ACT ICA; SA
SECTION 7(d); 3(c)(1); 3(c)(7)
RULE 902
PUBLIC AVAILABILITY 10/5/98

October 5, 1998
Our Ref. No. 98-435-CC
Goodwin, Procter & Hoar
File No. 132-3

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Your letter dated October 5, 1998 requests our confirmation that an investment company formed under the laws of a jurisdiction other than the United States ("Foreign Fund") would not be deemed to be making a public offering for purposes of Section 7(d) of the Investment Company Act of 1940 (the "Act") if certain functions that, for U.S. tax purposes, previously have been performed offshore by or on behalf of the Foreign Fund are performed in the United States. You also request our confirmation that a Foreign Fund will not be deemed to be making a public offering for purposes of Section 7(d) of the Act if it simultaneously conducts a private U.S. offering and an offshore public offering and uses U.S. jurisdictional means in connection with the offshore offering.

FACTS

You state that a foreign entity engaging in a trade or business in the United States generally subjects itself or its shareholders to U.S. taxation. Section 864(b)(2)(A)(ii) of the Internal Revenue Code of 1986, as amended (the "Code"), contains a specific safe harbor that generally provides that mere trading in securities by a company, other than as a dealer, for its own account, does not constitute a trade or business in the United States.[1] You state that until recently, this safe harbor was not available to a Foreign Fund that had its "principal office" in the United States.

You state that the determination of whether a Foreign Fund's principal office was in the United States for U.S. tax purposes was made by comparing the activities (other than trading in securities) that the fund conducted from offices located in the United States to the activities that it conducted from offices located outside of the United States. If the Foreign Fund performed "all or a substantial portion" of ten specific activities, typically referred to as the "Ten Commandments," from offices outside of the United States, the Internal Revenue Service considered the fund not to have its principal office in the United States.[2] You state

[1] 26 U.S.C. § 864 (1998).

[2] See Treas. Reg. § 1.864-2(c)(2)(iii). The Ten Commandments activities were as follows: (1) communicating with the fund's shareholders (including the furnishing of financial reports); (2) communicating with the general public; (3) soliciting sales of the fund's stock; (4) accepting subscriptions of new shareholders; (5) maintaining the fund's principal corporate records and books of account; (6) auditing the fund's books of account; (7) disbursing payments of dividends, legal fees, accounting fees, and officers' and directors' salaries; (8) publishing or furnishing the offering and redemption price of the stock issued by the fund; (9) conducting meetings of the fund's shareholders and board of directors; and (10) making redemptions of the fund's stock (collectively, the "Ten

that U.S. sponsors of Foreign Funds generally have sought to comply with the Ten Commandments by hiring trust companies and other independent contractors located in foreign jurisdictions to carry out the specified functions. You assert that, in many cases, this structure has resulted in operating inefficiencies because U.S. sponsors have been unable to combine the back office functions of their Foreign Funds with those of their funds that are organized and operated in the United States.

The Taxpayer Relief Act of 1997 modified the securities trading safe harbor by eliminating the requirement that a foreign entity's principal office be located outside of the United States.[3] This change, which is effective for tax years beginning after December 31, 1997, eliminates the need for a Foreign Fund to comply with the Ten Commandments.[4] Because the performance of the Ten Commandments activities in the United States represents a departure from the historical operations of Foreign Funds, you request our confirmation that a Foreign Fund would not be deemed to be making a public offering for purposes of Section 7(d) of the Act if the Ten Commandments activities are performed by or on behalf of the Foreign Fund in the United States. In particular, you seek our concurrence that the Ten Commandments activities generally may be performed in the United States in connection with a Foreign Fund's private U.S. offering of its securities, as long as those activities that amount to the offer or sale of securities are consistent with the regulatory restrictions on non-public offerings. Similarly, you request our concurrence that the Ten Commandments activities generally may be performed in the United States in connection with a Foreign Fund's offshore public offering, as long as those activities that amount to the offer or sale of securities are directed offshore to non-U.S. persons. In a separate but related question, you ask us to confirm that a Foreign Fund will not be deemed to be making a public offering for purposes of Section 7(d) of the Act if it simultaneously conducts a private U.S. offering and an offshore public offering and uses U.S. jurisdictional means in connection with the offshore offering.

ANALYSIS

Section 7(d) of the Act states:

> No investment company, unless organized or otherwise created under the laws of the United States or of a State . . . shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, any security of which such company is the issuer.

Commandments activities"). Id.

[3] Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1162, 111 Stat. 788 (1997).

[4] See H.R. Rep. No. 220, 105th Cong., 1st Sess. (1997).

The Commission has indicated that the prohibitions of Section 7(d) apply only to a public offering by a Foreign Fund in the United States or to U.S. persons.[5] Several positions taken by the staff have applied a similar principle in permitting a Foreign Fund to simultaneously make an offshore public offering and a private U.S. offering of its securities. Under these positions, a Foreign Fund that is conducting an offshore offering also may make, under certain circumstances, a private U.S. offering in reliance on Section 3(c)(1)[6] or 3(c)(7)[7] of the Act consistent with the U.S. public offering prohibition in Section 7(d). A Foreign Fund generally may rely on the definition of "U.S. person" in Rule 902(k) of Regulation S under the Securities Act of 1933 ("Securities Act") in determining whether a potential investor must be counted or qualified for purposes of complying with Section 3(c)(1) or 3(c)(7) of the Act, respectively.[8]

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[5] Investment Company Act Release No. 23071 (Mar. 23, 1998) at n. 12 and accompanying text. See also S. Rep. No. 1775, 76th Cong., 3d Sess. 13 (1940); H.R. Rep. No. 2639, 76th Cong., 3d Sess. 13 (1940) ("foreign investment companies may not register as investment companies or *publicly offer securities of which they are the issuer in the United States* unless the Commission finds that these foreign investment companies can be effectively subjected to the same type of regulation as domestic investment companies") (emphasis added).

We note that Section 7(d) of the Act is implicated only when a Foreign Fund uses U.S. jurisdictional means in connection with its public offering. As a result, we believe that an offshore public offering by a Foreign Fund to U.S. persons that does not make use of U.S. jurisdictional means would not constitute a public offering for purposes of Section 7(d) of the Act. Global Mutual Fund Survey (pub. avail. July 14, 1992).

[6] Touche Remnant & Co. (pub. avail. Aug. 27, 1984). Section 3(c)(1) of the Act provides an exclusion from the definition of investment company for any fund that is not conducting, and does not presently propose to conduct, a public offering of its securities and that has 100 or fewer beneficial owners.

[7] Goodwin, Procter & Hoar (pub. avail. Feb. 28, 1997). Section 3(c)(7) of the Act provides an exclusion from the definition of investment company for any fund the securities of which are owned exclusively by persons who, at the time of acquisition, are "qualified purchasers," and that is not conducting, and does not at that time propose to conduct, a public offering of its securities. The term "qualified purchaser" is defined in Section 2(a)(51) of the Act to include certain investors with a high degree of financial sophistication.

[8] Goodwin, Procter & Hoar, supra note 7. We note that if U.S. persons become shareholders of a Foreign Fund as a result of activities beyond the control of the fund or persons acting on its behalf, the fund would not be required to count those shareholders as U.S. persons for purposes of determining whether it may rely on Section 3(c)(1) or 3(c)(7) of the Act. See Investment Funds Institute of Canada (pub. avail. Mar. 4, 1996); Investment Company Act Release No. 23071, supra note 5, at n. 41.

Ten Commandments Activities

You request our confirmation that a Foreign Fund would not be deemed to be making a public offering for purposes of Section 7(d) of the Act if the Ten Commandments activities are performed by or on behalf of the Foreign Fund in the United States.[9] As discussed below, we believe that the Ten Commandments activities generally may be performed in the United States in connection with a private U.S. offering of a Foreign Fund's securities, as long as those activities that amount to an offer or sale of securities are consistent with the regulatory restrictions on non-public offerings. We also believe that the Ten Commandments activities generally may be performed in the United States in connection with a Foreign Fund's offshore public offering, as long as those activities that amount to an offer or sale of securities are directed offshore to non-U.S. persons.[10]

Private Offerings

We believe that the Ten Commandments activities generally may be performed in the United States in connection with a Foreign Fund's private offering without implicating Section 7(d). We believe, however, that any Ten Commandments activities conducted by or on behalf of the Foreign Fund that amount to an offer or sale of the fund's securities must be consistent with the regulatory restrictions on non-public offerings. Specifically, any unregistered securities offering in the United States by a Foreign Fund must be made in compliance with Section 4(2) of the Securities Act, or Regulation D or other exemption from

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[9] We note that in several prior no-action letters, we have taken the position that we would not recommend enforcement action under Section 7(d) of the Act against a Foreign Fund that performed certain of its activities (e.g., receiving and effecting purchase and redemption orders for its shares) in the United States. See G. T. Global Financial Services, Inc. (pub. avail. Aug. 2, 1988); Merrill Lynch (pub. avail. May 12, 1986); and Shearson International Dollar Reserves (pub. avail. July 15, 1981). In each of those situations, counsel represented that the Foreign Fund was not doing business in the United States for federal tax purposes. This representation seems to indicate that those Foreign Funds were performing all or a substantial portion of the Ten Commandments activities outside of the United States. We believe that a Foreign Fund that structures its operations consistent in all material respects with these prior letters, and conducts its Ten Commandments activities in the United States consistent with the standards articulated in this response, should not be deemed to be making a public offering for purposes of Section 7(d) of the Act.

[10] In analyzing whether the performance of the Ten Commandments activities in the United States by or on behalf of a Foreign Fund implicates Section 7(d) of the Act, we recognize that many of the activities that make up the Ten Commandments (e.g., maintaining the fund's principal corporate records and books of account; auditing the fund's books of account; and disbursing payments of dividends, legal fees, accounting fees, and officers' and directors' salaries) typically are not part of the offer or sale of securities. The performance of those Ten Commandments activities that could be part of the offer or sale of securities (e.g., soliciting sales of the fund's stock) in the United States will only implicate Section 7(d) if such activities result in the Foreign Fund making a public offering of its securities in the United States or to U.S. persons.

registration under the Securities Act, as well as Section 3(c)(1) or 3(c)(7) of the Act.

Offshore Public Offerings

We believe that the Ten Commandments activities generally may be performed in the United States in connection with a Foreign Fund's offshore public offering without implicating Section 7(d). We believe, however, that those Ten Commandments activities performed in the United States that amount to an offer or sale of securities must be directed offshore to non-U.S. persons in a manner consistent with an exemption or safe harbor from the registration requirements of the Securities Act. Regulation S under the Securities Act provides guidance in evaluating whether any Ten Commandments activities performed in the United States should be viewed as directed offshore to non-U.S. persons for purposes of Section 7(d) of the Act.

Regulation S clarifies the extraterritorial application of the registration provisions of the Securities Act.[11] The regulation generally provides that Section 5 of the Securities Act does not apply to any offer or sale of securities by certain issuers, including Foreign Funds not registered or required to be registered under the Act, that occurs outside of the United States.[12] By its terms, Regulation S does not directly address whether an offshore public offering by a Foreign Fund triggers the U.S. public offering prohibition of Section 7(d) of the Act. The requirements of Regulation S, however, are intended to ensure that an issuer relying on the regulation is offering and selling its securities offshore.[13] For example, under Rule 903 of Regulation S, an issuer whose securities have no substantial U.S. market interest must satisfy only two conditions to comply with the safe harbor: (1) any offer or sale of its securities must be made in an "offshore transaction;" and (2) no "directed selling efforts" may be made in the United States.

Rule 902(h) under Regulation S generally defines an "offshore transaction" as a transaction in which no offer is made to a person in the United States and, at the time that the buy order is originated, the buyer is outside of the United States or the seller reasonably

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[11] Securities Act Release No. 6863 (Apr. 24, 1990) (adopting Regulation S).

[12] Preliminary Note 8 of Regulation S states that the regulation does not apply to offers and sales of securities issued by open-end investment companies or unit investment trusts registered or required to be registered or closed-end investment companies required to be registered, but not registered, under the Act.

[13] Regulation S does not preclude a Foreign Fund from selling its securities to U.S. persons, provided that the conditions of the regulation are satisfied. For purposes of Section 7(d), however, a Foreign Fund may not make a public offering to U.S. persons if it makes use of U.S. jurisdictional means. We believe that a Foreign Fund must count (for Section 3(c)(1) purposes) or qualify (for Section 3(c)(7) purposes) all U.S. persons to whom it sells securities as part of its offshore offering. <u>See</u> Goodwin, Procter & Hoar, <u>supra</u> note 7.

believes that the buyer is outside of the United States. In our view, the Ten Commandments activities generally may be performed by or on behalf of a Foreign Fund in the United States consistent with the offshore transaction requirement of Regulation S because all of these activities can be conducted from or in the United States while all offerees and buyers are outside of the United States.[14]

Rule 902(c) under Regulation S generally defines "directed selling efforts" as any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the U.S. market for any of the securities being offered in reliance on the regulation. We believe that the performance of the Ten Commandments activities in the United States in connection with the offer or sale of a Foreign Fund's securities offshore generally would not constitute directed selling efforts within the meaning of rule 902(c), as long as these activities are directed offshore. For example, although we believe that it would not be consistent with Section 7(d) for a Foreign Fund or its service providers to mail printed materials to U.S. investors, or place advertisements in publications with a general circulation in the United States, we believe that it would be consistent with Section 7(d) to develop and distribute mailings or advertisements from the United States for dissemination offshore.[15]

Use of U.S. Jurisdictional Means

You ask us to confirm that a Foreign Fund will not be deemed to violate Section 7(d) of the Act if it simultaneously conducts a private U.S. offering and an offshore public offering and uses U.S. jurisdictional means in connection with the offshore offering. You state that some confusion has arisen from the wording of a 1997 no-action letter which implies that an offshore offering under these circumstances should involve only "incidental U.S. jurisdictional contacts."[16]

As discussed above, although Section 7(d) refers broadly to a Foreign Fund using U.S. jurisdictional means to make a public offering, the Commission has interpreted the prohibitions of Section 7(d) to apply only to a public offering in the United States or to U.S.

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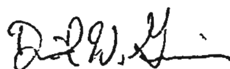
[14] We note that we would not view offers and sales that are specifically targeted at identifiable groups of U.S. citizens abroad, such as members of the armed forces serving overseas, as meeting the offshore transaction requirement. This view is consistent with the provisions of Regulation S. See Rule 902(h)(2) of Regulation S.

[15] We note that we would view selling efforts targeted at identifiable groups of U.S. citizens abroad, such as members of the armed forces serving overseas, as directed selling efforts. This view is consistent with the Commission's interpretation of Regulation S. See Securities Act Release No. 6863, supra note 11, at n. 35.

[16] See Goodwin, Procter & Hoar, supra note 7, at n. 33 and accompanying text.

persons.[17] As a result, we believe that Section 7(d) prohibits the use of U.S. jurisdictional means by a Foreign Fund in connection with a public offering in the United States or to U.S. persons, rather than the use of U.S. jurisdictional means *per se*. We believe, therefore, that Section 7(d) of the Act does not prohibit a Foreign Fund that is conducting a private U.S. offering from using U.S. jurisdictional means in connection with a concurrent offshore public offering, provided that the fund counts or qualifies all U.S. person shareholders for purposes of Sections 3(c)(1) or 3(c)(7) of the Act, respectively.[18]



David W. Grim
Senior Counsel

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[17] See supra note 5 and accompanying text.

[18] In KBS International Ltd. (pub. avail. Mar. 18, 1985), we took the position that for purposes of determining the applicability of Section 7(d) of the Act, "whether an offer made by a foreign investment company . . . to persons outside the United States . . . would be integrated with an offer by the foreign investment company to United States persons, would depend on whether jurisdictional means were used directly or indirectly in connection with the foreign offer." KBS International Ltd. is superseded to the extent that it is inconsistent with the position taken in this response.

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**Investment Company Act
of 1940--Section 7(d)**

October 5, 1998

Office of Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Attention: Douglas J. Scheidt, Associate Director and General Counsel

Ladies and Gentlemen:

We are seeking interpretative advice on an issue arising from a recent change in U.S. tax law relevant to investment companies organized outside of the United States ("foreign funds"). This change effectively permits certain activities that have historically been conducted for foreign funds by offshore service providers to be conducted within the United States. We ask you to confirm that the performance of these activities within the United States by or on behalf of a foreign fund will not adversely affect the ability of the fund to rely on the Touche Remnant doctrine under Section 7(d) of the Investment Company Act of 1940, as amended (the "1940 Act").

I. BACKGROUND.

<u>The "Ten Commandments</u>." When a foreign entity engages in a "trade or business in the United States," it generally subjects itself or its shareholders to U.S. taxation. Accordingly, a critical aspect of tax planning for a foreign fund is ensuring that the U.S. activities of the fund and its service providers do not cause the fund to be engaged in a "trade or business in the United States." This is possible because the term "trade or business in the United States" generally does not extend to passive investment activities. Moreover, the Internal Revenue Code of 1986, as amended (the "Code"), contains specific safe harbors that protect these activities from giving rise to a U.S. trade or business.

Section 864(b)(2)(A)(ii) of the Code provides the most important safe harbor for foreign funds that use a U.S. investment adviser. That provision states generally that trading in

OCT-05-98 15:36 From:GOODWIN, PROCTER & HOAR 6179739488 T-070 P.02/10 Job-532

securities for a fund's account does not constitute a trade or business in the United States. Until recently, this exception has not been available if the fund's "principal office" is in the United States.

The determination of whether a foreign fund's principal office is located in or outside the United States has been made under Treasury Regulation §1.864-2(c)(2)(iii) by comparing the activities (other than securities trading) that the fund conducts from a U.S. office with the activities it conducts from one or more offices outside the United States. The Regulations have provided that if a foreign corporation performs "all or a substantial portion" of ten specific functions from one or more offices located outside the United States, the corporation will not be considered to have its principal office in the United States.

These ten functions are often referred to by industry participants as the Ten Commandments.[1] U.S. sponsors of foreign funds have generally sought to comply with the "Ten Commandments" by hiring trust companies and other independent contractors located in foreign jurisdictions to carry out the requisite back office functions. In many cases, this has resulted in operating inefficiencies because U.S. fund sponsors have been unable to combine the back office functions of their foreign funds with those of their U.S. funds.

The Taxpayer Relief Act of 1997 eliminates the requirement that a foreign fund's principal office be outside of the United States, effectively eliminating the need for foreign funds to comply with the Ten Commandments. This change is effective for taxable years beginning after December 31, 1997.[2]

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[1] The "Ten Commandments," are as follows: (1) communicating with the fund's shareholders (including the furnishing of financial reports); (2) communicating with the general public; (3) soliciting sales of the fund's own stock; (4) accepting subscriptions of new stockholders; (5) maintaining the fund's principal corporate records and books of account; (6) auditing the fund's books of account; (7) disbursing payments of dividends, legal fees, accounting fees and officers and directors salaries; (8) publishing or furnishing the offering and redemption price of the shares of stock issued by the fund; (9) conducting meetings of the fund's shareholders and board of directors; and (10) making redemptions of the fund's own stock.

[2] The legislative history of the Taxpayer Relief Act of 1997 indicates that Congress recognized that the Ten Commandments served little real purpose and had negative economic consequences for the United States. *See* House Ways and Means Committee Report, CCH Federal Tax Reports Vol. 84, Issue no. 32, p. 297 ("The Committee understands that the principal office rule operates simply to shift certain administrative functions with respect to securities trading -- and the associated jobs -- offshore.") We believe that the confirmation requested below is consistent with the Congressional intent behind the elimination of the Ten Commandments.

OCT-05-98 15:37 From:GOODWIN, PROCTER & HOAR 6173739488 T-070 P.03/10 Job-532

Section 7(d). Section 7(d) of the 1940 Act provides that, "[N]o investment company, unless organized or otherwise created under the laws on the United States . . . shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, any security of which such company is the issuer [in the absence of an order from the Commission]." Although the language of Section 7(d) appears to broadly limit the ability of a foreign investment company to use jurisdictional means to make a "public offering," there is abundant evidence in the legislative history that Section 7(d) was intended only to limit the ability of foreign funds to publicly offer their securities *in the United States*.[3] We have been unable to find any legislative history which suggests that Section 7(d) was intended as a restriction on using jurisdictional means in connection with a *foreign* public offering.

Interpretations by the Commission and the Staff are consistent with the conclusion that Section 7(d) limits only public offerings in the United States. In a series of no-action letters beginning with *Touche, Remnant & Co.* (August 27, 1984), the Staff stated that it would not recommend that the Commission take any enforcement action against foreign funds for failing to register under the 1940 Act, provided that (i) they do not publicly offer their securities in the United States and (ii) they limit the U.S. beneficial ownership of their securities in certain stated ways.[4] A foreign fund meeting these requirements is then free to conduct a foreign public offering and have an unlimited number of foreign shareholders without violating the 1940 Act. The principles of *Touche Remnant* have been modified by the Staff in various subsequent letters, including most recently, *Investment Funds Institute of Canada* and

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[3] *See* S. Rep. No. 1775, 76th Congress, 3d Sess. (1940) accompanying S. 4108, 76th Congress, 3d Session (1940) at 13 ("Foreign investment companies may not register as investment companies or publicly offer securities of which they are the issuer in the United States unless the Commission finds that these foreign investment companies can be effectively subjected to the same type of regulation as domestic investment companies."). *See also* H.R. Rep. No. 2639, 76th Congress, 3d Sess. (1940) accompanying H.R. 10065, 76th Congress, 3d Session (1940) at 13; House consideration and passage of H.R. 10065, as amended, August 1, 1940, 86 Cong. Rec. 9807, 9810 (1940); Senate consideration and passage of S. 4108, as amended, August 8, 1940, 86 Cong. Rec. 10069, 10074 (1940).

[4] Whether a fund's U.S. activities constitute a public offering will be determined by reference to 1933 Act principles, e.g. Section 4(2) and Rule 506 of Regulation D. The composition of a fund's U.S. shareholder base will be judged by reference to Section 3(c)(1) and Section 3(c)(7) of the 1940 Act.

Goodwin, Procter & Hoar.[5] The Commission has endorsed the basic principles of the Touche Remnant doctrine set forth by the Staff, as well as these two most recent modifications.[6]

II. INTEGRATION OF FOREIGN AND DOMESTIC OFFERINGS.

Where a foreign fund carries out its Ten Commandment functions obviously has no direct effect upon its ability to comply with the two basic components of the Touche Remnant doctrine (i.e. no public offering in the United States and a U.S. shareholder base consistent with Section 3(c)(1) or Section 3(c)(7)). Moreover, it is now well established that Section 7(d) imposes no *per se* prohibition on the use of U.S. jurisdictional means in connection with a foreign public offering. Accordingly, the location of the Ten Commandment functions can be significant for purposes of Section 7(d) only if it provides the basis for integrating a foreign public offering with a private offering in the United States. For the reasons stated below, we believe that it does not.

Integration Prior to Adoption of Regulation S. To avoid integration of a fund's U.S. private placement with its foreign public offering, applicants requesting no-action or interpretive relief traditionally represented that certain activities related to the funds' foreign offerings would take place outside of the United States. In general, the key representations appear to have been based upon Release 4708, which (until the adoption of Regulation S) provided the primary framework for evaluating the integration of onshore and offshore

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5 In *Investment Funds Institute of Canada* (March 4, 1996) the staff stated that if U.S. persons become shareholders of a foreign fund for reasons beyond the control of the fund (or persons acting on its behalf), the fund would not be required to count those shareholders as U.S. persons under the Touche Remnant doctrine. In *Goodwin, Procter & Hoar* (February 28, 1997) the Staff stated, among other things, that foreign funds may offer and sell their shares to U.S. residents in accordance with the limitations imposed by either Section 3(c)(1) or Section 3(c)(7) under the 1940 Act and that the definition of a U.S. person set forth in Rule 902(o) of Regulation S may be used for purposes of determining who is a U.S. resident beneficial owner under the Touche Remnant doctrine.

6 *See* Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities under Rules 144 and 145, Release No. 33-6862 (April 23, 1990); *see also* Statement of the Commission Regarding Use of Internet Web Sites To Offer Securities, Solicit Transactions, or Advertise Investment Services Offshore. Release Nos. 33-7516, 34-39779, IA-1710, IC-23071 (March 23, 1998) (hereinafter referred to as the "Internet Release") at note 41.

offerings under the 1933 Act.[7] Under this approach, the focus was on whether the foreign offering was reasonably designed to preclude distribution of the securities offered abroad within the United States or to U.S. nationals. Thus applicants provided assurances to the effect that foreign investors would not be solicited while they were present in the United States, that no funds from U.S. sources would be used to purchase shares in the foreign offering, and that the shares would be purchased by foreign investors solely for investment purposes and not for distribution.

In many cases the applicants also recited that some or all of the Ten Commandments would be performed outside of the United States. However, it is unlikely that the Staff relied upon these recitals in granting no-action relief. Only one of these functions directly involves the offering of securities[8] and even the most restrictive no-action letters under the Touche Remnant doctrine focused upon the scope of U.S. activities *in connection with the foreign offering*, rather than the issuer's use of jurisdictional means per se.[9]

A 1988 no-action letter, *G.T. Global Financial Services, Inc.*,[10] is particularly significant in this regard. In *G.T. Global*, the staff granted no-action relief under circumstances in which the applicant intended to use U.S.-based brokers to offer foreign funds, a strategy which has generally been viewed by tax experts as a violation of the one commandment that deals expressly with the offering of securities. Although the applicant contemplated that brokers would be physically present in the United States and would transmit offers to overseas investors using the mails and other facilities of interstate commerce, the foreign offering would be conducted in accordance with restrictions modeled on Release 4708. We believe that *G.T. Global* illustrates that the Staff has historically resolved integration issues

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7 Release No. 33-4708 (July 9, 1964). While at least one early no-action letter under the Touche Remnant doctrine stated that onshore and offshore offers would be integrated if U.S. jurisdictional means were used directly or indirectly in connection with the offshore offer, *KBS International Ltd.* (March 18, 1985), the Staff subsequently granted no-action relief in numerous letters involving the use of U.S. jurisdictional means in connection with the foreign offering.

8 *I.e.*, number (3), "soliciting sales of the fund's own stock." Certain other Commandments involve functions that may have an indirect relationship to the offering of securities (*e.g.*, number (1) may involve the communication of information that indirectly causes a shareholder to make an additional investment in the fund).

9 *See KBS International*, footnote 5 above.

10 *G.T. Global Financial Services, Inc.* (August 2, 1988).

OCT-05-98 15:38 From:GOODWIN, PROCTER & HOAR 6179739488 T-070 P.06/10 Job-532

under the Touche Remnant doctrine by reference to the Commission's own principles under the 1933 Act and has given little or no weight to an issuer's compliance with the Ten Commandments.

Integration Following the Adoption of Regulation S. In 1990, the Commission adopted Regulation S to clarify the extraterritorial application of the registration provisions of the 1933 Act.[11] Regulation S provides two "safe harbors" for specified transactions. Offers and sales meeting all of the conditions of the applicable safe harbor are deemed to be outside the United States. When Regulation S was adopted, the Commission also amended Regulation D to provide that, "[g]enerally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offerings being made outside the United States in compliance with Regulation S."[12] We believe that compliance with Regulation S enables a foreign fund to avoid the integration of its U.S. and non-U.S. offerings for purposes of Section 7(d), just as it does for other purposes under the federal securities laws.[13]

To comply with Regulation S, certain transactions (including offers and sales by foreign private issuers whose securities have no substantial U.S. market interest) need satisfy only two conditions: that (a) the offer or sale be made in an offshore transaction and (b) there be no directed selling efforts in the United States.[14]

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11 *See* Offshore Offers and Sales, Release Nos. 33-6863, 34 -27942; IC-17458 (April 24, 1990) (hereinafter, the "Regulation S Adopting Release").

12 *See* Note to Rule 502(a).

13 In light of the *Goodwin, Procter & Hoar* letter, we understand that the Staff's view is that a foreign public offering will not be integrated with a U.S. private placement provided that the foreign offering is conducted in compliance with Regulation S and the fund observes limitations upon U.S. beneficial ownership consistent with Section 3(c)(1) or Section 3(c)(7) under the 1940 Act. We are aware that some confusion has arisen from certain language in the Staff's response which implies that an offshore offering should "involve only incidental U.S. jurisdictional contacts." *See* footnote 33 of the Staff's response in *Goodwin Procter & Hoar* and the accompanying text. Based upon our contemporaneous discussions with the Staff, we do not believe that the Staff intended to establish an additional "incidental contacts" test. Moreover, we do not believe that such an additional test would be consistent with the purpose and intent of Section 7(d) as described above. In order to provide greater certainty under the *Goodwin, Procter & Hoar* letter, we ask you to confirm that that letter does not adopt an "incidental contacts" standard.

14 *See* Regulation S, Rule 903. Terms are defined in Rule 902 under Regulation S.

OCT-05-98 15:38 From:GOODWIN, PROCTER & HOAR 6179739488 T-070 P.07/10 Job-532

The prohibition on directed selling efforts protects against the possibility that an offer that is nominally made offshore will be targeted at investors in the United States. Directed selling efforts are defined as "any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered in reliance on this Regulation S." Activities such as mailing printed material to U.S. investors, conducting promotional seminars in the United States, or placing advertisements with radio or television stations broadcasting into the United States or in publications with a general circulation in the United States all constitute directed selling efforts.[15]

For purposes of Regulation S, *where* the Ten Commandments functions are performed is not important. Rather, it is *how* they are performed that is significant. For example, traditional Ten Commandment analysis required that information about a fund's offering of securities be disseminated from an office outside of the United States.[16] Under this analysis, it was the physical location of a Fund representative when he or she placed or answered a telephone call, sent offering material, or transmitted a press release that determined compliance with the Ten Commandments. Under Regulation S, the content of the material, to whom it is targeted, and where the investors are located, takes precedence over the physical location of the Fund's representatives.[17]

<u>The Commission's Internet Release</u>. Technology is further complicating any analysis based upon a person's physical location. On March 23, 1998, the Commission published the Internet Release to articulate its views on the application of the registration obligations under the federal securities laws to certain uses of Internet Web sites, observing that information posted on the Internet can be made readily available without regard to geographical and political boundaries.

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[15] Regulation S Adopting Release at p.29. See also Rule 902(c) under Regulation S.

[16] This could have implicated at least three of the Ten Commandments: #2 (communicating with the general public); #3 (soliciting sales of the fund's own stock); and #8 (publishing or furnishing the offering and redemption price of the shares of stock issued by the fund).

[17] Assuming *the investors* are not present in the United States when they are solicited or when they place their orders, Regulation S clearly permits U.S. financial intermediaries to offer and sell securities to their offshore clients from offices within the United States.

The Commission declined to require registration for every Internet offering accessible by persons physically located in the United States, adopting instead a balanced approach designed to regulate only those offers that are "targeted to persons in the United States or to U.S. persons." The Commission stated that when an offeror implements adequate measures to prevent U.S. persons from participating in an offshore Internet offer, it would not view the offer as targeted at the United States and thus would not treat it as occurring in the United States for registration purposes.[18]

As with Regulation S generally, it is not *where* the functions contemplated by the Ten Commandments are performed, but *how* they are performed that is significant for purposes of the Internet Release. Thus, the location of an issuer's representative when he or she placed information onto a Web site is irrelevant; rather it is the issuer's intent to target U.S. investors, as evidenced by the content of the offering information, that is critical.

III. INTERPRETATION REQUESTED

For the reasons stated above, we ask you to confirm our understanding that a foreign fund may perform the activities contemplated by the Ten Commandments in the United States in connection with a U.S. offering, provided that the fund has procedures in place reasonably designed to ensure that such U.S. offering is private in nature. We also request your concurrence that a foreign fund may perform the activities contemplated by the Ten Commandments in the United States in connection with a non-U.S. offering, provided that any activities performed in connection with such non-U.S. offering are targeted offshore. In this regard we also ask you to confirm that compliance with Regulation S in connection with a non-U.S. offering will be sufficient to establish that such offering is targeted offshore.

In order to provide greater certainty to foreign funds seeking to rely upon the Touche Remnant doctrine, we also ask you to confirm our general understanding that a foreign public offering will not be integrated with a U.S. private placement provided that the foreign offering is conducted in compliance with Regulation S and the fund observes limitations upon U.S. beneficial ownership consistent with Section 3(c)(1) or Section 3(c)(7) under the 1940 Act.[19]

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[18] A significant portion of the Internet Release is dedicated to providing guidance on the scope of "adequate measures" under various facts and circumstances.

[19] Regulation S incorporates the general principle that the safe harbors are not available with respect to any transaction or series of transactions that, although in technical compliance with the relevant rules, "is part of a plan or scheme to evade the registration provisions of the [1933] Act." Preliminary Note 2 to

OCT-05-98 15:39 From:GOODWIN, PROCTER & HOAR 6179739488 T-070 P.09/10 Job-532

If you should have any questions concerning the above, please feel free to call Elizabeth Shea Fries or me at (617) 570-1000.

Sincerely yours,

Geoffrey R. T. Kenyon

CC: Elizabeth Shea Fries, Esq.

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Regulation S. *See also* Section 48 of the 1940 Act.