove scienter or negligence: a person who sells securities in violation of the registration provisions of the Securities Act is strictly liable.[146] Thus, a plaintiff who proves that his seller made materially false or misleading statements or used a materially false or misleading prospectus, and that the plaintiff had no knowledge of any such untruth or omission, has established his case under Section 12(a)(2).[147] Section 12(a)(2), however, provides sellers with a "due diligence" defense: the seller is not liable if he can prove that "he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."[148] The effect of this defense is to turn Section 12(a)(2) into a negligence statute, with the burden on defendants to prove lack of negligence.[149]

Like Section 11, Section 12(a)(2) also provides a "negative loss causation" affirmative defense. Specifically, the PSLRA added Section 12(b) of the Securities Act, which provides that if a person "proves that any portion or all of the amount recoverable under subsection [12](a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication . . . not being true or omitting to state a material fact . . . then such portion or amount . . . shall not be recoverable."[150] Consequently, "[a] Section 12 defendant is liable only for depreciation that results directly from the misrepresentation at issue."[151] The defendant bears the burden of showing this absence of loss causation.[152]

In contrast to Section 11, the primary remedy provided by Section 12 is rescission, whereby a plaintiff tenders his securities to the defendant and receives his purchase price, with interest, in return. Interest is computed at what the court deems an equitable rate.[153] But there are several wrinkles. First, where the plaintiff has received income (*i.e.*, dividends or interest) on his securities, this income is subtracted from the purchase price in determining what he will get upon tendering his shares. Second, where the plaintiff has, before the filing of suit, disposed of the relevant securities, and thus can-not rescind the sale, he may recover damages, measured as the difference between the purchase price and the disposal price of the securities, plus interest, and less any income from the security received by the plaintiff.[154] Of course, where the defendant is a person from whom the plaintiff did not receive title, such as a broker (to the extent a broker can be held liable under Section 12), the result of the Section 12 remedy is not rescission, strictly speaking, although it will be the equivalent to the plaintiff.[155]

3. Section 17 of the Securities Act

Section 17 is the general antifraud provision of the Securities Act. It governs all sales, not just those that are part of a public offering. Sections 17(a)(1), (2) and (3), respectively, prohibit use of any means of interstate commerce (1) to employ any device, scheme or artifice to defraud, (2) to obtain money or property by means of material misstatements or omissions or (3) to engage in any course of business that would operate as a fraud upon a purchaser. In keeping with the general scheme of the Securities Act, Section 17 protects only purchasers and operates only against sellers, unlike Section 10(b) of the Exchange Act, which operates against both purchasers and sellers. The Supreme Court has emphasized that each of Section 17(a)(1), (2) and (3) contain different prohibitions, to be interpreted separately.[156]

As previously discussed, Section 17 does not expressly create a private right of action, and, as noted, the lower U.S. courts have generally concluded that no private right of action should be implied from that provision. Section 17 has therefore been important primarily in actions brought by the SEC pursuant to Section 20(b) of the Securities Act, which authorizes the SEC to seek injunctions against violations of that Act, and in criminal actions brought by the DOJ pursuant to Section 24 of the Securities Act, which imposes criminal liability for willful violations of that Act.

While Section 17 is textually similar to Rule 10b-5, the scope of the conduct that it reaches is broader in significant ways. Most notably, the Supreme Court has held that proof of negligence will suffice under Sections 17(a)(2) and 17(a)(3); scienter is not required, as it is under Rule 10b-5 (and Section 17(a)(1)).[157] The result is that if an action can be framed under Section 17(a)(2) or (3)—as virtually any action against a seller under Section 10(b) or Section 17(a)(1) can be—it can be tried by the SEC under a negligence, rather than a scienter, standard. Another distinction between Section 17(a) and Section 10(b) is that "Section 10(b) and Rule 10b-5 apply to acts committed in connection with a *purchase or sale of* securities while Section 17(a) applies to acts committed in connection with an offer or sale of securities."[158] As a result, "Section 17(a)'s proscription extends beyond consummated transactions."[159]

The majority view is that punitive damages are not available under Section 17(a).[160] Disgorgement is available, however, and often sought in SEC enforcement actions. "In order to be entitled to disgorgement, the SEC needs to produce only a reasonable approximation of the defendant's ill-gotten gains."[161] In addition, under its general civil penalty authority, the SEC can seek monetary penalties when it charges violations of Section 17(a).

4. Section 14(e) of the Exchange Act

As noted above, Section 14(e) of the Exchange Act is a general antifraud provision applicable to tender offers. In April 2018, the U.S. Court of Appeals for the Ninth Circuit ruled that in the tender offer context, Section 14(e) of the Exchange Act does not require scienter for violation, but rather a lower standard of negligence.[162] This ruling arose in the context of a buyout of a public company by tender offer, where a shareholder class action alleged that the failure by the target to include a summary of its investment bank's

comparable transaction premium analysis was a material omission that violated Section 14(e). By contrast, the Second, Third, Fifth, Sixth and Eleventh Circuits have held that Section 14(e) requires a showing of scienter. In January 2019, the U.S. Supreme Court granted certiorari on the Ninth Circuit holding and its deviation from the holdings of the other Circuits, but the Supreme Court subsequently vacated that grant, and therefore did not address the merits.

5. Sarbanes-Oxley and Dodd-Frank

Sarbanes-Oxley and Dodd-Frank made several changes to liability under the federal securities laws, including enhancing the SEC's powers and creating new criminal provisions. Specifically, Sarbanes-Oxley: (i) gave the SEC the authority to freeze possible "extraordinary payments" to directors, officers, agents and employees during the course of an investigation involving "possible" violations of the U.S. federal securities laws; (ii) gave the SEC the authority to bar persons from serving as directors or officers of public companies in cease-and-desist proceedings; (iii) created a new securities fraud crime with respect to public companies that does not contain a purchase or sale requirement, and simply prohibits knowingly defrauding any person (or attempting to do so) in connection with any security of an issuer, with violators subject to fines and imprisonment of up to 25 years; (iv) imposed fines of up to $5 million and prison terms of up to 10 years for CEOs and CFOs who knowingly make false certifications of the accuracy of SEC-filed financial reports (20 years in the case of willfully false certifications); (v) increased maximum prison terms for mail and wire fraud and violations of the Exchange Act; and (vi) enacted a broad new "anti-shredding" prohibition and sweeping new obstruction of justice offenses not limited to document destruction.

Dodd-Frank also: (i) granted the SEC the power to impose civil penalties on persons or companies (or their directors, officers or employees) for violations of the Securities Act and Exchange Act through out-of-court actions before ALJs; (ii) provides federal courts with jurisdiction to hear cases brought by the SEC or other agencies of the U.S. government under the antifraud provisions of the Securities Act and Exchange Act that involve either (a) conduct within the U.S. that constitutes significant steps in furtherance of a violation of those provisions, even if the securities transaction occurs outside the U.S. and involves only non-U.S. investors or (b) conduct outside the U.S., if that conduct would have a foreseeable substantial effect in the U.S.;[163] (iii) establishes that persons who "knowingly" or "recklessly" provide substantial assistance to conduct that violates the antifraud provisions of the Securities Act or Exchange Act can be criminally or civilly liable for such conduct; and (iv) extends the statute of limitations for criminal violations of the Securities Act and Exchange Act from five years to six years.

C. Foreign Corrupt Practices Act

The FCPA, which amended the Exchange Act, imposes requirements relating to company records and internal controls (the "Accounting Provisions") and generally prohibits corrupt payments to non-U.S. officials for the purpose of obtaining or keeping business (the "Anti-Bribery Provisions"). Issuers, including FPIs, will be subject to both the Accounting Provisions and the Anti-Bribery Provisions if they have a class of securities

registered under Section 12 of the Exchange Act or are required to file periodic reports under Section 15(d) of the Exchange Act. In addition, the Anti-Bribery Provisions would apply to the issuer's officers, directors, employees and agents, and shareholders acting on behalf of the issuer.

FCPA violations can result in significant fines and penalties. A company can be criminally fined up to $2 million per violation of the Anti-Bribery Provisions; culpable individuals can be subject to a criminal fine of up to $250,000 per violation and imprisonment for up to five years. Willful violations of the Accounting Provisions can result in a criminal fine of up to $25 million for a company; culpable individuals can be subject to a criminal fine of up to $5 million as well as imprisonment for up to 20 years. Fines can be even higher in certain circumstances, depending on the gain or loss resulting from the violation, and fines imposed on an individual may not be paid by his or her employer. In addition, the SEC is able to seek civil monetary penalties in similar amounts, as well as disgorgement of a company's profits on contracts secured with improper payments, plus interest.

D. Director Personal Liability and Directors' and Officers' Insurance

The risk of personal liability under the federal securities laws is very slight when directors act conscientiously. Put simply, a director who performs his or her duties in good faith is unlikely to be found liable for losses suffered by reason of such performance.

While Sarbanes-Oxley signaled toughness by substantially increasing criminal penalties for securities fraud and by creating a criminal offense of knowingly executing, or attempting to execute, a scheme to defraud shareholders of public companies, as well as by prohibiting loans to directors and coercion of auditors (violations of which could result in SEC enforcement actions), it did not otherwise change the elements of civil liability under the securities laws or create new rights of civil actions for which directors may be liable.

The SEC has on occasion signaled a more rigorous enforcement posture. In 2013, the SEC announced the creation of a "Financial Reporting and Audit Task Force," the purpose of which was to expand the SEC's efforts to identify securities law violations relating to the preparation of financial statements, issuer reporting and disclosure and audit failures. Several recent SEC enforcement actions have underscored the SEC's focus on financial statements and issuer reporting, including in situations that do not involve fraud or material misstatements.[164]

Companies should, and generally do, purchase sufficient directors' and officers' insurance ("D&O Insurance") to protect them against the risk of personal liability for their services to the company. The nature and extent of D&O Insurance coverage is always a matter requiring reference to the particular contract language involved since such contracts may vary in material ways. In particular, one must consider the policy period; the policy limits; the retention (or self-insurance) amount; policy exclusions; the severability of knowledge/wrongful acts and policy rescission; and the scope and nature of coverage.

It is important that directors and their counsel have an opportunity to review on a regular basis the particular terms of the relevant D&O Insurance policy, with particular

focus warranted on exclusions from coverage. Among other things, counsel should try to ensure that, in the event that a restatement is required at a future time, such restatement does not give the insurer a right to rescind or otherwise limit the coverage. Counsel should also try to ensure that the knowledge of one director or officer is not attributable to any other directors or officers for the purpose of determining coverage. Another risk to directors in D&O Insurance arises from a possible bankruptcy filing. Where the company itself is a beneficiary of the D&O Insurance policy, a trustee in bankruptcy, as its successor, may have a conflict of interest with directors who are named in a suit. This risk can and should be managed by having the company purchase policies known as Side A-only coverage[165] that cover just officers and directors but not the company, in addition to the policies that cover both the company and the directors and officers individually.[166]

E. Liability of Controlling Shareholders

Controlling shareholders can be held secondarily liable for primary violations of the securities laws under Section 15 of the Securities Act or Section 20(a) of the Exchange Act. Despite differences in wording, Section 15 of the Securities Act and Section 20(a) of the Exchange Act have always been interpreted as parallel statutes.[167] Section 15 imposes secondary liability on controlling persons for primary liabilities of controlled persons under Sections 11 and 12 of the Securities Act. Section 20(a) imposes secondary liability on controlling persons for primary liabilities of controlled persons under any provision of the Exchange Act or any regulation promulgated thereunder. Because Sections 15 and 20(a) are secondary liability provisions, establishing a primary violation is a prerequisite for liability under both sections, yet the controlled person need not be joined in an action under either one.[168]

"Control" is defined in the Securities Act as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise,"[169] yet determining exactly who meets this standard requires a case-by-case assessment. Certainly controlling shareholders, directors and even lenders *can* be controlling persons, provided they have the power or potential power to influence the activities of the controlled person.[170] Circuits remain split as to whether a plaintiff must establish that the defendant was a "culpable participant" in the alleged violation to qualify as a "controlling person" under these sections. Furthermore, neither section contains any scienter, or even negligence, requirement. But Section 15 states that the controlling person is not liable if he had no knowledge or reason to know the facts that establish the liability of the controlled person. Section 20(a) states that the controlling person is not liable if he acted in good faith and did not induce the acts on which the liability of the controlled person is founded. Courts have uniformly held that these are affirmative defenses to be pleaded and proved by defendants.[171] Courts adopting the "culpable participant" standard, however, require plaintiffs to prove some culpability as part of a prima facie case before the burden of proving good faith shifts to the defendant.

A controlling person liable under Section 15 or 20(a) is jointly and severally liable for any damages for which the controlled person is liable. Thus, the measure of damages

that can be assessed against a controlling person under these sections varies with the underlying claims or possible claims against the controlled person.

F. Whistleblowing Procedures and Up-the-Ladder Reporting

Sarbanes-Oxley amended Exchange Act Section 10A and added Section 1514A to the United States Code to require that audit committees establish "whistleblowing" procedures for the confidential submission of concerns regarding questionable accounting or auditing matters, as well as "up-the-ladder" reporting. This provision applies to both U.S. issuers and FPIs. Whistleblowing procedures must include procedures for receiving, treating and retaining any complaints received by an issuer regarding accounting, internal accounting controls or auditing matters. An issuer may, for example, permanently appoint a business practices officer to investigate complaints and report directly to the audit committee. FPIs must be careful to design their retention and other whistleblowing procedures so they comply with labor and local data protection laws and guidelines. If found to have taken retaliatory action against employee whistleblowers, public issuers are subject to civil and, in certain circumstances, criminal liability. In addition, whistleblowers are given protections against wrongful dismissal by their employers, including rights to reinstatement, back pay and damages.

Up-the-ladder reporting requires attorneys who appear and practice before the SEC in the representation of issuers that file periodic reports with the SEC who become aware of evidence of a material violation of U.S. law that has occurred or is reasonably likely to occur, by the issuer or by an officer, director, employee or agent of the issuer, to report that violation internally to the issuer's chief legal officer ("CLO") forthwith and to determine whether an appropriate response has been made. In some cases, further reports to the board of directors or audit committee may be required or permitted. A CLO who receives such a report must then conduct an inquiry. If the CLO determines that no material violation has occurred, is ongoing or is about to occur, the reporting attorney must be so advised. Unless the CLO reasonably believes no material violation has occurred, is ongoing or is about to occur, he or she must take all reasonable steps to cause the issuer to adopt an appropriate response and advise the reporting attorney of the response. As an alternative to this procedure, an attorney may notify the qualified legal compliance committee, if the issuer has previously formed such a committee. Only the SEC may enforce requirements regarding attorneys representing issuers; that is, a private cause of action may not be brought. And a "non-appearing foreign attorney" does not "appear and practice" before the SEC for purposes of the rules.[172]

Cross-Border M&A Guide Endnotes

[1] *See* 17 C.F.R. § 240.14d-1.

[2] 17 C.F.R. § 240.3b-4(b).

[3] 17 C.F.R. § 240.3b-4(c).

[4] Note to paragraph (c)(1) of the Exchange Act Rule 3b-4.

[5] *Id*.

[6] Final Rule: Commission Guidance and Revisions to the Cross-border Tender Offer, Exchange Offer, Rights Offering, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, 73 Fed. Reg. 60050, 60052 (Oct. 9, 2008).

[7] Rule 13e-4 under the Exchange Act applies only to tender offers that meet both of the following conditions: (1) the tender offer is for equity securities of an issuer that (a) has a class of equity security registered under Section 12 of the Exchange Act, or (b) is required to file periodic reports under Section 15(d) of the Exchange Act (*i.e.*, an issuer that has had a registration statement under the Securities Act of 1933, as amended (the Securities Act), declared effective) and (2) the tender offer is made by the issuer of such equity security or by an affiliate of such issuer. Section 14(e) and Regulation 14E, discussed below, also would apply to such a tender offer.

[8] *See Wellman* v. *Dickinson*, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d. Cir. 1982), *cert. denied*, *Dickinson* v. *SEC*, 460 U.S. 1069 (1983).

[9] *See* 17 C.F.R. § 240.14e-1(a)- § 240.14e-1(b).

[10] *See* 17 C.F.R. § 240.14e-1(c).

[11] *See* 17 C.F.R. § 240.14e-1(b), § 240.14e-1(d).

[12] *Interpretive Release Relating to Tender Offers Rules*, SEC Release No. 34-24296 (Apr. 9, 1987).

[13] *See* 17 C.F.R. § 240.14e-2.

[14] *See* 17 C.F.R. § 240.14e-3.

[15] *See id*.

[16] *See* 17 C.F.R. § 240.14e-4.

[17] *See* 17 C.F.R. § 240.14e-5.

[18] *See* 17 C.F.R. § 240.

[19] *See id*.

[20] *See* 17 C.F.R. § 240.14d-4, 17 C.F.R. § 240.14d-6.

[21] *See* 17 C.F.R. § 240.14d-10.

[22] *See* 17 C.F.R. § 240.14d-7.

[23] *See* 17 C.F.R. § 240.14d-9.

[24] *See* 17 C.F.R. § 240.14d-11.

[25] 17 C.F.R. § 230.145.

[26] 17 C.F.R § 240.12b-23.

[27] *See* Final Rule: Cross-border Tender and Exchange Offers, Business Combinations and Rights Offerings, 64 Fed. Reg. 61382, 61382 (Nov. 10, 1999).

[28] Final Rule: Commission Guidance and Revisions to the Cross-border Tender Offer, Exchange Offer, Rights Offering, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, 73 Fed. Reg. 60050, 60052 (Oct. 9, 2008).

[29] *See* 17 C.F.R. § 240.14d-1(c)(4). Note that the Tier I exemptions can apply to a registered closed-end investment company.

[30] *See* 17 C.F.R. § 240.14d-1(c)(2).

[31] Cross-Border Rules Securities and Exchange Commission Release No. 8917, (proposed May 6, 2008).

[32] Final Rule: Commission Guidance and Revisions to the Cross-border Tender Offer, Exchange Offer, Rights Offering, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, 73 Fed. Reg. 60050, 60052 (Oct. 9, 2008).

[33] *Id*.

[34] *Id*.

[35] *Id*.

[36] *Id*.

[37] Interpretation: Re: Use of Internet Web Sites To Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore, Securities and Exchange Commission International Series Release No. 1125 (effective March 23, 1998), available at https://www.sec.gov/rules/interp/33-7516.htm.

[38] *Id*.

[39] *Id*.

[40] Depending on the circumstances, other Securities Act exemptions may be available. For example, Rule 903 under Regulation S provides a safe harbor for issuers, distributors, and affiliates from registration under the Securities Act for offerings made outside the United States. This safe harbor is non-exclusive and applies to both domestic issuers and FPIs. An issuer seeking safe harbor under Rule 903 must meet, at minimum, two primary requirements: (1) the offer or sale must be made in an "offshore transaction" (*i.e.*, an offer not made to a person in the United States and where either the buyers is outside the United States or the transaction is executed on a foreign securities exchange); and (2) the offer or sale cannot involve "direct selling efforts" (*i.e.*, sales activities that tend to condition the market) in the United States. Regulation S also contains a safe harbor for certain offshore resales in Rule 904. However, Regulation S is primarily relevant to capital-raising transactions and may be difficult to rely upon in business combinations.

[41] 17 C.F.R. § 230.800(c).

[42] 17 C.F.R. § 230.800(a).

[43] Securities Act § 3(a)(10).

[44] Division of Corporate Finance: Revised Staff Legal Bulletin No. 3 (CF) *available at* https://www.sec.gov/interps/legal/cfslb3r.htm#FOOTNOTE_5.

[45] *Id*.

[46] NYSE Listing Company Manual Section 312.03; Nasdaq Listing Rule 5635.

[47] Final Rule: Commission Guidance and Revisions to the Cross-border Tender Offer, Exchange Offer, Rights Offering, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, 73 Fed. Reg. 60050, 60052 (Oct. 9, 2008).

[48] On two occasions, the FTC and DOJ temporarily suspended the practice of granting early termination. The first temporary suspension occurred during the month after the initial Covid-19 shutdown. The FTC announced another temporary suspension on February 4, 2021, as a result of the transition to the new Administration and heavy inflow of HSR filings. While the FTC's announcement indicated that the agency anticipates that the temporary suspension would be brief, as of the publication of this Guide, this suspension had not been lifted.

[49] Horizontal Merger Guidelines, FTC and DOJ (August 19, 2010) *available at* https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

[50] 31 C.F.R. § 800.303.

[51] 31 C.F.R. § 800.207; The Foreign Investment Risk Review Modernization Act of 2018 *available at* https://home.treasury.gov/sites/default/files/2018-08/The-Foreign-Investment-Risk-Review-Modernization-Act-of-2018-FIRRMA_0.pdf.

[52] 31 C.F.R. § 800.601; Office of Investment Security; Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. 74567, 74569 (Dec. 8, 2008).

[53] 3 Fed. Reg. 74567, 69 (Dec. 8, 2008).

[54] CFIUS Reform: Guidance on National Security Considerations *available at* https://www.treasury.gov/resource-center/international/foreign-investment/Documents/GuidanceSummary_12012008.pdf.

[55] Exec. Order No. 20,005, 82 Fed. Reg. 43665 (Sept. 13, 2017).

[56] Exchange Act Section 12(b).

[57] 17 C.F.R. § 240.12g-1.

[58] Exchange Act Section 15(d).

[59] For purposes of 17 C.F.R. § 240.12g3-2(b), primary trading market means: (1) at least 55% of the trading of the shares on a worldwide basis took place on a securities market in one or at most two foreign jurisdictions during the FPI's most recently completed fiscal year; (2) if the FPI has to aggregate the trading in two foreign jurisdictions to meet the 55% threshold, then the trading in at least one of those two foreign jurisdictions must be greater than the trading in the United States for those shares.

[60] SEC Form 20-F, General Instruction A(b)(2).

[61] MD&A is meant to explain the company's performance and financial condition during the fiscal period in a way that is easy for investors to understand, describe the company's earnings and cash flows, and enhance the company's financial disclosure. This section may include an overview, a discussion of results of operations and a comparison of financial information, a description of the company's liquidity and capital resources, a description of recently adopted accounting standards, a description of related-party transactions, etc. *See* SEC Form 20-F Item 5.

[62] For example, the Form 20-F must disclose the amount of executive compensation and benefits in kind given for services to the company and its subsidiaries. While FPIs may make this disclosure in the aggregate in certain instances, they must provide it on an individual basis if home-jurisdiction regulation requires that they do so or they otherwise publicly disclose such information. This requirement represents an accommodation in comparison to the more detailed individual executive compensation disclosures that U.S. companies are required to make.

[63] Sarbanes-Oxley § 404(a).

[64] Sarbanes-Oxley § 404(b).

[65] SEC Form 20-F, Item 15; SEC Form 20-F, Item 18.

[66] FPIs (other than non-accelerated filers) must disclose the existence of material unresolved SEC comments on their Forms 20-F. For this and other reasons, companies usually seek to resolve SEC comments expeditiously.

[67] *See* NYSE Listed Company Manual, § 203.03; Nasdaq Listed Company Manual Rule 5250(c)(2).

[68] Form 6-K must be submitted in English. While English summaries are permitted for certain documents, full translations are required for press releases, most communications distributed directly to security holders, annual audited or interim consolidated financial information and certain other information.

[69] Exchange Act Section 21E; Securities Act Section 27A; 7 C.F.R. § 230.175.

[70] *Harris* v. *Ivax Corp*., 182 F.3d 799 (11th Cir. 1999); and *Asher* v. *Baxter Int'l Inc.*, 377 F.3d 727 (7th Cir. 2004).

[71] SEC Form 20-F, Item 6.B.

[72] Financial Statements and Periodic Reports for Related Issuers and Guarantors, 65 Fed. Reg. 51,715 (Aug. 24, 2000) (codified at 17 C.F.R. pts. 240, 243, and 249).

[73] SEC Form SD Section 1, Item 1.01(d)(3).

[74] SEC Form SD Section 1, Item 1.01(b), 1.01(c).

[75] ADSs are treated as the same class as the underlying equity securities for this purpose. Any ADSs listed on a U.S. exchange have been registered under Section 12(b) of the Exchange Act. If a registrant does not have any listed securities and is exempted from or terminates its registration under Section 12(g), the Schedule 13D rules will no longer apply, even if it remains obligated to file reports under Section 15(d).

[76] 17 C.F.R. § 240.13d-2(a).

[77] Although an investor that agitates for a change of control of the company is the classic example of a non-passive investor, the definition also excludes investors who merely seek to have an effect on how the company is run. Moreover, directors and officers cannot be considered passive investors.

[78] 17 C.F.R. §§ 240.13d-1(c), 240.13d-2(b) and 240.13d-2(d).

[79] 17 C.F.R. §§ 240.13d-1(b), and 240.13d-2(b)-(c).

[80] 17 C.F.R. § 240.13d-1(d).

[81] 17 C.F.R. § 240.13d-2(b).

[82] Exchange Act Section 13(d)(6)(B).

[83] FPIs subject only to Section 15(d) also are not subject to the third-party tender offer rules in Section 14(d). However, they are subject to the Exchange Act provisions related to issuer tender offers and going-private transactions.

[84] SEC Form 20-F, Items 17(c) and 18.

[85] SEC Form 20-F, Item 17(c). Items that frequently require discussion and quantification as a result of the reconciliation requirements include stock compensation, restructuring charges, impairments, deferred or capitalized costs, investments, foreign currency translation, deferred taxes, pensions, derivatives, consolidation, asset retirement obligations, research and development and revenue recognition.

[86] *See* SEC Division of Corporation Finance, Financial Reporting Manual, Topic 6410.2.

[87] Item 10(e) of Regulation S-K additionally requires disclosure of the reasons why management believes the non-GAAP measure provides information that is useful to investors and, if material, any additional purposes for which management uses it that are not otherwise disclosed. 17 C.F.R. § 240.100(a); 17 C.F.R. § 229.10(e)(1)(i).

[88] 17 C.F.R. § 240.101; 17 C.F.R. § 229.10(e)(2)-(5).

[89] 17 C.F.R. § 240.100(c).

[90] Management's Report on Internal Control Over Financial Reporting, 68 Fed. Reg. 36,635 (June 18, 2003) (Codified at 17 C.F.R. pts. 210, 228, 229, 240, 249, 270, 274).

[91] Note to 17 C.F.R. § 229.10(e).

[92] SEC, Non-GAAP Financial Measures (Apr. 4, 2018), https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm.

[93] In addition to assessing independence, the audit committee is also responsible for assessing the competency of its independent auditors.

[94] Order Approving Proposed Ethics and Independence Rule 3526, Exchange Act Release No. 34-58415, 93 S.E.C. Docket 3003 (August 22, 2008).

[95] Improper Influence on Conduct of Audits, Exchange Act Release No. 34-47890, 80 S.E.C. Docket 770 (May 20, 2003).

[96] Certification of Disclosure in Companies' Quarterly and Annual Reports, SEC Securities Act Release No. 33-8124. 78 S.E.C. Docket 875, (August 28, 2002).

[97] 18 U.S.C. § 1350 (2002).

[98] Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 41877 (proposed June 14, 2002) (to be codified at 17 C.F.R. pts. 232, 240, and 249).

[99] SEC Form 20-F Item 7.B.

[100] SEC Form 20-F Item 6.E.

[101] 17 C.F.R. § 240.10b-5.

[102] For an FPI, a "blackout period" generally means a period that occurs when (i) at least 50% of the participants located in the United States are subject to the trading

suspension and (ii) U.S. plan participants either total 50,000 or account for 15% of all participants worldwide.

[103] In addition, the issuer must file the notice as an exhibit to its Form 20-F.

[104] 17 C.F.R. § 240.144.

[105] NYSE Listed Company Manual § 303A.02(a).

[106] Nasdaq Marketplace Rules 4200, 4350.

[107] 17 C.F.R. § 240.10A-3(C)-(E).

[108] 17 C.F.R. § 240.10A-3(c)(3).

[109] SEC Form 20-F, Item 16D.

[110] SEC Form 20-F, Item 16A.

[111] The requirements relating to the compensation committee do not apply to "controlled companies," meaning companies with a single individual, group or other issuer that controls more than 50% of their shares.

[112] Dodd-Frank goes beyond the clawback provision contained in Sarbanes-Oxley, which applies only (i) to compensation received by the CEO and CFO during the 12-month period following the first issuance of the restatement and (ii) if the restatement resulted from misconduct.

[113] The case, *SEC* v. *Jenkins*, 718 F. Supp. 2d 1070 (D. Ariz. 2010) involved Maynard L. Jenkins, the former CEO of CSK Auto Corporation. Although civil and criminal charges were brought against four other CSK Auto executives, the SEC did not charge Jenkins with any wrongdoing in connection with the accounting fraud that occurred at CSK. Nevertheless, relying on Sarbanes-Oxley Section 304, the SEC filed a complaint seeking to claw back $4 million of incentive compensation that Jenkins received during the period of the fraud. Jenkins moved to dismiss the complaint, but that motion was denied in June 2010. On November 15, 2011 a settlement was announced by the SEC.

[114] Listing Standards for Recovery of Erroneously Awarded Compensation, 80 Fed. Reg. 41,144 (proposed July 1, 2015) (to be codified at 17 C.F.R. pts. 229, 240, 249, and 274).

[115] SEC Form 20-F, Item 16B.

[116] 17 C.F.R. § 240.12d2-2.

[117] 17 C.F.R. § 240.12g5-1.

[118] *See, e.g.*, *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (stating that the purpose common to the securities laws was to "substitute a philosophy of full disclosure for the philosophy of caveat emptor").

[119] *Basic Inc.* v. *Levinson*, 485 U.S. 223, 239 n.17 (1988).

[120] Rule 10b-5, for example, provides that a party that makes public statements may not omit relevant information if the information is "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5. And Section 11 of the Securities Act prohibits a party from "omit[ing] to state a material fact . . . necessary to make the statements [in the registration statement] not misleading." 15 U.S.C. § 77k(a).

[121] *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976).

[122] *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund* v. *Hewlett-Packard Co.*, 845 F.3d 1268, 1275-77 (9th Cir. 2017) (citation omitted).

[123] *Musick, Peeler & Garrett* v. *Emp'rs Ins. of Wausau*, 508 U.S. 286, 296 (1993).

[124] *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 380 (1983).

[125] *Ernst & Ernest* v. *Hochfelder*, 425 U.S. 185, 193 (1976).

[126] *See, e.g.*, *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336, 341-42 (2005).

[127] 17 C.F.R. § 240.12b-20.

[128] "Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain." *Dirks* v. *SEC*, 463 U.S. 646, 659 (1983) (discussing insider trading claim brought by the SEC under Rule 10b-5).

[129] Securities Class Action Settlements, 2018 Review and Analysis, Cornerstone Research, https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2018-Review-and-Analysis.

[130] The *Morrison* decision has been interpreted to apply to the liability provisions of the Securities Act as well. *See, e.g.*, *In re Vivendi Universal, S.A., Sec. Litig.*, 842 F. Supp. 2d 522, 529 (S.D.N.Y. 2012) (applying Morrison to §§ 11, 12(a)(2) and 15 of the Securities Act); *SEC* v. *Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 164 (S.D.N.Y. 2011) (applying Morrison to § 17(a) of that Act).

[131] See, e.g., *City of Pontiac Policemen's and Firemen's Ret. Sys.* v. *UBS AG*, 752 F.3d 173 (2d Cir. 2014); *Parkcentral Global Hub Ltd.* v. *Porsche Auto. Holdings SE.*, 763 F.3d 198 (2d Cir. 2014).

[132] The first U.S. appellate court to consider the issue held that Dodd-Frank had successfully overruled the *Morrison* decision in this way. *See SEC* v. *Scoville*, 913 F.3d 1204, 1215-18 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 483 (2019).

[133] *See, e.g.*, *Tully* v. *Mott Supermarkets, Inc.*, 540 F.2d 187, 194 (3d Cir. 1976).

[134] *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128, 155 (1972).

[135] *See, e.g.*, *Abell* v. *Potomac Ins. Co.*, 858 F.2d 1104, 1139 (5th Cir. 1988), *vacated on other grounds sub nom. Fryar* v. *Abell*, 492 U.S. 914 (1989); *Straub* v. *Vaisman & Co.*, 540 F.2d 591, 599 (3d Cir. 1976); *Green* v. *Wolf Corp.*, 406 F.2d 291, 302-03 (2d Cir. 1968).

[136] *See, e.g.*, *In re Lehman Bros. Mortg.-Backed Sec. Litig.*, 650 F.3d 167 (2d Cir. 2011) (finding that ratings agencies are not underwriters under § 11).

[137] Section 27A(c) of the Securities Act, added by the PSLRA, establishes a limited exception to Section 11's scienter-less liability. It provides that no liability will attach in a private action based on certain statutorily defined "forward-looking statements" unless the plaintiff proves "actual knowledge" of the false or misleading nature of the statement on the part of a natural person making the statement or on the part of an executive officer approving the statement if made on behalf of a business entity. *See* 15 U.S.C. § 77z-2(c)(1)(B).

[138] As the Second Circuit has explained, while materiality "will rarely be dispositive in a motion to dismiss" a § 11 claim, it "remains a meaningful pleadings obstacle" whereby the court must ascertain whether there is a "*substantial* likelihood that disclosure of the omitted information would have been viewed by the *reasonable* investor as having *significantly* altered the total mix of information [already] made available." *In re ProShares Tr. Sec. Litig.*, 728 F.3d 96, 103 (2d Cir. 2013) (affirming dismissal after "read[ing] the prospectus cover-to-cover" and considering "whether the disclosures and representations, taken together and in context, would have misl[ed] a reasonable investor about the nature of the [securities]" (second and third alterations in original) (internal quotation marks omitted)).

[139] 17 C.F.R. § 230.158.

[140] *See* 15 U.S.C. § 77k(b)(3)(A), (C).

[141] The SEC, however, has taken the position that indemnification by the issuer of its officers, directors or controlling persons for liability arising under the Securities Act is against public policy and, therefore, unenforceable, and there is support for this position in court decisions. *See, e.g., Eichenholtz* v. *Brennan*, 52 F.3d 478, 484-85 (3d Cir. 1995); *Globus* v. *Law Research Serv., Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969). The SEC has also indicated that in addressing requests for prompt declaration of effectiveness of a registration statement, it will refuse to accelerate its declaration of effectiveness if the registrant indemnifies any of its officers, directors or controlling persons, unless: (i) such person waives the benefits of indemnification with respect to the proposed offering or (ii) the registration statement contains a certain undertaking to submit to a court of appropriate jurisdiction the question of whether such indemnification is against public policy and to be governed by the final adjudication of such issue.

[142] *See, e.g.*, *Sanders* v. *John Nuveen & Co.*, 619 F.2d 1222, 1227 (7th Cir. 1980) (finding commercial paper reports to be prospectuses).

[143] *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 571 (1995).

[144] *See, e.g.*, *Lewis* v. *Fresne*, 252 F.3d 352, 358 (5th Cir. 2001); *Maldonado* v. *Dominguez*, 137 F.3d 1, 8-9 (1st Cir. 1998); *Whirlpool Fin. Corp.* v. *GN Holdings, Inc.*, 67 F.3d 605, 609 n.2 (7th Cir. 1995); *Joseph* v. *Wiles*, 223 F.3d 1155, 1161 (10th Cir. 2000); *Vannest* v. *Sage, Rutty & Co.*, 960 F. Supp. 651, 655 (W.D.N.Y. 1997); *In re JWP Inc. Sec. Litig.*, 928 F. Supp. 1239, 1259 (S.D.N.Y. 1996).

[145] *Yung* v. *Lee*, 432 F.3d 142, 149 (2d Cir. 2005).

[146] However, as with Section 11, after the PSLRA, a plaintiff cannot premise a Section 12(a)(2) on statutorily defined "forward-looking statements" unless the plaintiff proves "actual knowledge" of the false or misleading nature of the statement on the part of a natural person making the statement or on the part of an executive officer approving the statement if made on behalf of a business entity. 15 U.S.C. § 77z-2(c)(1)(B).

[147] *See In re Adams Golf, Inc. Sec. Litig.*, 381 F.3d 267, 274 (3d Cir. 2004); *Currie* v. *Cayman Res. Corp.*, 835 F.2d 780, 782-83 (11th Cir. 1988); *Hill York Corp.* v. *Am. Int'l Franchises, Inc.*, 448 F.2d 680, 695 (5th Cir. 1971), *abrogated on other grounds by Pinter* v. *Dahl*, 486 U.S. 622, 649-51 (1988), *as recognized in In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 540 F. Supp. 2d 759, 782 n.28 (S.D. Tex. 2007).

[148] *See Casella* v. *Webb*, 883 F.2d 805, 807 n.5 (9th Cir. 1989); *Gilbert* v. *Nixon*, 429 F.2d 348, 357 (10th Cir. 1970).

[149] *See Dennis* v. *Gen. Imaging, Inc.*, 918 F.2d 496, 507 (5th Cir. 1990).

[150] 15 U.S.C. § 77l(b).

[151] *Miller* v. *Thane Int'l, Inc.*, 519 F.3d 879, 892 (9th Cir. 2007).

[152] *See Lalor* v. *Omtool, Ltd.*, 2000 WL 1843247, at *3 (D.N.H. Dec. 14, 2000) ("As to claims under §§ 11 and 12 of the Securities Act, 'loss causation' is not an essential element of a viable cause of action. It is, however, an affirmative defense that may be raised by a defendant."); *Kennilworth Partners L.P.* v. *Cendant Corp.*, 59 F. Supp. 2d 417, 424 (D.N.J. 1999) ("If the person who sold or offered the security can prove that all or part of the depreciation in value was caused by factors other than the false or misleading statement, he is not liable for that amount."). *But see In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 289 F. Supp. 2d 429, 437 (S.D.N.Y. 2003) (dismissing a § 12(a)(2) claim over plaintiff's argument that defendants bear the burden of proving "negative causation," where the absence of causation was clear from the face of the complaint).

[153] *See Commercial Union Assurance Co.* v. *Milken*, 17 F.3d 608, 615 (2d Cir. 1994); *Fed. Hous. Fin. Agency* v. *Merrill Lynch & Co.*, 903 F. Supp. 2d 274, 280 (S.D.N.Y. 2012); *SEC* v. *Tome*, 638 F. Supp. 638, 640 (S.D.N.Y. 1986), *aff'd*, 833 F.2d 1086 (2d Cir. 1987); *Koehler* v. *Pulvers*, 614 F. Supp. 829, 850 (S.D. Cal. 1985); *Scheve* v. *Clark*, 596 F. Supp. 592, 596 (E.D. Mo. 1984); *W. Fed. Corp.* v. *Davis*, 553 F. Supp. 818, 821 (D. Ariz. 1982), *aff'd sub nom. W. Fed. Corp.* v. *Erickson*, 739 F.2d 1439 (9th Cir. 1984); *Johns Hopkins Univ.* v. *Hutton*, 297 F. Supp. 1165, 1229 (D. Md. 1968), *rev'd on other grounds*, 422 F.2d 1124 (4th Cir. 1970).

[154] *See, e.g.*, *Wigand* v. *Flo-Tek, Inc.*, 609 F.2d 1028, 1036 n.8 (2d Cir. 1979); *Cady* v. *Murphy*, 113 F.2d 988, 990-91 (1st Cir. 1940); *Reves* v. *Ernst & Young*, 937 F. Supp. 834, 837 (W.D. Ark. 1996). *But see Randall* v. *Loftsgaarden*, 478 U.S. 647, 659-60 (1986) (finding that § 12(a)(2) damages need not be reduced by the amount of tax benefits received from a shelter investment).

[155] Section 12 expressly provides only for remedies in rescission or damages. The Supreme Court has held, however, that in an appropriate case brought primarily for rescission or damages under Section 12, ancillary relief, including injunctive relief, can be given. *Deckert* v. *Indep. Shares Corp.*, 311 U.S. 282, 287-90 (1940); *see also In re Gartenberg*, 636 F.2d 16, 17-18 (2d Cir. 1980). *Cf. SEC* v. *Beisinger Indus. Corp.*, 552 F.2d 15, 18-19 (1st Cir. 1977) ("It is well established that Section 22(a) of the Securities Act of 1933 and Section 27 of the Securities Exchange Act of 1934 confer general equity powers on the district courts." (citations omitted)).

[156] *See Aaron* v. *SEC*, 446 U.S. 680, 695-97 (1980); *United States* v. *Naftalin*, 441 U.S. 768, 773-74 (1979).

[157] *See Aaron*, 446 U.S. at 701-02.

[158] *SEC* v. *Maio*, 51 F.3d 623, 631 (7th Cir. 1995) (emphasis in original); *see SEC* v. *Bauer*, 723 F.3d 758, 768 (7th Cir. 2013).

[159] *SEC* v. *Tourre*, 2013 WL 2407172, at *6 (S.D.N.Y. June 4, 2013); *see also, e.g.*, *SEC* v. *Am. Commodity Exch., Inc.*, 546 F.2d 1361, 1366 (10th Cir. 1976) (holding that "actual sales were not essential" to a claim under Section 17(a)).

[160] *See, e.g.*, *Globus* v. *Law Research Serv., Inc.*, 418 F.2d 1276, 1284-87 (2d Cir. 1969); *Ambrosino* v. *Rodman & Renshaw, Inc.*, 635 F. Supp. 968, 972 (N.D. Ill. 1986); *Hadad* v. *Deltona Corp.*, 535 F. Supp. 1364, 1371 (D.N.J. 1982), *aff'd*, 725 F.2d 668 (3d Cir. 1983); *Vogel* v. *Trahan*, 1980 U.S. Dist. LEXIS 10539, *26-27 (E.D. Pa. Jan. 11, 1980). *But see Anvil Inv. Ltd. P'ship* v. *Thornhill Condos., Ltd.*, 407 N.E.2d 645, 654 (Ill. App. Ct. 1980) (punitive damages available under Section 17 for willful and malicious conduct).

[161] *SEC* v. *Monterosso*, 756 F.3d 1326, 1337 (11th Cir. 2014); *see also SEC* v. *ETS Payphones, Inc.*, 408 F.3d 727, 735 (11th Cir. 2005).

[162] *Varjabedian* v. *Emulex Corp.*, 888 F.3d 399 (9th Cir. 2018).

[163] Note that the extraterritoriality provision of Dodd-Frank applies only to the SEC and other U.S. government agencies, not to claims brought by private plaintiffs.

[164] Powersecure Int'l, Inc., Exchange Act Release No. 79256 (Nov. 7, 2016) (involving SEC charges against an energy management company for financial reporting, books and records, and internal control violations related to its segment reporting); Magnum Hunter Res. Corp., Exchange Act Release No. 77345 (March 10, 2016) (involving SEC charges against an oil company and several individuals, including a company consultant and the company's external auditor, for deficient evaluation of the company's internal controls over financial reporting); Exchange Act Release No. 75958 (September 22, 2015)

(involving SEC charges against a retailer for materially misstating its pre-tax income due to improper valuation of inventory subject to price discounts and for having inadequate internal accounting controls); Hampton Roads Bankshares, Inc. and Neal A. Petrovich, CPA, Exchange Act Release Nos. 73750 and 73751, (December 5, 2014) (involving SEC charges against a bank holding company and its former CFO for violating the federal securities laws by improperly accounting for a deferred tax asset that was not fully realizable due to the company's deteriorating loan portfolio and financial condition); Grupo Simec S.A.B. de C.V., Exchange Act Release No. 84996 (Jan. 29, 2019) (involving SEC charges for failing to maintain internal controls over financial reporting); Lifeway Foods, Inc., Exchange Act Release No. 84995 (Jan. 29, 2019) (same); Digital Turbine, Inc., Exchange Act Release No. 84998 (Jan. 29, 2019) (same); CytoDyn, Inc., Exchange Act Release No. 84994 (Jan. 29, 2019) (same).

165 Side A-only coverage also provides various other benefits to directors and officers individually, including with respect to derivative actions and the fact that these policy limits are not subject to reduction by claims against the company or claims for which the company makes indemnity payments.

166 In bankruptcy cases in which the D&O Insurance policy covers both individual directors and the company, courts have held that the proceeds will be property of the company if depletion of the proceeds would have an adverse effect on the bankruptcy estate of the company. *See In re MF Glob. Holdings Ltd.*, 515 B.R. 193, 203 (Bankr. S.D.N.Y. 2014).

167 *Cent. Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

168 *See, e.g.*, *SEC* v. *Savoy Indus., Inc.*, 587 F.2d 1149, 1170 n.47 (D.C. Cir. 1978); *Kemmerer* v. *Weaver*, 445 F.2d 76, 78-79 (7th Cir. 1971) (holding that action may continue against control-ling persons when suit against controlled persons dismissed on procedural grounds); *Keys* v. *Wolfe*, 540 F. Supp. 1054, 1061-62 (N.D. Tex. 1982), *rev'd on other grounds*, 709 F.2d 413 (5th Cir. 1983); *Primavera Familienstiftung* v. *Askin*, 1996 WL 580917, at *2 (S.D.N.Y. Oct. 9, 1996); *McCarthy* v. *Barnett Bank of Polk Cty.*, 750 F. Supp. 1119, 1126 (M.D. Fla. 1990); *see also In re Stone & Webster, Inc., Sec. Litig.*, 424 F.3d 24, 27 (1st Cir. 2005) (holding that the dismissal of Rule 10b-5 claims against individual defendants "is in no way incompatible" with a plaintiff's right to establish their secondary liability under § 20(a) as controlling persons of a liable corporation).

169 17 C.F.R. § 230.405.

170 *See, e.g.*, *No. 84 Emp'r-Teamster Joint Council Pension Tr. Fund* v. *Am. W. Holding Corp.*, 320 F.3d 920, 945-46 (9th Cir. 2003) (finding a *prima facie* showing of control had been made where a corporation's two largest stockholders controlled 57.4% of the total voting power and "had some of their own officers seated on" the corporation's board); *Paracor Fin., Inc.* v. *Gen. Elec. Capital Corp.*, 96 F.3d 1151, 1162-63 (9th Cir. 1996) (discussing standards for finding lenders and directors to be "controlling persons"); *Arthur Children's Trust* v. *Keim*, 994 F.2d 1390, 1396-97 (9th Cir. 1993) (directors); *In re Gaming Lottery Sec. Litig.*, 1998 WL 276177, at *8 (S.D.N.Y. May 27, 1998) (officers), *vacated on other grounds sub nom. Pecarsky* v. *Galaxiworld.com Ltd.*, 249 F.3d 167 (2d

Cir. 2001); *Stern* v. *Am. Bankshares Corp.*, 429 F. Supp. 818, 824 (E.D. Wis. 1977) (directors); *Klapmeier* v. *Telecheck Int'l, Inc.*, 315 F. Supp. 1360, 1361 (D. Minn. 1970) (stating that a "majority shareholder might as a matter of law be held to 'control' the entity regardless of his actual participation in management decisions and the specific transaction in question"). *But see In re Lehman Bros. Mortg.-Backed Sec. Litig.*, 650 F.3d 167, 187 (2d Cir. 2011) (finding that rating agencies were not controlling persons of banks that issued rated securities because "providing advice that the banks chose to follow does not suggest control").

[171] *See, e.g.*, *Kaplan* v. *Rose*, 49 F.3d 1363, 1382-83 (9th Cir. 1994); *Marbury Mgmt., Inc.* v. *Kohn*, 629 F.2d 705, 716 (2d Cir. 1980); *Gould* v. *Am.-Hawaiian S.S. Co.*, 535 F.2d 761, 779 (3d Cir. 1976).

[172] A "non-appearing foreign attorney" is defined as an attorney admitted to practice in a jurisdiction outside the U.S., who does not hold himself out as practicing, and does not give legal advice regarding, U.S. laws, who conducts activities before the SEC only incidental to, and in the ordinary course of practice of law in a jurisdiction outside the U.S., and appears before the SEC only in consultation with counsel admitted to practice law in the United States.