This note provides an overview of the basic technical requirements of securities offerings made into the United States in reliance on Rule 144A (“Rule 144A”) under the US Securities Act of 1933, as amended (the “Securities Act”), as well as some of the main practical differences between a Rule 144A offering and one that is conducted wholly outside the United States in reliance on Regulation S (“Regulation S”) under the Securities Act.

1. General Background

The Securities Act provides in effect that every security offered or sold in the United States must either be registered with the US Securities and Exchange Commission (the “SEC”) or must qualify for an exemption from registration.

SEC registration requires preparation of an offering document that meets specific, detailed disclosure requirements mandated by SEC rules, including both financial/accounting and non-financial disclosures. While SEC registration is advantageous in that it permits securities to be offered and sold to the public (including retail investors) in the United States, the registration process is burdensome, time-consuming and expensive. Additionally, making a US public offering will, for at least some period of time, subject the issuer to ongoing (and costly) SEC reporting requirements and corporate governance requirements under the Sarbanes-Oxley Act.

Under US securities laws, offerings and sales of securities may be structured to qualify for available exemptions from SEC registration, assuming various requirements are complied with. The vast majority of exempt transactions are typically structured to take advantage of two main Securities Act registration exemptions:

- Regulation S provides an exemption for offers and sales of securities that are made outside the United States; and
- Rule 144A provides an exemption for sales that are limited to “qualified institutional buyers” (“QIBs”), which are large institutional investors in the United States as part of a resale of eligible securities, or purchasers that the seller and any person acting on behalf of the seller reasonably believe to be QIBs. QIBs, generally speaking, are institutional investors that own or invest on a discretionary basis at least US$100 million worth of securities. Note that Rule 144A applies only to resales of securities and not to their initial issuance. Thus in a typical underwritten offering, it is only the resale of the security from underwriter to end investor that constitutes a Rule 144A transaction. The initial sale of the security from issuer to underwriter would ordinarily be analyzed as a Regulation S sale or as an exempt private placement. The other technical requirements of Rule 144A are discussed in Annex 1 to this note. The remainder of this note describes some of the practical implications of making a Rule 144A offering.

2. Disclosure in Rule 144A Offerings

Importantly, there are no specific SEC disclosure requirements in a Rule 144A offering; that is, the availability of the exemption does not depend upon providing investors with an offering document that includes any particular information. Thus, the content of a Rule 144A offering document is driven by market practice. That market practice is significantly informed by the desire of issuers and underwriters to avoid potential liability to investors under US law and, in particular, Rule 10b-5, the basic antifraud rule under US securities law. To avoid such exposure, the offering document must provide investors with all information that is “material” to their decision whether to invest in the securities on offer.
Generally, for US purposes, information is “material” if a reasonable investor would consider it significant in making an investment decision.

Against this background, the market practice is to look to SEC disclosure rules for SEC-registered offerings for guidance as to what constitutes “material” information requiring disclosure in a Rule 144A offering document, even though these rules are not technically applicable. In practice, Rule 144A offering documents are quite similar to prospectuses prepared for SEC-registered offerings in terms of the scope and depth of disclosure, though they may deviate substantially and in important ways from what would be required by SEC rules. For example, in an SEC-registered offering, all financial statements would need to be prepared in accordance with, or reconciled to, US GAAP. For a Rule 144A offering, accounts can be prepared in accordance with home country GAAP, with a brief narrative discussion of the principal ways in which such GAAP differs from US GAAP. In addition, strict adherence to the SEC’s “industry guide” requirements is not necessary in Rule 144A offerings by banks, insurance companies and mining or extractive enterprises, although efforts will invariably be made to follow these guides as closely as is reasonably practicable. The determination of what information is and is not “material” in the context of a Rule 144A issue is, in the end, a matter for the judgment of the issuer, its counsel and the other offering participants, informed, once again, by what would be included in an SEC disclosure document.

An offering document for a Rule 144A sale of debt securities will thus need to contain disclosure that goes well beyond what would be required for a non-US offering of debt securities. However, properly managed with the assistance of experienced US counsel, the process of preparing a Rule 144A offering document should not be overly burdensome for the issuer. Please refer to Annex 2 for a schedule of the typical sections in a Rule 144A offering document.

2.1 Customary Specific Disclosures

Note that the question of how much information to provide and in what form will depend not only on what is advisable from a legal point of view, but also on what the underwriters believe is needed to meet investor expectations and assist marketing of the issue. In speaking of what is “required” in this context, we generally mean what market practice and the risk management concerns of underwriters typically call for. Any specific disclosure requirements of the exchange on which the securities will be listed will also need to be addressed, although these are ordinarily relatively easy to satisfy.

- **Annual Financial Statements.** In a Rule 144A context, it is typical to include three full years of annual financial statements. The annual financial statements will need to be audited but, as noted above, need not be prepared in accordance with or reconciled to US GAAP.

- **Interim Financial Statements.** In connection with any issuance of securities occurring more than nine months after the most recent annual audited financial statements, interim financial statements covering the first six months of the year would ordinarily be required. At any other time, the offering document would ordinarily be expected to include whatever interim financial statements or other interim financial information the issuer has made public with respect to the current financial year. Any interim financial statements will not need to be audited. However, the underwriters will require a “SAS 72” equivalent “comfort letter” (which has a different format but is conceptually similar to the ICMA-style comfort letter typically used in Regulation S offerings) from the issuer’s auditors covering any such financial statements, and in this connection will ordinarily request that the interim financials be “reviewed” by the auditors. Such a review will entail a certain amount of additional work by the auditors, though this work stops short of an actual audit.

Underwriters will request that the auditors provide “negative assurance” as to any subsequent changes in specified financial statement line items in the comfort letter post the date of the latest audited/reviewed financials. In this context, SAS72 specifically provides that “if the underwriter requests negative assurance as to subsequent changes in specified financial statement items as of a date
135 days or more subsequent to the end of the most recent period for which the auditors have performed an audit or a review, the auditors may not provide negative assurance but are limited to reporting procedures performed and findings obtained—this essentially means that from the 135th day, the auditors can only give another, less desirable type of comfort, referred to as agreed-upon procedures. Depending on the circumstances, underwriters may not accept such lower form of comfort. For this reason, it is important that the issuer, in discussion with the underwriters and legal counsel, take this potential negative assurance timing issue into consideration at the kick-off of the offering process in order to ensure that the any necessary review or audit of the requisite financial statements will be completed and available in a timely manner, in order to avoid any potential delays in launching the deal.

- **MD&A.** A Management’s Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") will need to be provided with respect to any periods for which annual or interim financial statements are included in the offering document. This is the critical piece of disclosure that differentiates a Rule 144A offering from a Regulation S offering and requires a fair amount of preparation time and discussions among legal counsel and the Issuer. The MD&A is intended to enable an investor to understand the issuer’s financial affairs from the point of view of management, and is ordinarily quite detailed. A typical MD&A would cover the following:
  - discussion of the factors that have principally affected the issuer’s financial performance during the periods under review, and that are likely to have a significant effect in the future;
  - analysis of changes in specific income statement line items from period to period to explain primary reasons for such changes;
  - analysis of assets and liabilities, if relevant;
  - off-balance sheet financing activities;
  - use of derivatives and exposure to currencies, interest rates and other “market risk”; and
  - information that would be required by SEC industry guides in context of a SEC registered offering, to the extent reasonably available.

- **Risk Factors, Business and Management Sections.** While these sections are largely similar in both Regulation S and Rule 144A offerings, Rule 144A offerings generally contain greater detail, particularly on certain risks pertaining to US investors.

2.2 **Due Diligence and 10b-5 Letters**

In order to manage US liability and litigation risk, the underwriters will wish to carry out a program of due diligence that is (or should be) sufficient to provide them with a defense to any action brought under US securities laws alleging that the offering document is false or misleading. The level of diligence required for a Rule 144A offering is substantially greater than that required for a Regulation S offering. In this connection, underwriters will ordinarily require delivery of a so-called “10b-5 letter” representing confirmation from the lawyers who have assisted in preparing the offering document that they are not aware of any material misstatement or omission in the document that could form the basis of a US securities law action. A 10b-5 letter would typically be issued upon establishment of the program with respect to the general offering document, and upon any issuance under the program with respect to the document as supplemented at the relevant time.

The nature of the due diligence process that is necessary in this connection is well established as a matter of market practice. Generally speaking, there are three aspects of such due diligence:
• Management due diligence. Discussions with senior management with respect to strategy, markets and competition, financial performance, risks and opportunities, and other matters. There are various ways in which this can be organized, depending on the issuer’s preference and the availability of the relevant officers.

• Legal/documentary due diligence. Discussions with those responsible for legal, regulatory and compliance matters, and review by counsel of material documents relating to the issuer, including:
  • board minutes and other corporate records;
  • financing and acquisition documents and other material contracts; and
  • regulatory reports and correspondence.

A documentary due diligence request list will be prepared by counsel, listing the various types of documents that will need to be reviewed. The request list should then be discussed to ensure that it is not broader than is necessary. The amount of time required to collect and catalogue the relevant documents depends on a number of factors, but can be substantial.

• Participation in preparation of offering document. Finally, in order to issue a 10b-5 letter, counsel will need to participate directly in the process of preparing the offering document, as a great deal of important information comes to light through the discussions and drafting sessions relating to the document.

While the management diligence process is broadly similar in a Rule 144A offering to a Regulation S offering, the emphasis on documentary diligence is substantially higher in a Rule 144A offering and the preparation of the offering document is a more involved process often requiring two to three drafting sessions on the offering document with the Issuer.

2.3 Term Sheet

A preliminary offering document is distributed to the investors before the pricing of the offering occurs. Once the offering prices, the preliminary offering document will be supplemented with a term sheet, which will contain the basic terms of the notes and the pricing details. The term sheet also provides an opportunity to disclose any additional material information that surfaced between the printing of the preliminary offering document and the pricing date (such as corrections to the preliminary offering document or recent business developments). A final offering memorandum incorporating the pricing details will be prepared thereafter.

This note is merely intended to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on the issues presented here, please contact one of your regular contacts at Dorsey & Whitney.
Requirements of Rule 144A

The procedural requirements of Rule 144A are relatively straightforward:

- **Non-fungibility.** The securities offered may not be “fungible” with (i.e., of the same class as) a security that is listed on a US stock exchange or quoted on Nasdaq.

- **Information requirement.** While Rule 144A does not include any specific disclosure requirements, as discussed above, it does require that certain basic information about the issuer be available to the holder of a Rule 144A security and to any prospective purchaser identified by that holder. This information requirement may be satisfied in one of three ways: (i) the issuer files periodic reports with the SEC, (ii) the issuer is a foreign private issuer that furnishes information that it makes publicly available in its home jurisdiction pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 or (iii) the issuer gives an undertaking to provide information required by Rule 144A (essentially, a set of current financial statements) on request. The undertaking with respect to this information requirement is typically a negotiated term of the offering. Note that such an undertaking is intended for the benefit of third parties and appropriate steps must be taken to ensure that it will be enforceable by them under the governing law of the agreement.

- **Notice requirement.** The potential investor must be made aware that the seller may be relying on the registration exemption provided by Rule 144A. This is typically accomplished through statements to that effect made at various points in the offering document.

- **No “general solicitation or general advertising”.** A Rule 144A offering is a form of private placement, and accordingly any advertising about the offering or other attempts to stimulate interest among US investors generally is impermissible. Practically speaking, “general solicitation or general advertising” for purposes of Rule 144A would include anything published in the press or posted on an internet site or that otherwise becomes public in the United States that could reasonably be expected to have the effect of increasing the interest of US investors in the offering. In a Rule 144A context, ensuring that offering participants observe US restrictions on publicity during the period up to and through the offering is critical, and written publicity guidelines are invariably produced for this purpose. While this restriction no longer applies post the JOBS Act, market practice is to continue to assume it applies given, among others, 10b-5 liability concerns. Accordingly, marketing documentation for a Rule 144A offering is generally limited to an offering memorandum, an investor presentation for the roadshow and pricing announcements.

- **Issuer not an investment company.** Rule 144A is not available with respect to securities of an issuer that is required to be registered under the US Investment Company Act of 1940. The classic “investment company” is a mutual fund (collective investment scheme), but the statutory definition is broadly drafted and can apply to many companies that would not ordinarily be thought of as investment companies – for example, holding companies that operate through a number of minority-owned subsidiaries, special purpose entities whose assets consist largely of securities and operating companies that, for any number of reasons, happen to be holding a substantial amount of securities at a particular point in time. There are, on the other hand, a number of exemptions from registration under the Investment Company Act, and an issuer that qualifies for one of these may rely on Rule 144A to conduct a securities offering.
Additional Considerations in Completing a Rule 144A Offering

- **Secondary market considerations, transfer restrictions and “seasoning” of Rule 144A securities.** Securities sold in reliance on Rule 144A are “restricted securities” for purposes of the Securities Act, meaning that they may not be freely resold in the US public markets. They can be resold pursuant to an exemption from Securities Act registration, for example, through another Rule 144A resale, or outside the United States under Regulation S. Generally, the securities will remain “restricted” for a period of one year following the initial Rule 144A placement, at which point they will “season” and no longer be subject to resale restrictions under the Securities Act. In addition, once sold in a bona fide Regulation S secondary market transaction, securities initially placed under Rule 144A will immediately “season” for US purposes.

An important characteristic of Rule 144A securities is that the issuer need not establish procedures to police compliance with the applicable US transfer restrictions. This greatly simplifies trading in Rule 144A securities and makes it possible for them to be cleared and settled through DTC.

- **Liability and other considerations in connection with Rule 144A offerings.** The risk of liability (or, at least, litigation) associated with securities offerings in the United States means that most investment banks will be unwilling to underwrite a Rule 144A offering unless an offering document is prepared and a full program of due diligence carried out, including delivery of lawyers’ “10b-5 letters” and auditors’ (SAS 72) comfort letters.
ANNEX 2

TYPICAL STRUCTURE OF THE OFFERING MEMORANDUM

Cover Page: The cover page provides basic information on the terms of the securities and names the underwriters

Notice to investors: This section includes certain disclaimers relating to the offering and its distribution

Summary: The summary section provides a brief description of the issuer, its business, the basic terms of the securities and summary historical financial information and operating data

Risk factors: The risk factors section describes material risks relating to the issuer, its business and the offering of the securities

Use of proceeds: This section provides information on how the proceeds of the offering will be used

Exchange rates and exchange controls: A section on exchange rates is typically included where the reporting of the issuer is done in a currency other than the US dollars and can be joined together with a section describing any applicable exchange controls

Capitalization: The capitalization table discloses the actual cash and debt structure of the issuer and the cash and debt structure as adjusted for the offering

Selected financial information and operating data: This section typically contains certain operating results, a balance sheet, the income statement and the cash-flow statement for the previous three fiscal years and any relevant interim period

Management’s discussion and analysis of financial condition and results of operations: The MD&A will cover any periods for which annual or interim financial statements are included in the offering memorandum

Regulatory framework: This section details the regulatory framework for the business of the issuer

Industry: The industry section provides an overview of the industry of the issuer and is usually prepared by one of the underwriters

Business: The business section describes the business activities of the issuer

Description of material agreements/material indebtedness: This section discloses detailed information on any agreements or indebtedness that is deemed material

Management: Management of the issuer is presented, including biographical details and certain information on the management’s compensation

Sponsors/Shareholders: This section provides further information on sponsors or shareholders of the issuer, as applicable

Related party transactions: Any material related party transactions are mentioned in this section, as applicable

Description of the notes: Applicable in debt transactions, the description of the notes section mirrors the material aspects of the indenture, which governs the terms of the securities
**Taxation:** This section provides an overview of the taxation frameworks in various jurisdictions that could be relevant for holders of the securities

**Plan of distribution:** The plan of distribution discloses the allocation of the securities among the underwriters and describes the distribution methods

**Transfer restrictions:** This section details any applicable transfer restrictions

**Financial statements:** This section includes audited financial statements for the past three financial years and any interim, reviewed financial statements