CARTER LEDYARD & MILBURN LLP
www.clm.com Partners for Your Business®

PRIVATE SECURITIES OFFERINGS IN THE UNITED STATES BY OFFSHORE INVESTMENT FUNDS

September 1, 2004

CARTER LEDYARD & MILBURN LLP
2 WALL STREET
NEW YORK, NEW YORK 10005
TELEPHONE: (212) 732-3200
FACSIMILE: (212) 732-3232

Copyright © 2004. Carter Ledyard & Milburn LLP. All rights reserved. No part of this document may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, facsimile, recording or otherwise, without the prior permission of the Copyright owner.

1134149.6

CARTER LEDYARD & MILBURN LLP
Counselors at Law

2 Wall Street
New York, NY 10005-2072
•
Tel (212) 732-3200
Fax (212) 732-3232

570 Lexington Avenue
New York, NY 10022
(212) 371-2720

701 Eighth Street, N.W.
Washington, DC 20001
(202) 898-1515

September 1, 2004

PRIVATE SECURITIES OFFERINGS IN THE UNITED STATES BY OFFSHORE INVESTMENT FUNDS

Private securities offerings in the United States by offshore investment funds, often made in conjunction with a concurrent offshore public offering, raise a number of issues under U.S. securities, tax and pension laws and regulations.

The annexed Memorandum is an introductory primer explaining these issues and suggesting solutions and models for an efficient offering in compliance with the various U.S. regulatory schemes.

Questions regarding this Memorandum may be addressed:

As to securities matters, to Robert A. McTamaney, Stephen V. Burger, Andris J. Vizbaras;

As to tax matters, to Howard J. Barnet, Jr. or Jerome J. Caulfield;

As to ERISA matters, to Patricia Matzye.

A directory is annexed. The authors would like to express special thanks to Ms. Diane D'Agostino and Ms. Doris Putney for their assistance in the preparation of this Memorandum.

CARTER LEDYARD & MILBURN LLP

DIRECTORY

CARTER LEDYARD & MILBURN LLP

2 Wall Street	**570 Lexington Avenue**	**Suite 300**
New York, New York 10005	**New York, New York 10022**	**701 Eighth Street, NW**
Telephone No.: 212-732-3200	**Telephone No.: 212-371-2720**	**Washington, DC 20001**
Facsimile No.: 212-732-3232	**Facsimile No.: 212-371-4234**	**Telephone no.: 202-898-1515**
		Facsimile no.: 202-898-1521

Robert A. McTamaney (Corporate)
Direct Tel. No.: 212-238-8711
Home Tel. No.: 908-322-8251
Home Fax No.: 908-322-4616

Patricia Matzye (ERISA)
Direct Tel. No.: 212-238-8730

Howard J. Barnet, Jr. (Tax)
Direct Tel. No.: 212-238-8606
Home Tel. No.: 212-996-5232

Stephen V. Burger (Corporate)
Direct Tel. No.: 212-238-8742
Home Tel. No.: 212-477-2740

Andris J. Vizbaras (Corporate)
Direct Tel. No.: 212-238-8698
Home Tel. No.: 212-924-3094

TIME CHECK*

NEW YORK E.S.T.	(0900)	9:00 A.M.	MONDAY		
BERMUDA	(1000)	10:00 A.M.	MONDAY	+	1 HOUR
LONDON	(1400)	2:00 P.M.	MONDAY	+	5 HOURS
BRUSSELS	(1500)	3:00 P.M.	MONDAY	+	6 HOURS
NEW DELHI	(1950)	7:30 P.M.	MONDAY	+	10½ HOURS
HONG KONG	(2200)	10:00 P.M.	MONDAY	+	13 HOURS
TAIPEI	(2200)	10:00 P.M.	MONDAY	+	13 HOURS
LOS ANGELES	(0600)	6:00 A.M.	MONDAY	-	3 HOURS
CHICAGO	(0800)	8:00 A.M.	MONDAY	-	1 HOUR

* Note: Adjust times for spring and fall adjustments in U.S. and Europe

TABLE OF CONTENTS

CHAPTER 1 INTRODUCTION 1

CHAPTER 2 THE PRIVATE INVESTMENT COMPANY EXCLUSIONS APPLICABLE TO OFFSHORE FUNDS UNDER THE 1940 ACT 4

Introduction 4

Private Investment Funds 4

Types of Investment Funds and Fund Structure 5

Planning an Offshore Fund Offering 6

The Section 3(c)(1) Exclusion from the Fund Registration Requirement and the Touche Remnant Doctrine 8

Acquisition of Fund Securities by U.S. Persons in Secondary Market Transactions 8

Attribution Rules 10

Fund Integration 11

The Section 3(c)(7) Exclusion from the Fund Registration Requirement 12

Sales to Knowledgeable Employees 14

Additional Considerations for 3(c)(1) and 3(c)(7) Funds 15

Limitations on the Number of Shareholders of an Offshore Fund and Consequences for Registration of the Fund's Securities 15

Restrictions on and Monitoring of Transactions in Fund Securities 17

Limitations on Investments by and in Offshore Funds 18

Location of the Fund's Principal Office and Dissemination of Offering Materials from the U.S 19

Penalties for Violations of the 1940 Act 20

CHAPTER 3 PRIVATE PLACEMENTS OF SECURITIES OF AN OFFSHORE FUND IN THE UNITED STATES 22

Registration Requirements of the 1933 Act 22

The Section 4(2) Exemption From the Securities Registration Requirement 23

Introduction 23

Offers and Sales 25

Subscription 26

Resale Restrictions 26

Publicity and Advertising 26

Disclosure Documentation 28

Investment Letter and Other Offering Documentation 30
Gramm-Leach-Bliley and PATRIOT Act Issues 31
Form of Securities and Legends 34
Registration Rights Provisions 34
Sales of Convertible Securities in the Private Placement 35
Compliance Requirements Under Antitrust Laws 35
The Regulation D Exemptions from the Securities Registration Requirement 36
Introduction 36
Definition of "Accredited Investor." Regulation D defines "accredited investor" to include the following: 36
Rule 506 and Blue Sky Requirements 37
No General Solicitation 38
Number of Investors and Their Financial Sophistication 38
Information Requirement 38
Resale Restrictions and the "Reasonable Care" Test 38
Integration Test 39
Form D Filing Requirement 39
Disclosure Documentation and Offering Procedures for Regulation D Private Placements 40
Debt Offering Made Pursuant to Regulation D 40
Potential Liability and Enforcement Actions Under U.S. Securities Laws 41
CHAPTER 4 RULE 144A OFFERINGS AND RESALES OF THE SECURITIES OF OFFSHORE FUNDS WITHIN THE UNITED STATES 42
Resales Under Rule 144A 42
Due Diligence in Rule 144A Offerings 43
Requirements of Rule 144A 44
Resales to QIBs 44
"Reasonable Belief" Requirement 46
Notice Requirement 46
Non-Fungible Securities 46
A security's eligibility for trading under Rule 144A is determined as of the date of issuance 46
Information Requirement for Non-Reporting Issuers 47
No General Solicitation 48

Additional Considerations in a Rule 144A Offering 48

Research Reports 48

Applicability of Regulation M 49

Debt Offerings Using Rule 144A.. 50

Rule 144A Registered Exchange Offers 50

Use of an ADR Program in a Rule 144A Offering 51

Secondary Market Trading of Rule 144A Securities 51

Application of Rule 144A 51

Resales Under "Section 4(1½)" 52

Resales to the U.S. Public Under Rule 144 Not Available to Offshore Funds............ 53

CHAPTER 5 SALES AND RESALES OF SECURITIES OF AN OFFSHORE FUND OUTSIDE THE UNITED STATES UNDER REGULATION S 55

Scope of Regulation S.. 55

General Conditions Necessary to Use Either the Issuer or Resale Safe Harbor Under Regulation S 57

"Offshore Transaction" Condition 57

Regulation S Safe Harbors.. 60

Issuer Safe Harbor: Rule 903 60

Category 1 Offerings... 60

Category 2 Offerings... 62

Category 3 Offerings... 63

Resale Safe Harbor: Rule 904 66

Interaction of Regulation S with Rule 144A 67

CHAPTER 6 BLUE SKY, BROKER-DEALER AND INVESTMENT ADVISER COMPLIANCE.. 68

Exemptions from Registration of the Securities of an Offshore Fund Under Blue Sky Laws and State Law Broker-Dealer Compliance 68

Introduction.. 68

The Institutional Investor Exemption from Blue Sky Registration 68

The Exemption from Blue Sky Registration Provided Under NSMIA 69

Resales under Blue Sky Laws 70

State Broker-Dealer Compliance 70

Blue Sky Compliance Strategy 71

Summary of Certain Blue Sky Statutes 72

California ... 72
Connecticut ... 73
Florida ... 73
Illinois ... 74
Massachusetts ... 75
New Jersey ... 76
New York ... 76
Pennsylvania ... 77
Texas ... 78
Additional Blue Sky Considerations ... 78
Anti-Fraud Provisions ... 78
Legends ... 78
State Regulation of Commodity Pool Operators and Commodity Trading Advisers ... 79
Federal Regulation of Broker-Dealers ... 79
Regulation of Investment Advisers ... 81
Federal Regulation of Investment Advisers ... 81
State Regulation of Investment Advisers ... 83
CHAPTER 7 U.S. REGULATION UNDER THE COMMODITY EXCHANGE ACT: REGISTRATION OF COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISERS ... 85
Introduction ... 85
Commodity Pools and Commodity Pool Operators ... 86
CFTC Rule 4.7(b) and 4.12(b) Exemptions from Certain Compliance Requirements ... 88
Commodity Trading Advisers ... 90
Introduction ... 90
Exemptions ... 90
CFTC Rule 4.7(c) Exemption from Certain Compliance Requirements ... 91
State Regulation ... 91
CHAPTER 8 ENFORCEMENT OF U.S. SECURITIES LAWS ... 93
Liabilities for Failure to Register and Report ... 93
Failure to Register Under the 1940 Act ... 94
Failure to Register Under the 1933 Act ... 94

Failure to Register and Report Under the 1934 Act.. 95
Liabilities Relating to Disclosure in Private Offerings... 95
Rule 10b-5.. 95
Section 17(a) of the 1933 Act 97
Liabilities Under Blue Sky Laws 97
Liabilities Relating to Disclosure Violations in Secondary Market Transactions.... 97
Additional Enforcement Considerations.. 98
Jurisdiction and Extraterritorial Application.. 98
Enforcement Issues for Broker-Dealers... 99
Enforcement Issues for Investment Advisers 99
Enforcement Issues Under the Commodities Exchange Act 100
CHAPTER 9 U.S. TAX CONSIDERATIONS FOR AN OFFSHORE FUND........ 101
CHAPTER 10 ISSUES CONCERNING INVESTMENTS BY PENSION PLANS IN OFFSHORE FUNDS.. 103
Consequences to Fiduciaries of ERISA Plans Investing in an Offshore Fund....... 105
Consequences to the Placement Agent 105
Possible Strategies to Address Risks of Offshore Fund Assets Being Characterized as Plan Assets....................................**Error! Bookmark not defined.**
Exclude ERISA Plans as Investors 106
Limit Participation by Benefit Plan Investors to Less than 25% 106
Determine if the Offshore Fund Qualifies as an Operating Company.................... 107
CHAPTER 11 CONCLUSION.. 108

APPENDIX

United States Private Placement Memorandum and Related Forms **Page**

Form 1: Cover Page ... App-1

Form 2: Legends Relating to Securities Laws ... App-3

Form 3: Restrictive Transfer Legend ... App-4

Form 4: Required Blue Sky Legend ... App-5

Form 5: Table of Contents and General Considerations ... App-6

Form 6: Foreign Judgment and Service of Process Disclosures ... App-8

Form 7: 1933 and 1940 Act Disclosures ... App-9

Form 8: Restrictions on Transfer Disclosures ... App-11

Form 9: Tax Considerations ... App-12

Form 10: ERISA Considerations ... App-16

Form 11: Red Herring Language and Printing Instructions ... App-19

Form 12: Form of Investment Letter for a Section 3(c)(1) Fund ... App-20

Form 13: Form of Investment Letter for a Section 3(c)(7) Fund ... App-29

Form 14: Suggested Provisions for Certificate of Incorporation or Other Organizational Documents of the Company ... App-39

Suggested Provisions for the Placement Agent's Agreement

Form 15: Form of Provisions for Placement Agent's Agreement ... App-42

Form 16: Provisions Regarding Company's Obligation to Provide Information for QEF Election ... App-46

CHAPTER 1

INTRODUCTION

The United States Investment Company Act of 1940, as amended (the "1940 Act"), grants the United States Securities and Exchange Commission (the "SEC") the authority to regulate "investment companies" that offer their securities in the United States.[1] The 1940 Act requires that any entity that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities be registered with the SEC as an "investment company" (the "fund registration requirement") unless it qualifies for an exclusion from the definition of "investment company."

The registration process is expensive and often complicated and includes, among other things, the filing of audited financial statements and ongoing disclosure reports prepared in accordance with or reconciled to U.S. generally accepted accounting principles ("U.S. GAAP"). In addition, the 1940 Act contains a variety of provisions applicable to registered investment companies, intended to protect investors against abuses such as self-dealing by management, conflicts of interest, undisclosed risks, misappropriation of funds, and overreaching regarding fees and expenses.

Based on the current provisions and the SEC's interpretations of the 1940 Act, it is as a practical matter virtually impossible for a fund organized outside of the U.S. (an "offshore fund") to register as an investment company under the 1940 Act, and therefore offshore funds are essentially precluded from making public offerings of their securities in the United States.

However, the 1940 Act provides two exclusions from the definition of investment company that permit two types of private investment companies to offer and sell securities to U.S. institutional and certain other financially sophisticated individual investors. These two exclusions from the 1940 Act definition of investment company may be referred to in this Memorandum as exclusions from the fund registration requirement.

The exclusions from the fund registration requirement allow a fund to avoid the expense and delay of the public registration process and the extensive regulatory requirements of the 1940 Act and otherwise give an offshore fund considerable flexibility in making offers and sales to financially sophisticated investors. Accordingly, offshore

[1] As used in this Memorandum, "United States" or "U.S." means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

funds that wish to offer and sell securities in the U.S. must qualify for one of the two exclusions, which are discussed in detail below.[2]

In addition to the fund registration requirement, the U.S. federal securities laws require that any offer or sale of a security that makes use of the U.S. mails or any means or instruments of transportation or communication in U.S. interstate commerce, including securities issued by an offshore fund, must be made pursuant to a current registration statement that is filed with the SEC (the "securities registration requirement"), unless the securities or the offer and sale are exempt from the securities registration requirement. This securities registration requirement is mandated by the U.S. Securities Act of 1933, as amended (the "1933 Act").

The 1933 Act (and rules and regulations promulgated by the SEC under the 1933 Act) contain private offering exemptions for securities transactions that allow offshore funds to offer and sell securities to institutional and financially sophisticated individual investors (those with substantial net assets or income) without being subject to the securities registration requirement. The 1933 Act and regulations also provide exemptions from the securities registration requirement that foster liquidity in privately placed securities by permitting their resale by investors, either offshore pursuant to Regulation S under the 1933 Act, or in the U.S. to institutional and financially sophisticated individual investors.

The fund registration requirement, with its exclusions and exemptions, is separate and distinct from the securities registration requirement and its exemptions. However, the exclusions and exemptions from the two requirements may be combined to produce a structure enabling offshore funds to make private offerings of securities in the United States. Diligent effort by an offshore fund sponsor[3] and its counsel is nonetheless required to guide an offering through the numerous regulatory requirements. As an introduction to these requirements, this Memorandum will discuss the following subject areas as they apply to offshore funds and private offerings in the U.S.:

(i) The 1940 Act exclusions from the fund registration requirement (discussed in Chapter 2);

(ii) The 1933 Act private offering exemptions from the securities registration requirement and the accepted practices for making private placements of the securities of an offshore fund in the U.S. (discussed in Chapter 3);

[2] Securities of an offshore fund are typically offered in the form of common shares, or limited partnership, limited liability company or trust interests or units, with each security representing a specified beneficial interest in the offshore fund.

[3] References in this Memorandum to "offshore fund sponsor" generally include the applicable fund manager.

(iii) The 1933 Act exemptions from the securities registration requirement for resales by investors of privately placed securities of offshore funds within the U.S. (discussed in Chapter 4);

(iv) The 1933 Act exemptions from the securities registration requirement for sales and resales of securities of offshore funds outside of the U.S. under Regulation S (discussed in Chapter 5);

(v) The exemptions from registration under "Blue Sky" laws (securities laws of individual states of the U.S.) applicable to offshore funds and the federal and state compliance requirements for broker-dealers and investment advisers (discussed in Chapter 6);

(vi) The requirements of the U.S. Commodities Exchange Act that apply to offshore funds trading in futures contracts or commodities options (discussed in Chapter 7);

(vii) The enforcement provisions of the U.S. securities laws (discussed in Chapter 8);

(viii) The U.S. tax effects of ownership of offshore fund securities and the impact on fund structure (discussed in Chapter 9); and

(ix) Considerations relevant to investments in offshore fund securities by pension plans (discussed in Chapter 10).

The reader should note that the Memorandum discusses in plain language general legal concepts that may be quite complicated to apply in practice and that often require a significant amount of fact-finding, research and legal analysis. When faced with a potential legal issue in establishing or operating a fund, fund sponsors and their local counsel should always consult U.S. counsel on the particular facts and circumstances.

In addition, the Appendix to this Memorandum contains model forms with provisions typically employed in a U.S. private placement of the securities of an offshore fund. The model forms are for illustrative purposes only and a fund sponsor and its local counsel should always consult with U.S. counsel before making an offer or sale of securities in the United States.

CHAPTER 2

THE PRIVATE INVESTMENT COMPANY EXCLUSIONS APPLICABLE TO OFFSHORE FUNDS UNDER THE 1940 ACT

Introduction. Investment companies that offer securities to the U.S. public are subject to extensive ongoing disclosure and regulatory requirements under the 1940 Act. While disclosure to the investing public is an important part of the 1940 Act, its primary focus is on substantive regulation, including the composition of boards of directors of investment companies, transactions between investment companies and their promoters, underwriters, advisers and affiliates, investments in other investment companies, securities custody arrangements and prices at which redeemable securities may be offered or redeemed.

Section 7(d) of the 1940 Act prohibits an offshore fund from making a public offering of its securities in the U.S. unless the SEC, upon application, finds that it is legally and practically feasible effectively to enforce the provisions of the 1940 Act against the offshore fund and that the public offering by the offshore fund is otherwise consistent with the public interest and the protection of investors.[4] The SEC has not authorized a public offering by an offshore fund since 1973 under this standard, effectively prohibiting a U.S. public offering by an offshore fund.

Private Investment Funds. It is possible, under the 1940 Act, to structure a private investment fund as an alternative to complying with the fund registration requirement. There are two ways to structure an offering that will exclude the offshore fund from the definition of investment company. The distinction between an "exclusion" and an "exemption" from the fund registration requirement is significant. Under the private investment fund exclusions, a fund that meets the applicable conditions is generally excluded from provisions of the 1940 Act, and not just exempted from certain of its provisions (such as the fund registration requirement) while otherwise remaining subject to other 1940 Act provisions.

---

[4] In June 1995, Voucher Investment Fund RUSS-INVEST, a Moscow-based investment company which was not registered with the SEC under the 1940 Act and the securities of which were not registered with the SEC under the 1933 Act, placed a half-page advertisement in the New York Times describing RUSS-INVEST and stating that readers could call for additional information or fax purchase orders to a designated fax number. The SEC determined that RUSS-INVEST had not only violated the 1933 Act by advertising unregistered securities for sale in a U.S. newspaper, but had violated Section 7(d) of the 1940 Act by making a public offering of its securities without making prior application to the SEC. See In the Matter of Voucher Investment Fund, RUSS-INVEST, Securities Act Release No. 7294, [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85,816 (May 21, 1996).

The first exclusion is found in Section 3(c)(1) of the 1940 Act.[5] As described in detail below, structuring and operating a Section 3(c)(1) offshore fund is complicated due to the application of the "Touche Remnant doctrine," which generally permits only 100 U.S. resident beneficial owners of an offshore fund's securities. The exclusion under Section 3(c)(1) nevertheless remains a popular means to structure an offshore fund.

The second exclusion available to private investment funds is created by Section 3(c)(7), under which securities may be offered and sold to an unlimited number of U.S. investors who are "qualified purchasers." Qualified purchasers are generally financially sophisticated investors that hold over $5 million in investments (for individuals or family companies) or persons (including companies) in the aggregate owning and investing on discretionary basis not less than $25 million in investments.

Types of Investment Funds and Fund Structure. Under the 1940 Act, investment companies are classified either as "management companies," which are actively managed, or as "unit investment trusts," which are not actively managed. Management companies, the predominant type of investment companies, are further divided into (i) open-end companies, which issue redeemable securities, and (ii) closed-end companies, which do not issue redeemable securities. A redeemable security permits the security holder to present his securities for redemption and receive his proportionate share of the current value of the fund's assets.

In the normal course of operation, an open-end company both sells and redeems its shares continuously, although in unusual circumstances an open-end fund may determine not to accept new investors (e.g., to keep the size of the fund from growing too rapidly). Shares of an open-end fund do not trade on a U.S. stock exchange or other securities market; rather, the purchases and sales of the open-end fund shares are made directly between the fund and the investor or through the investors' broker-dealer.

A closed-end management company is like an ordinary corporation in that security holders do not have a continuous redemption right. A closed-end company may elect to be an "interval fund" which conducts regular periodic share buybacks in order to reduce the discount of the market value of its shares from its net asset value.

Offshore funds may have a wide variety of investment objectives ranging from the typical diversification strategies used by mutual funds to the types of sophisticated trading, hedging, and goal-oriented investment activities conducted by domestic hedge

---

[5] Among the many types of vehicles that rely on the Section 3(c)(1) exclusion, "hedge funds" are particularly noteworthy. This type of vehicle is typically available to a limited number of financially sophisticated and wealthy investors and frequently employs more active and aggressive investment techniques, such as arbitrage, extensive use of derivatives, trading on margin and other forms of leveraging, than those of registered investment companies. The term "hedge fund" is also used more broadly to refer to any unregistered investment fund.

funds. If a fund sponsor anticipates trading in futures contracts or commodity options, *see* Chapter 7 for a discussion of regulation under the Commodities Exchange Act.

Offshore funds may be organized in a variety of structures in accordance with the business aims of their participants. A common model is the single corporation structure in which an offshore fund is organized as a corporation in an offshore jurisdiction with favorable tax laws. The fund invests money provided by non-U.S. and U.S. investors (or either) in a portfolio of securities in accordance with stated investment objectives.

Open-end funds may utilize a two-tiered master-feeder structure, also called a hub-and-spoke structure, in which separate feeder funds contribute their assets to a master fund that collectively manages a single pool of assets. Because master and feeder funds may be organized in different countries, this structure allows fund shares to be offered through a variety of distribution channels, but managed in a single pool. Typically, a master fund is established as an offshore partnership to invest in a specified range of portfolio securities consistent with certain stated investment objectives. The partnership interests in the master fund are held by the second-tier feeder funds, with a U.S. domestic partnership structured as one feeder and one or more offshore corporations structured as additional feeders. The interests in the feeder entities are then offered to U.S. and offshore investors. Because of the availability of multiple distribution channels, the fund may be organized to accommodate both taxable and tax-exempt investors. International master-feeder funds may need to comply with the applicable regulatory requirements in all jurisdictions in which securities are offered, which could limit flexibility.

A mirror fund structure, also called a side-by-side structure, involves legally distinct funds with similar characteristics. Mirror funds are commonly organized by establishing a U.S. domestic limited partnership (for U.S. investors) and an offshore corporation (for non-U.S. investors), both of which may be managed by the same investment manager. Mirror funds are more flexible than master-feeder structures because they allow the organizer to adapt the individual funds to comply with the regulatory regimes of the various countries in which the securities of each mirror fund are offered. The creation of mirror funds, while increasing flexibility, may not be a practical option because the structure may be costly and may result in the loss of economies of scale. Also, if a fund establishes a U.S. mirror fund to make a public offering to U.S. investors, the fund must register under the 1940 Act and the securities offered must be registered under the 1933 Act.

There are significant U.S. taxation issues involved in planning and organizing an offshore fund. Offshore fund sponsors should consult U.S. counsel prior to establishing a fund structure to minimize the impact of U.S. tax laws on the fund and its investors. *See* Chapter 9.

Planning an Offshore Fund Offering. Based on the fund and securities registration requirements discussed above, if an offshore fund sponsor wishes to offer

securities to U.S. investors, the only practicable alternative is a private placement of the fund's securities through (i) a Section 3(c)(1) fund to not more than 100 U.S. investors (and to an unlimited number of non-U.S. investors) or (ii) a Section 3(c)(7) fund to an unlimited number of U.S. persons who are qualified purchasers, of which not more than 300 may be U.S. residents. *See* the discussion below under "Limitations on the Number of Shareholders of an Offshore Fund and Consequences for Registration of the Fund's Securities."

The private placement may be made in conjunction with a concurrent offshore public offering of the offshore fund's securities.

The U.S. offering is made under Regulation D or another private placement exemption under Section 4(2) of the 1933 Act[6] and the concurrent offshore offering is made in compliance with Regulation S under the 1933 Act ("Regulation S").[7]

Although offshore funds are often structured as open-end funds offering securities that are redeemable and not traded, there may be secondary trading of securities of closed-end funds among "qualified institutional buyers" ("QIBs") in the U.S. pursuant to Rule 144A under the 1933 Act ("Rule 144A") if the provisions of that rule are satisfied.[8] Such securities may also be listed or at least approved for listing on offshore securities exchanges and cleared through an offshore depository such as Euroclear and Clearstream.

There are generally seven areas an offshore fund sponsor should consider when contemplating a private placement of securities in the U.S.:

(i) Compliance with U.S. federal securities laws and SEC regulations, including applicable restrictions on beneficial ownership of fund securities;

(ii) The resale opportunities and restrictions for fund securities under U.S. securities laws and regulations;

(iii) If there will be a concurrent offshore offering of the fund's securities, the guidelines for the proper conduct of the offshore offering;

(iv) Compliance with Blue Sky laws;

(v) Compliance with the Commodities Exchange Act if trading in futures contracts or commodities options is contemplated;

[6] Discussed in Chapter 3.

[7] Discussed in Chapter 5.

[8] Discussed in Chapter 4.

(vi) Disclosures and restrictions relevant to investments by pension plans in offshore funds in connection with the Employee Retirement Income Security Act of 1974, as amended ("ERISA"); and

(vii) U.S. tax considerations and disclosure and the impact of U.S. tax laws on fund structure.

The Section 3(c)(1) Exclusion from the Fund Registration Requirement and the Touche Remnant Doctrine.

Section 3(c)(1) of the 1940 Act excludes from the definition of an "investment company" "[a]ny issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities." Such private investment funds are generally referred to as "3(c)(1) funds" and they are frequently used to manage money for a relatively small group of financially sophisticated investors. As interests in 3(c)(1) funds may not be offered or sold in public offerings, securities of 3(c)(1) funds must be offered and sold in private placements that rely on 1933 Act exemptions from the securities registration requirement. Many 3(c)(1) funds are organized as limited partnerships or other business forms that are not subject to federal income tax at the entity level.

Structuring and operating a 3(c)(1) fund is complicated by the SEC's position known as the Touche Remnant doctrine. This doctrine requires in general that, if after the completion of an offering of the fund's securities, there are more than 100 U.S. resident beneficial owners of the securities, then the offshore fund must register under the 1940 Act, even though the securities may have been offered and sold in a bona fide private placement with financially sophisticated investors.[9] The SEC takes the position that the Touche Remnant doctrine applies to both open-end and closed-end funds.

Acquisition of Fund Securities by U.S. Persons in Secondary Market Transactions. SEC interpretations following Touche Remnant confirm, however, that the fund's securities must be held by not more than 100 U.S. residents only at the completion of the initial private placement, and secondary market trading will not cause a fund to become an investment company, provided that the fund and its agents are not

[9] Touche, Remnant & Co., SEC No-Action Letter, [1984-1985 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 77,810 (August 27, 1984); *see also* Division of Investment Management, U.S. Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Regulation (May 1992). Generally, issuers may rely on the definition of "U.S. person" in Rule 902 of Regulation S to determine whether an investor is a U.S. resident beneficial owner. *See* Goodwin, Procter & Hoar LLP, SEC No-Action Letter, [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,330 (Feb. 28, 1997) ("Goodwin, Procter"); *see also* Chapter 5 under "Condition that there be No Directed Selling Efforts" for the definition of "U.S. person."

involved in any resales to U.S. residents.[10] The SEC conditioned its position on requiring that the fund and its agents must not have engaged in activities, including U.S. advertising, that could condition the U.S. market for the fund's securities, and may not engage in activities to facilitate secondary market trading in the U.S. of the fund's securities. Accordingly, the fund and its agents or affiliates should not engage in a marketing strategy to circumvent the restrictions on resales by U.S. persons. The fund also must not direct marketing efforts calculated to result in the sale of securities to offshore investors who are relocating to the U.S.

This relaxation of the Touche Remnant doctrine is beneficial for offshore funds that wish to make public offerings abroad because the U.S. holders of fund securities initially sold to non-U.S. persons outside the U.S. pursuant to Regulation S and subsequently sold to such U.S. holders in secondary market transactions, will not count towards the 100-U.S. person limitation if the fund does not in any way facilitate the resale.[11]

However, the fund sponsor should restrict the transfer of fund securities from U.S. holders that purchased in the private placement (and their transferees that are U.S. persons) to other U.S. holders. Thus, the sponsor of a closed-end fund that trades on an offshore exchange should put the burden on any U.S. holder who purchased in the original private placement to show that a contemplated resale will not be made to a U.S. person (or the sponsor may consent to the resale knowing that the 100-U.S. person limitation will not be exceeded). This obligation to police transfers continues until the securities are resold to a non-U.S. person, after which the holder of the securities need not be counted towards the limitation even if the securities subsequently flow back to a U.S. person. The sponsor should inform the fund's transfer agent and selling agents regarding these restrictions. *See also* below under "The Section 3(c)(7) Exclusion from the Fund Registration Requirement" and "Restrictions On and Monitoring of Transactions In Fund Securities."

This less stringent interpretation of Touche Remnant would generally not apply to open-end funds as the fund would necessarily facilitate any new sales to U.S. holders

---

[10] *See* Investment Funds Institute of Canada, SEC No-Action Letter, [1995-1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,133 (March 4, 1996); Goodwin, Procter. In addition, Rule 3c-6 under the 1940 Act provides relief for transfers of securities of a 3(c)(1) fund by gift, bequest, divorce or separation agreement, under which the securities transferred are deemed to be beneficially owned by the 3(c)(1) fund transferor, provided that the transferee is the estate of the transferor, a qualified donee or a company established by the transferor for the benefit of the transferor and the transferor's estate or qualified donees.

[11] Thus, for example, a 3(c)(1) offshore fund that privately places securities with 20 U.S. purchasers could place securities with up to 80 additional U.S. persons in a later offering, even if it has accumulated, between the two private offerings, 100 U.S. security holders through secondary market purchases, changes in residence, and other events that were not directly or indirectly facilitated by the fund (or its agents, affiliates or intermediaries).

above the 100-U.S. person limitation. Open-end funds must continue to closely monitor the number of U.S. beneficial holders.

Note also that under Touche Remnant the SEC essentially treats offshore funds more liberally than domestically-organized funds, since unregistered domestic funds are limited to 100 investors wherever they reside and offshore funds may have unlimited offshore investors, provided that, subject to the discussion above, the number of U.S.-resident beneficial owners never exceeds 100.[12] However, as discussed below, there are other legal limitations on the number of security holders of the fund.

Attribution Rules. When a 3(c)(1) fund has investors who are all individuals, the counting of beneficial owners is relatively straightforward. Each individual that directly owns a security issued by the fund for his own account is counted separately, notwithstanding family relationships. Thus, spouses who jointly own securities in a 3(c)(1) fund are counted as two beneficial owners.

However, when an owner of securities of a 3(c)(1) fund is an entity, additional analysis may be necessary. In order to prevent abuses of the 100-U.S. person limitation through the use of intermediate investing funds or entities, Section 3(c)(1) also includes an "attribution" provision, which provides a test for determining when the degree of public interest in a 3(c)(1) fund warrants "looking through" to the owners of the intermediate investing fund or entity and counting the shareholders of such fund or entity as beneficial owners for purposes of the 100-U.S. person limitation.

Under the current rule, beneficial ownership of securities by an entity will be treated as beneficial ownership by a single person for purposes of determining the 100-U.S. person limit, unless the entity owns 10% or more of the outstanding voting securities of the 3(c)(1) fund (or, if interests other than shares or units such as partnership interests are held, the holder's 10% or greater interest allows the holder to influence the 3(c)(1) fund's operations or management), and is, or except for Section 3(c)(1) or Section 3(c)(7) would be, an "investment company" within the meaning of the 1940 Act. In that case, each of the intermediate entity's security holders would be deemed to be the beneficial owners of the 3(c)(1) fund.[13]

---

[12] The SEC has taken the position that Internet web sites may be used to solicit offshore securities transactions under certain conditions even if the securities and the investment company are not registered. The SEC will not view an offer made through an Internet Website as targeted to U.S. persons when offerors implement "adequate measures to prevent U.S. persons from participating in an offshore Internet offer." Adequate measures include, but are not limited to, placing a disclaimer in the Internet offer and requiring the offerees to disclose their addresses and phone numbers prior to the sale of the securities. *See* Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 33-7516, Fed. Sec. L. Rep. (CCH) ¶ 3060 (March 23, 1998).

[13] SEC Rule 3c-1 permits existing 3(c)(1) funds to rely on the two-part attribution test in effect prior to the enactment of the National Securities Markets Improvements Act of 1996 ("NSMIA") for

Fund Integration. An additional issue in the analysis of the 100-U.S. person limitation of Section 3(c)(1) is the concept of fund integration. In determining whether an offshore fund meets the 100-U.S. person limitation of Section 3(c)(1), the SEC staff may "integrate" the fund with one or more of its affiliated funds. The general rule is that if the funds involve economically equivalent investments, then they likely will be integrated. The SEC will not integrate an offshore fund's U.S. private offering with a concurrent offshore public offering, but the SEC would integrate successive tranches of the same offshore fund's (or an economically equivalent fund's) securities in the U.S., and would aggregate the total number of U.S. beneficial owners of the fund or funds for purposes of analyzing the 100-U.S. person limitation.[14]

The SEC takes the position that the key inquiry for integration analysis is whether an interest in one fund, as compared to a second fund, would be considered materially different by a reasonable investor qualified to purchase interests in both funds. For example, the SEC staff has determined that funds designed to accommodate the differing tax needs of clients (such as those of offshore clients compared to domestic clients, or those of taxable investors as compared to tax-exempt investors) are materially different and do not require integration. If the SEC determines that the funds at issue are not sufficiently different, then the funds may be examined in a fact-specific inquiry to analyze the similarity of the funds' investment objectives, securities and risk/return characteristics.[15]

Section 3(c)(7)(E) of the 1940 Act clarifies that 3(c)(1) and 3(c)(7) funds will not be integrated for purposes of determining whether the 100-U.S. person limitation of

---

investors who held more than 10% of the voting securities of the fund on April 1, 1997, even if the investors make additional investments.

[14] However, the SEC granted a no-action request under the Section 3(c)(1) integration rules to Coutts Global Fund, an umbrella fund which issued multiple series of securities of its various sub-funds. The decision was based on the fact that under Irish law (the jurisdiction in which the umbrella fund was registered), each sub-fund was considered to be a separate trust. As a separate trust, only the assets of that trust could be applied to discharge claims against that trust, and could not be applied to discharge claims relating to other trusts. The SEC concurred that under such facts it would not consider the umbrella fund to be a single issuer for purposes of the 100-person limitation, and that the limitation would apply on a sub-fund by sub-fund basis. *See* Coutts Global Fund, SEC No-Action Letter, [1994-1995 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 76,957 (Dec. 7, 1994).

[15] For example, the SEC determined that two funds must be integrated (and therefore could not rely on the 3(c)(1) exclusion) because "based upon the similar portfolio composition, the similarities in the potential risks and return on the partnership investment, the common sponsor, and the close ties between the respective general partners of the Funds, a reasonable investor would not consider the interests in the Funds to be materially different. Accordingly, the Funds should be integrated in order to determine the number of beneficial owners of each fund for purposes of Section 3(c)(1)." In the Matter of George W. Meyers, et al., Investment Company Act Release No. 22,723 [1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,951 (June 23, 1997).

Section 3(c)(1) has been met (or, for a 3(c)(7) fund, whether any U.S. investors are not "qualified purchasers").

The difficulties associated with Touche Remnant have led to a great deal of criticism of the SEC's position. Although the majority of offshore funds are structured under Section 3(c)(1), the Touche Remnant doctrine substantially limits the number of investors that may purchase securities in a 3(c)(1) fund offering as well as the liquidity of those securities.

The Section 3(c)(7) Exclusion from the Fund Registration Requirement

Section 3(c)(7) of the 1940 Act, which came into effect in 1997, excludes from the definition of "investment company," and therefore from the fund registration requirement, a fund that does not engage in a public offering and whose securities are held exclusively by "qualified purchasers." There is no limit to the number of investors in a 3(c)(7) fund, so long as all U.S. investors who subscribe in the initial private placement (and, except in certain cases, their subsequent transferees) are qualified purchasers (except those funds that convert from 3(c)(1) funds).

However, other legal considerations may limit the number of investors in a 3(c)(7) fund. Section 3(c)(7) funds structured to be treated as partnerships for U.S. tax purposes may instead be treated as corporations if interests in the fund are held by more than 100 persons worldwide and the interests are considered "publicly traded" under U.S. tax laws. Also, if more than 300 U.S. residents hold beneficial interests in the fund, the fund may be required to register its securities under the U.S. Securities Exchange Act of 1934, as amended (the "1934 Act"). *See* below under "Limitations on the Number of Shareholders of an Offshore Fund and Consequences for Registration of the Fund's Securities."

The qualified purchaser requirement does not apply to non-U.S. resident purchasers of the securities of an offshore fund. Accordingly, an offshore fund may sell its securities to U.S. qualified purchasers in a private offering while simultaneously making a public offering (to "non-qualified" purchasers) outside of the U.S.

As discussed above in the case of a 3(c)(1) fund, a 3(c)(7) fund should comply with Section 3(c)(7) for securities sold by the fund directly to U.S. residents or subsequently transferred by such U.S. resident purchasers to other U.S. residents. In the case of closed-end funds, the purchasers of securities that flow into the U.S. in secondary market transactions need not be qualified purchasers, provided that the fund, its agents or its affiliates do not facilitate the resale to U.S. persons who are not qualified purchasers. This also applies to those securities initially sold to U.S. residents but that are subsequently sold to non-U.S. residents and then flow back into the U.S. in secondary trading. However, the fund's sponsor and transfer agent will need to monitor secondary market transactions to ensure that all transferees of the original U.S. purchasers are

qualified purchasers or non-U.S. persons. *See* below under "Restrictions On and Monitoring of Transactions In Fund Securities."

The definition of qualified purchaser under the 1940 Act is narrower than the definition of "accredited investor" under Regulation D. *See* Chapter 3, under "The Regulation D Exemptions from the Securities Registration Requirement" for a definition of accredited investor. The following categories of qualified purchasers are eligible to participate in a 3(c)(7) fund:

(i) any natural person (and spouse if they invest jointly) owning not less than U.S. $5 million in investments (as defined by the SEC);

(ii) any family-owned entity owning not less than U.S. $5 million in investments (a "Family Company") (except that, according to SEC Rule 2a51-3(a), if the company is formed specifically for the purpose of acquiring the securities offered, each beneficial owner of the company's securities must be a qualified purchaser);

(iii) any trust (other than one covered by (ii) above) established and funded, and for which investment decisions are made, by qualified purchasers, so long as the trust is not established specifically for the purpose of acquiring the securities offered;

(iv) any natural person or business entity, acting for its own account or for the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis at least U.S. $25 million in investments (including defined benefit plans, but not participant-directed defined contribution plans (such as 401(k) plans) unless all plan participants are qualified purchasers) (except that if the entity is formed specifically for the purpose of acquiring the securities offered, each beneficial owner of the entity's securities must be a qualified purchaser); and

(v) any business entity if each beneficial owner of the entity's securities is a qualified purchaser.

SEC Rule 2a51-1 under the 1940 Act defines "investment" for the purposes of the definition of "qualified purchaser" to be in general the following:

(i) virtually all types of securities except those issued by a non-public company with shareholders' equity of less than $50 million or by a company controlling, controlled by, or under common control with, the prospective qualified purchaser;

(ii) investment real estate (real estate not treated as the owner's residence for tax purposes or as a place of business);

(iii) commodity interests and physical commodities held for investment purposes and financial contracts (to the extent they are not securities) entered into for investment purposes;

(iv) if the prospective qualified purchaser is a 3(c)(1) or 3(c)(7) fund or commodity pool, investment commitments to such fund or pool; and

(v) cash or cash equivalents held for investment purposes, including the net cash surrender value of an insurance policy and, in certain circumstances, unfunded capital commitments (but not cash held to meet expenses or for working capital). [16]

In each case, all outstanding indebtedness incurred to acquire the investments must be deducted from the amount of the investments (and for a Family Company, all outstanding indebtedness incurred by an owner of the Family Company to acquire the Family Company's investments must be deducted).

Sales to Knowledgeable Employees. Rule 3c-5 under the 1940 Act permits investment in both 3(c)(1) and 3(c)(7) funds by certain "knowledgeable employees" without causing a fund to lose its exclusion from the fund registration requirement.

Under this rule, the following persons may purchase securities of a 3(c)(1) or 3(c)(7) fund and are not counted towards the 100-U.S. person limit for a 3(c)(1) fund and will be excluded from the determination whether all purchasers are qualified purchasers for a 3(c)(7) fund:

(i) natural persons who are the fund's executive officers, directors, general partners, trustees, advisory board members or persons serving in similar capacities;

(ii) the executive officers, directors, general partners, trustees, advisory board members or persons serving in similar capacities of an "Affiliated

---

[16] Investments of a parent company and its majority-owned subsidiaries may be aggregated, and natural persons may include investments held with a spouse. The definition of "investment" does not include jewelry, antiques, artwork or other collectibles, residential real estate or real estate used as a place of business.

Note also that an investor must be a qualified purchaser each time he or she acquires securities of a 3(c)(7) fund. However, if additional investments are made based on a binding commitment and the investor was a qualified purchaser when he or she entered into the binding commitment, the fund should not lose its exclusion if the investor subsequently does not meet the qualified purchaser requirements. In addition, under SEC Rule 3c-6, securities transferred by gift, bequest, divorce or separation agreement will be deemed to be owned by a qualified purchaser, provided that the transferee is the estate of the transferor, a qualified donee or a company established by the transferor for the benefit of the transferor and the transferor's estate or qualified donees.

Management Person" of the fund (an "Affiliated Management Person" is a person or entity affiliated with the fund such as a controlling interest holder in the fund that manages its investment activities); and

(iii) the employees of the fund or an Affiliated Management Person who participate in the investment activities of the fund or of other investment companies managed by the Affiliated Management Person (and have done so for the fund for at least 12 months).

The SEC has confirmed that knowledgeable employees should also be excluded in determining whether a 3(c)(7) fund is itself (on the basis that all of its beneficial owners are qualified purchasers) a qualified purchaser eligible to invest in another 3(c)(7) fund.

Additional Considerations for 3(c)(1) and 3(c)(7) Funds

Limitations on the Number of Shareholders of an Offshore Fund and Consequences for Registration of the Fund's Securities. The offer and sale of offshore fund securities to U.S. investors does not automatically subject the fund to registration, periodic reporting and other obligations under the 1934 Act. Such obligations depend upon (i) whether an issuer is listed on a U.S. securities exchange, (ii) the number of shareholders of the issuer worldwide and in the U.S., and (iii) the amount of the issuer's total assets. Issuers who are required to file 1934 Act periodic reports with the SEC may be referred to in this Memorandum as "Reporting Issuers" and issuers who are not required to file such periodic reports may be referred to as "Non-Reporting Issuers."

The 1934 Act registration requirements are in addition to the securities registration requirements under the 1933 Act that generally arise when securities of a fund are sold in a non-private offering. The 1934 Act securities registration process is complicated and expensive and triggers the filing of periodic reports with financial statements prepared in accordance with or reconciled to U.S. GAAP. Although the types of offshore funds under consideration in this Memorandum should and almost always will be Non-Reporting Issuers, fund sponsors should be aware of the 1934 Act registration requirements particularly in connection with limiting the number of shareholders of the fund.

The SEC rules under the 1934 Act draw a distinction between "domestic" issuers and "foreign private issuers."

A foreign private issuer is any issuer that is a corporation or other organization incorporated or organized under the laws of any foreign country, *unless*: (i) more than 50 percent of the outstanding voting securities of such issuer are held of record either directly or through voting trust certificates or depositary receipts by U.S. residents; *and* (ii) any one of the following applies: (A) the majority of the issuer's executive officers or

directors are U.S. citizens or residents, (B) more than 50 percent of the assets of the issuer are located in the U.S., or (C) the business of the issuer is administered principally in the U.S.

If an issuer does not meet the definition of foreign private issuer it is treated like a domestic issuer. Thus, certain offshore entities with significant U.S. contacts may be deemed to be domestic issuers for purposes of U.S. securities laws.

For domestic issuers, 1934 Act reporting and other requirements are triggered not only by the listing of a security on a U.S. securities exchange or Nasdaq (through Nasdaq, not SEC, requirements), but also when the issuer has total assets of at least U.S. $10 million and a class of equity securities held of record by at least 500 persons.

For foreign private issuers, which will generally include most offshore funds, 1934 Act registration and reporting requirements are triggered by listing on a U.S. securities exchange or Nasdaq, or can be triggered when the foreign private issuer has total assets of at least U.S. $10 million and a class of equity securities held of record by at least 500 persons worldwide and by at least 300 beneficial owners resident in the U.S.

Thus, for foreign private issuers, each entity that invests in the fund is counted as one investor except for the holders of those securities held in street name (securities held of record by a broker, dealer, bank or nominee for any of them for the accounts of customers resident in the U.S.). In that case, each separate account holder is counted as a record holder.

Note, however, that if an entity is formed for the specific purpose of acquiring securities of the fund, each owner of the securities of such entity will be counted for purposes of the U.S. shareholder threshold noted above.

These 1934 Act asset and shareholder tests apply whether or not the foreign private issuer has taken any action to offer its securities in the U.S. or to encourage a trading market for its securities in the U.S. However, a foreign private issuer with a class of equity securities held of record by more than 500 persons worldwide and more than 300 U.S. resident beneficial owners may claim an exemption from 1934 Act registration by perfecting the "information furnishing exemption" provided in Rule 12g3-2(b) under the 1934 Act. *See* Chapter 4 under "Information Requirement."

Assuming that an offshore fund has at least $10 million in total assets, if the offshore fund meets the definition of foreign private issuer, the fund's equity securities will be automatically exempt from 1934 Act registration unless the fund has a class of equity securities held of record by 500 or more persons worldwide *and* by 300 or more beneficial shareholders resident in the U.S. In other words, the equity securities of a fund that is a foreign private issuer having any number of non-U.S. shareholders will be automatically exempt from 1934 Act registration so long as such class is beneficially owned by fewer than 300 U.S. residents.

Again assuming that an offshore fund has at least $10 million in total assets, if an offshore fund does not meet the definition of foreign private issuer, the fund will be required to register its securities with the SEC under the 1934 Act when it has 500 or more shareholders of record worldwide, irrespective of the number of shareholders that are U.S. residents. As a technical matter, the fund must register if it exceeds the 500 shareholder threshold and "engages in [U.S.] interstate commerce" which, for this purpose, includes offering and selling securities in the U.S.

Obviously, the 1940 Act limitation of 100 U.S. resident holders for a 3(c)(1) foreign private issuer would apply well before these thresholds are approached, but offshore fund sponsors who intend to structure 3(c)(7) funds should be cognizant of the 300-U.S. beneficial owner threshold under the 1934 Act. Also, if a 3(c)(1) or 3(c)(7) fund did not meet the definition of foreign private issuer, the threshold of 500 worldwide shareholders could be implicated, particularly if the fund will also make an offshore public offering.

As noted above, however, under the 1940 Act an offshore fund may not make a public offering in the U.S. The SEC generally takes the position that an offering is non-public if it complies with Section 4(2) of the 1933 Act or Rule 506 of Regulation D thereunder. *See* Chapter 3. U.S. securities practitioners generally agree that a 3(c)(7) fund may have up to 300 U.S. beneficial shareholders without necessarily having made a public offering in the U.S. As discussed further below, one of the most important factors in the inquiry is whether the fund sponsor or manager had a pre-existing relationship with each of the offerees.

Restrictions on and Monitoring of Transactions in Fund Securities. Despite the many issues discussed above, it is entirely possible to make a legal private placement of an offshore fund's securities with U.S. investors using either the 3(c)(1) or 3(c)(7) exclusions, but sponsors must exercise caution to ensure, in the case of a closed-end 3(c)(1) fund, that unauthorized resales of the securities to U.S. residents by the original U.S. subscribers (or their subsequent transferees) will not result in more than 100 U.S. beneficial owners, or, in the case of a closed-end 3(c)(7) fund, that no resales of securities are made by the original U.S. subscribers (or their subsequent transferees) to U.S. non-qualified purchasers, either of which would require compliance with the fund registration requirement.

For open-end funds, which issue redeemable securities, or where the securities are in registered form, determination of beneficial ownership may be monitored by the fund with relative ease since redemption or registration places the issuer on notice of changes in ownership.

However, because of Touche Remnant and the Section 3(c)(7) restriction that all U.S. holders be qualified purchasers, it is not recommended that securities be held in global book-entry form (such as with The Depository Trust Company), or in bearer form,

as the fund sponsor or manager will not be able to readily monitor secondary market transactions.

At a minimum, for a 3(c)(1) fund, the securities and any secondary market transfer forms should be imprinted with a legend warning the parties to any transfer of the securities that the fund may prohibit any transfer if it will cause the fund to violate the 100-U.S. person limitation. For a 3(c)(7) fund, the securities and any secondary market transfer forms should be legended to prohibit transfers by the original U.S. purchasers to U.S. persons other than qualified purchasers. In both cases, the fund should be permitted automatically to redeem any securities transferred in violation of these restrictions, and it is recommended that the fund include a provision to this effect in its articles of association or other constituent documents.

Further, the transfer agent and any persons associated with the fund, such as broker-dealers, that will be involved in secondary market transactions should be made aware of the relevant resale restrictions.

As discussed above, for both 3(c)(1) and 3(c)(7) funds, the focus of the monitoring activities of the fund and its transfer agent should be on the secondary market transactions of the original U.S. subscribers in the private placement and subsequent holders of their securities. The provisions relating to restrictions on transfer and the requirement that investors make appropriate representations regarding their intentions to distribute and resell the securities will be an integral part of the offering documents for the U.S. private placement. The documentation for a private placement for an offshore fund is discussed in Chapter 3 under "Disclosure Documentation."

Resale restrictions may make the securities of an offshore fund less attractive to U.S. institutional investors, particularly when securities which could be sold on an offshore exchange may be available to U.S. institutional investors who trade through offshore brokers. However, many offshore fund sponsors find 3(c)(1) and 3(c)(7) funds to be effective and relatively inexpensive vehicles to privately place securities with U.S. institutional and other financially sophisticated investors.

Limitations on Investments by and in Offshore Funds. Fund sponsors should be aware that all 3(c)(1) and 3(c)(7) funds, although generally excluded from the requirements of the 1940 Act, are considered "investment companies" for purposes of Section 12(d)(1) of the 1940 Act, which prohibits the pyramiding of investments by both registered and unregistered investment companies.

The Section 12(d)(1) prohibitions apply to the acquisitions of securities of an offshore fund by a registered investment company (such as a U.S. mutual fund).

Under Section 12(d)(1), a registered investment company may not: (i) acquire more than 3% of an offshore fund's voting securities; (ii) acquire securities of an offshore fund where the acquisition exceeds 5% of the total assets of the registered investment

company; or (iii) acquire securities of an offshore fund where the acquisition, when aggregated with the purchases of the securities of all other investment companies (which includes 3(c)(1) and 3(c)(7) funds and registered investment companies), exceeds 10% of the total assets of the registered investment company.

The Section 12(d)(1) prohibitions also apply to the acquisitions of securities of a registered investment company by an offshore fund.

Thus, an offshore fund may not: (i) acquire more than 3% of the voting securities of a registered investment company; (ii) acquire securities of a registered investment company where the acquisition exceeds 5% of the total assets of the offshore fund; or (iii) acquire securities of a registered investment company where the acquisition, when aggregated with the purchases of the securities of all other investment companies (which includes 3(c)(1) and 3(c)(7) funds restricts investment companies), exceeds 10% of the total assets of the offshore fund.

The National Association of Securities Dealers ("NASD") restricts sales of "hot issue" securities to offshore investment funds. "Hot issue" securities are defined as securities of a public offering that trade at a premium in the secondary market whenever such trading commences.

The restriction on sales of hot issue securities do not apply to an offshore fund if the fund meets the following conditions: (i) the fund has 100 or more investors (counting for that purpose the owners of an investor that is an entity); (ii) the fund is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority; (iii) no more than 5 percent of the fund's assets are to be invested in the "hot issue" securities being offered; and (iv) any person owning more than 5 percent of the shares of the fund is not a "restricted person," such as persons affiliated with the member firm.

In order for an NASD member to sell hot issue securities to an offshore fund, the member must receive a written certification prepared by counsel admitted to practice law before the highest court of any state of the U.S. or the foreign jurisdiction where the fund is organized, or by the fund's independent certified public accountant licensed in any state of the U.S. or the foreign jurisdiction where the fund is organized[17].

Fund sponsors should also be aware of issues relevant to investments in offshore fund securities by pension plans. These issues are discussed in detail in Chapter 10.

Location of the Fund's Principal Office and Dissemination of Offering Materials from the U.S. Prior to 1998, in order for an offshore fund to avoid being treated as engaged in a U.S. trade or business for federal income tax purposes, the fund

[17] The certification must state that the attorney or accountant reasonably believes, after reviewing certain specified documents, that no person with a beneficial interest in the fund is a restricted person under NASD rules. *See* NASD Interpretive Memorandum, IM-2110-1: "Free-Riding and Withholding."

was required to have its principal office located outside of U.S. jurisdiction. U.S. tax regulations generally provided that if a foreign corporation performed all or a substantial portion of ten specific functions from one or more offices located outside of the U.S., the corporation would not be considered to have its principal office in the U.S. Industry participants referred to these ten functions as the "Ten Commandments," and they included communicating with the fund's shareholders, maintaining the fund's corporate records and accounts and soliciting sales of the fund's securities.

The Taxpayer Relief Act of 1997 eliminated the requirement that an offshore fund's principal office be located outside of the U.S. for tax years beginning on or after January 1, 1998, effectively eliminating the requirement for an offshore fund to comply with the Ten Commandments. The SEC has confirmed that an offshore fund may perform the ten functions in the U.S. provided that any offers or sales to U.S. persons are made in compliance with an exemption from the securities registration requirement such as the exemptions under Section 4(2) under the 1933 Act or Regulation D thereunder (*see* Chapter 3) and that any offshore public offerings of securities be directed offshore to non-U.S. persons in accordance with Regulation S (*see* Chapter 5).

Thus, following the elimination of the Ten Commandments, an offshore fund managed in the U.S. may now perform its back office functions in the U.S. Foreign investors who are interested in purchasing the securities of an offshore fund may wish to speak with the fund's managers or other personnel when visiting the U.S. As discussed above, offshore funds are effectively precluded under the 1940 Act from making public offerings of securities in the U.S. The SEC has confirmed that for a global *private* offering, private meetings with foreign persons who are temporarily in the U.S. will not result in the fund being deemed to be making a public offering for purposes of Section 7(d) of the 1940 Act provided that the offer or sale of securities is made in a non-public offering in compliance with Section 4(2) or Regulation D or other exemption from registration under the 1933 Act. The fund may not make offers or sales to non-U.S. persons temporarily in the U.S. if such persons will not qualify as financially sophisticated investors for purposes of the Section 4(2) exemption or "accredited investors" under Regulation D (or qualify under another exemption). Such offers or sales must comply with the offering restrictions discussed in Chapter 3. The SEC further confirmed that a fund may conduct private meetings with foreign persons who are temporarily in the U.S. in the context of a global private offering without counting or qualifying the foreign investor as a U.S. person under the Section 3(c)(1) and 3(c)(7) exclusions under the 1940 Act. As discussed above, the fund should take precautions to determine the residency status of any persons purchasing securities of the fund. *See* Chapter 9 for a discussion of other issues involving U.S. taxation.

Penalties for Violations of the 1940 Act. Penalties for willful violation of the 1940 Act provisions requiring fund registration (in the absence of an exclusion or exemption) include possible civil and criminal liability for both the fund and its controlling persons (such as the fund's directors), with possible fines and imprisonment

for egregious violations. Also, a subscriber may rescind its purchase of the fund's securities if the fund is an unregistered investment company which should have been registered. *See* Chapter 8 for a more extensive discussion of the enforcement of U.S. securities laws.

CHAPTER 3

PRIVATE PLACEMENTS OF SECURITIES OF AN OFFSHORE FUND IN THE UNITED STATES

Registration Requirements of the 1933 Act

The securities registration requirement, found in Section 5 of the 1933 Act, requires that any offer or sale of a security be registered with the SEC if any means or instruments of transportation or communication in U.S. interstate commerce or the U.S. mails are employed in connection with the offer or sale of a security, unless the transaction is exempt from the registration requirement.[18] The requirement for the use of U.S. interstate commerce is satisfied by almost any contact with the U.S. by mail, telephone or other transmission facilities.

In general, the rules that govern a private placement of the securities of an offshore fund in the U.S. are the same rules that govern a private offering in the U.S. by a U.S. (domestic) issuer.

"Traditional" private placements in the U.S. are typically made in reliance on an exemption from 1933 Act registration, such as Sections 3(b) or 4(2) of the 1933 Act or Regulation D promulgated thereunder.

Section 4(2) provides an exemption from 1933 Act registration for transactions that do not involve a public offering of securities. Regulation D provides a "safe harbor" for limited or private offers and sales of securities which meet its conditions.[19] U.S. securities lawyers have developed fairly standardized procedures and documentation to allow issuers to make private placements in the U.S. with assurance that an exemption from the securities registration requirement under Section 4(2) or Regulation D is available. Rule 144A under the 1933 Act, although technically an exemption for resales of privately placed securities as opposed to initial placements, is a popular means of

---

[18] The "securities" exemption from 1933 Act registration refer to the exemptions found in Section 3 of the 1933 Act, which apply to offers and sales of specified securities, such as those issued by a U.S. federal, state or local government, a bank or certain collective trust funds. The securities "transaction" exemptions from 1933 Act registration refer to the exemptions found in Section 4 of the 1933 Act, which apply to offers and sales of securities made in transactions not involving a public offering or transactions by any person other than an issuer, underwriter or dealer.

[19] A safe harbor is an objective set of conditions that, if satisfied, assures eligibility for an exemption. Safe harbors are generally non-exclusive; that is, a failure to satisfy all of the conditions does not preclude reliance on a more general, statutory exemption (such as Section 4(2)).

privately placing securities with certain large institutional investors and is discussed in detail in Chapter 4.

Securities offered and sold in a private placement are often sold with an "illiquidity" discount (sometimes called a "haircut") to the price that would be received in public transaction, because such securities are subject to resale restrictions and are not freely tradeable.

As discussed in Chapter 4, for foreign reporting issuers privately placing securities with investors concerned with liquidity, the offering may be structured as a private placement followed by an A/B exchange offer, or may include registration rights to reduce the discount. Also, if the securities of a foreign issuer may be freely traded in the foreign issuer's domestic market, the foreign issuer may seek to place securities with U.S. investors pursuant to Rule 904 of Regulation S in an effort to reduce or eliminate any illiquidity discount.

In addition, U.S. private offerings by offshore funds are often made along with concurrent offshore offerings made in reliance upon the Regulation S safe harbor which, as discussed in Chapter 5, confirms that the registration requirements of the 1933 Act do not apply to offers and sales that occur outside the U.S. Accordingly, sales efforts made in connection with the U.S. private offering, if done at or about the time of an offering outside the U.S., must take into consideration the requirements of Regulation S.

The Section 4(2) Exemption From the Securities Registration Requirement

Introduction. The Section 4(2) exemption from the securities registration requirement applies to "transactions by an issuer not involving any public offering." For an offering to be "non-public," the investors must purchase the securities without any intent to make a distribution of the securities in the U.S. or (in some circumstances) to U.S. persons abroad. Thus, both the sale and any resale of privately placed securities in the U.S. or to U.S. persons must be made in compliance with applicable regulations and requirements. Any securities purchased in a private placement are deemed "restricted securities" by SEC rules and are subject to restrictions on resale.[20]

---

[20] The definition of "restricted securities" is found in Rule 144(a)(3) promulgated under the 1933 Act ("Rule 144"). Restricted securities are:

> (i) securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering;
>
> (ii) securities acquired from the issuer that are subject to the resale limitations of Regulation D (the private offering safe harbor) or Rule 701(c) under the 1933 Act (an exemption for offers and sales of securities by non-public companies pursuant to compensatory plans and contracts);

The Section 4(2) exemption reflects the policy that all purchasers in a private placement, by virtue of their financial sophistication, should be able to "fend for themselves" so that they do not need the protections provided by the securities registration requirement. The premise is that purchasers in a private placement should be in a position to obtain information from the fund similar to or more extensive than what would be disclosed in a 1933 Act registration statement.

The availability of the Section 4(2) exemption depends upon a number of factors, including, as a general rule: (i) whether the offerees are able to bear the economic risk of the investment for an indefinite period of time, their access to relevant information concerning the issuer of the securities, their relationship to the issuer, and the degree of financial sophistication that they or their advisers possess; (ii) the number of offerees; (iii) the manner in which the offering is made; and (iv) the imposition of restrictions on resale. However, the scope of Section 4(2) is often unclear when applied in practice and it can be difficult to ascertain whether the contemplated purchasers, particularly individuals, are financially sophisticated enough and limited in number for the offering to qualify for the exemption.

The guidelines discussed below are intended not only to describe established standards, but also to discuss risks peculiar to a private placement of an offshore fund's securities in the U.S.

The Regulation D private placement safe harbor (discussed in more detail below) is "non-exclusive," which means that a fund, even if it fails to meet the conditions of Regulation D, nevertheless may be able to rely on the general statutory Section 4(2) exemption, depending on the facts and circumstances of the particular situation. This is significant because, as discussed below, it is recommended that an offshore fund seek to meet the objective standards of Regulation D; however, should an offshore fund inadvertently fail to meet any requirement of Regulation D, it would not be precluded

---

(iii) securities that are acquired in a transaction or chain of transactions meeting the requirements of Rule 144A (*see* Chapter 4);

(iv) securities acquired from the issuer in a transaction subject to the conditions of Regulation CE (an exemption from 1933 Act registration for offers and sales which qualify for a certain exemption from registration under California Blue Sky laws); or

(v) equity securities of domestic issuers acquired in a transaction or chain of transactions subject to the conditions of Rules 901 and 903 under Regulation S.

Rule 144 provides a non-exclusive safe harbor for the resale of restricted and "control" securities without registration under the 1933 Act but generally does not provide an exemption applicable to the resale of securities of offshore funds. *See* Chapter 4 under "Resales to the U.S. Public Under Rule 144 Not Available to Offshore Funds." "Control" securities are securities (whether or not previously registered under the 1933 Act) held by affiliates of an issuer. An affiliate of an issuer is a person that directly or indirectly controls, is controlled by, or is under common control with, the issuer.

from claiming another exemption under Section 4(2). A substantial portion of the discussion below of the Section 4(2) exemption will also apply to Regulation D offerings.

Offers and Sales. In general, offers and sales under Section 4(2) must be limited to a small number of offerees who are financially sophisticated investors. If offers and sales will be made to non-institutional investors, it is generally recommended that such investors have substantial net worth or current income or substantial business and financial experience, preferably in the same or similar industry as that of the issuer. It is also generally recommended that the fund, sponsor, manager or the fund's agents have a pre-existing relationship with each of the offerees.

Typically, only one investment bank would be assigned to act as a placement agent in a traditional Section 4(2) or Regulation D private placement. An offshore bank will often make the U.S. private placement through its U.S. affiliate. If more than one offshore banker is involved, there must be precise coordination of the number of U.S. offerees, the manner of the offering, and the eventual number of actual U.S. purchasers and their qualifications.

As discussed above, if an offshore fund sponsor intends to utilize the Section 3(c)(1) exclusion under the 1940 Act, there may be no more than 100 U.S. beneficial owners at the conclusion of the offering. To ensure compliance, the offering should be limited at the outset to perhaps two-thirds of that number of U.S. offerees with additional offers made only if initial indications of interest are not sufficient. As a precautionary measure, an absolute upper limit of 80 financially sophisticated U.S. investors for a 3(c)(1) fund is recommended.

Most traditional private placements are made by the U.S. placement agent on a "best efforts" basis,[21] unless they are done concurrently with an underwritten offering offshore. In a traditional private placement, it may be possible to pay the fees of the placement agent by issuing securities to such placement agent in addition to or in lieu of paying cash.

Due diligence in a Section 4(2) or Regulation D offering can be extensive or abbreviated, depending on the demands made by the purchasers. Venture capital investors making substantial investments in an issuer will typically require extensive due diligence, which may at times be disruptive to the issuer's operations. If the issuer is directly placing its securities with qualified investors, each investor may wish to have its counsel review and comment on the offering documentation. The involvement of numerous counsel may create delays and increase the expenses of the offering. Prior to

[21] "Best efforts" refers to an underwriting arrangement under which an investment bank agrees to do its best to sell the issuer's securities to investors as agent for a specified commission and makes no guarantee regarding the amount of securities to be sold. This is generally contrasted with a "firm commitment" underwriting arrangement under which an investment bank purchases the securities outright and then resells them to investors and earns a spread on the difference between the purchase and sale price.

the due diligence process, the issuer and its counsel should determine the nature of any sensitive due diligence issues and address those matters, particularly any that could affect the timing of the offering.

If a fund intends to use the Section 3(c)(7) exclusion, the 1940 Act would not limit the number of investors, as long as all U.S. purchasers in the original private placement are qualified purchasers. It should be kept in mind, however, that there are limitations on the number of shareholders that the fund may have without registering its securities under the 1934 Act. *See* Chapter 2 under "Limitations on the Number of Shareholders of an Offshore Fund and Consequences for Registration of the Fund's Securities."

Subscription. There is no minimum U.S. subscription amount required for an offering made under Section 4(2) or Rule 506 of Regulation D, but large minimum subscriptions, where possible, tend to reduce the number of purchasers and give some comfort as to their qualifications as private placees. For a 3(c)(1) fund, the minimum subscription amount must be substantial to justify the professional and other expenses necessary to make such an offering, because the initial number of U.S. purchasers should be limited to approximately 80. An absolute minimum of U.S. $50,000 per subscription is recommended.

Resale Restrictions. Any securities offered and sold under Section 4(2) are restricted securities and therefore are not freely tradeable. To rely on the Section 4(2) exemption, the issuer must take reasonable steps to ensure that the investors in the private placement are not acquiring the securities with the intent or effect of distributing the securities offered and sold. The issuer will not be able to use the exemption if qualified investors are used as conduits to unqualified investors. *See* "Investment Letter and Other Offering Documentation" below.

Publicity and Advertising. In order to qualify for the Section 4(2) exemption, there may be no advertising to, or general solicitation of, U.S. purchasers in any U.S. private placement. This means that there should be no advertising or other publicity whatsoever in the U.S. media regarding the private placement. Interviews with U.S. newspapers during the pendency of the offering should also be discouraged. The fund and persons involved in the offshore selling effort should also, where a simultaneous offering is being made in the U.S., avoid all activities which could be characterized as "directed selling efforts" within the meaning of Regulation S. *See* Chapter 5.

Meetings between officers of the foreign issuer and prospective investors may occur during a U.S. private placement, but to avoid claims that any meetings constitute a general solicitation of U.S. investors, these activities should not exceed those reasonably necessary to complete the private placement. Solicitations of indications of interest should generally be made only to those persons who have an existing relationship with the foreign issuer or the selling agents involved in the offering, or who are otherwise believed to be eligible to purchase the offered securities. Attendance at meetings should

be limited to potential investors and their representatives, and attendance by representatives of securities firms and financial analysts should be restricted.

Press announcements in the U.S. should only be made in compliance with the safe harbor of Rule 135c under the 1933 Act. Rule 135c permits a foreign private issuer or reporting issuer, exempt under Rule 12g3-2(b) and proposing to make a private offering, to publish a press release or notice without violating the 1933 Act prospectus delivery requirements, provided that (i) the notice is not used to condition the market for the securities, (ii) the notice states that the securities will not be registered under the 1933 Act, and (iii) no more than the name of the issuer and the purpose and basic terms of the offering (without naming the underwriters) is provided. Foreign reporting issuers must file the Rule 135c announcement with the SEC on Form 6-K. Foreign private issuers exempt under Rule 12g3-2(b) must furnish the announcements to the SEC.

Rule 135e under the 1933 Act allows an offshore fund to comply with objective standards when marketing securities offshore so that those marketing efforts will not be considered "offers" under U.S. securities laws and thus subject to 1933 Act registration. However, Rule 135e does not shield an issuer from the anti-fraud or civil liability provisions of the federal securities law. The rule provides that, subject to certain conditions described below, foreign private issuers (most offshore funds under consideration in this Memorandum will meet the definition of foreign private issuer; *see* Chapter 2 under "Limitations On the Number of Shareholders of an Offshore Fund and Consequences for Registration of the Fund's Securities"), a selling security holder of the securities of such issuers, or representatives of the issuer or such holders, will not be deemed to offer any security for sale by virtue of providing any journalist with access to its press conferences held outside of the U.S., or providing any written press-related materials released (and received by the recipient) outside the U.S. at or in which a present or proposed offering of securities is discussed. These conditions are as follows:

(i) The present or proposed offering is not being conducted solely in the U.S. (an offering will be considered not to be made solely in the U.S. only if there is an intent to make a bona fide offering offshore);

(ii) Access is provided to both U.S. and foreign journalists; and

(iii) Any written press-related materials pertaining to transactions in which any of the securities are being offered in the U.S. must satisfy the following requirements:

(A) the materials must state that they are not an offer of securities for sale in the U.S., that the securities may not be offered or sold in the U.S. absent registration or an exemption from registration, and that any public offering of securities to be made in the U.S. will be made by means of a prospectus that will contain detailed

information about the issuer and management, as well as financial statements;

(B) if the issuer or selling security holder intends to register any part of the present or proposed offering in the U.S., the materials must include a statement of this intention; and

(C) the materials must not include any form of purchase order or coupon that could be returned indicating interest in the offering.

The safe harbor does not cover paid advertisements, but it does cover analysts' research reports that are included in the press package (even if other SEC safe harbor sales rules specifically covering such reports are not complied with) to the same extent, and under the same conditions, as other written materials in the package. "One-on-one" interviews with a U.S. journalist can be covered by the safe harbor. However, the SEC will view a one-on-one interview conducted on an exclusive basis with a primarily U.S. publication as covered by the safe harbor only if the issuer or its representatives also conduct a press conference that complies with the requirements of the safe harbor (i.e., where both U.S. and foreign journalists are allowed to attend), either before or after the exclusive one-on-one meeting with a U.S. journalist.

If the above requirements are met, an offshore fund sponsor will not be deemed to have offered a security within the meaning of the 1933 Act, engaged in a general solicitation or advertising within the meaning of Regulation D, or engaged in directed selling efforts within the meaning of Regulation S (discussed in Chapter 5).

Disclosure Documentation. Although not always required for the purposes of establishing an exemption from the 1933 Act registration, U.S. purchasers should have access to adequate information upon which to base an investment decision. The form of information, such as a private placement memorandum or offering circular,[22] and amount of detail required, will vary depending upon the foreign issuer, the type of offering (whether it is, for example, a traditional private placement or a Rule 144A offering), and the marketing requirements of the U.S. placement agent. Offering documentation produced in a non-U.S. jurisdiction should be reviewed early in the transaction to determine whether it is sufficient to meet U.S. legal requirements governing disclosure, as well as the expectations of U.S. institutional investors. A crucial practical consideration for a foreign issuer in a private offering is the commencement of discussions with the issuer's independent accountants concerning the issuer's financial statements. Reconciliation of the issuer's financial statements to U.S. GAAP may, if required, take several weeks to complete. As a result, the issuer should start this process

[22] In a global offering, the U.S. private placement memorandum is sometimes referred to as the "U.S. Wrap" because the U.S. disclosure document is literally wrapped around the offshore disclosure documentation, such as the offshore offering circular or offering memorandum.

in advance and seek to identify special issues that could delay the offering. All disclosure documents will be subject to the anti-fraud provisions of the U.S. securities laws imposing liability for materially misleading statements or omissions. *See* below and Chapter 8.

Generally, U.S. prospectus-type disclosures should be made for sales or resales to non-institutional offerees; less disclosure may be acceptable when securities of the offshore fund are sold to persons that have a substantial pre-existing relationship with the issuer, its officers or directors, or are sold only to U.S. qualified institutional buyers in a privately underwritten Rule 144A transaction. *See* Chapter 4. Reporting issuers will often use an abbreviated form of private placement memorandum that incorporates the issuer's most recent annual and quarterly reports. These periodic reports are typically bound together with the memorandum to form the offering "book", and the abbreviated memorandum will include customary legends, the terms of the offering, a discussion of risk factors and transfer restrictions, and the plan of distribution. In either case, the private placement memorandum must include a prominent discussion of risk factors inherent in the securities offering.

For offshore funds holding securities of emerging market issuers, accurate disclosures must be made regarding the numerous risk factors inherent in such investments. The disclosure document should discuss risks associated with political change and economic developments in or affecting the countries of issuers in whose securities the fund invests. The disclosure document should also include risks associated with currency devaluation, exchange rate fluctuations, security price volatility, confiscatory taxation and restrictions on the repatriation of funds. In addition, government regulation of securities markets is often less stringent in non-U.S. jurisdictions, and accounting, auditing and auditor independence rules may also differ. It may be difficult to enforce overseas a judgment of a U.S. court, or to obtain a judgment in non-U.S. courts, for liabilities under U.S. securities laws. These and other relevant investment considerations must be adequately disclosed as risk factors to protect the fund from any potential claims that all material risks were not adequately disclosed.

The U.S. wrap must also contain clear and prominent disclosures of the resale restrictions applicable to the offshore fund's securities. The restrictions on resale should also be printed on the share certificates and transfer forms for secondary market transactions. Suggested forms of disclosure are included in the Appendix to this Memorandum.

The decision to include projections in the disclosure documentation may raise liability concerns for a foreign issuer under U.S. securities laws and market practice is mixed over whether to include them. Certain offshore exchanges prohibit the inclusion of projections while other exchanges require them. *See* Chapter 8 under "Rule 10b-5."

Before finalizing the offering documentation, participating placement agents and U.S. counsel should thoroughly review the disclosure, and an adequate opportunity

should be allowed for comment and revision. Since a U.S. private placement may be accompanied by a concurrent offshore public offering, special considerations concerning U.S. offers and sales will apply to the offshore tranche as well. Foreign issuers should seriously consider having U.S. counsel involved from the inception of the offering process; introducing U.S. counsel as an afterthought may cause substantial delays.

Investment Letter and Other Offering Documentation. The purchaser of the securities will typically sign a subscription or securities purchase agreement and an "investment letter." These two documents may also be combined.[23] In the investment letter, the purchaser will make representations and warranties regarding its status as an accredited investor or a qualified institutional buyer (if required), its financial qualifications, its intentions to purchase the securities for its own account and not for distribution, and its ability to hold the securities indefinitely. For a Section 3(c)(7) fund, the investment letter should also contain a representation regarding any U.S. purchaser's status as a qualified purchaser. In all cases, the purchaser must also acknowledge that it is purchasing restricted securities and must represent that it will only resell the securities either outside the U.S., under Regulation S, or in the U.S., pursuant to a registration statement or an exemption from 1933 Act registration. In addition, investment letters often include a representation of the purchaser that in the absence of registration, resales of the securities will only be allowed if accompanied by a legal opinion that the resale is exempt from the securities registration requirement.

For Section 3(c)(1) funds, in light of the upper limit of 100 U.S. beneficial owners in the original offering, the fund must have appropriate safeguards against unauthorized resales in its constituent documents. The most common safeguards are restrictive provisions in the articles of association, articles of partnership, or trust documents, as applicable. These provisions typically provide that if the designated upper limit on the number of the U.S. investors would be exceeded by any proposed transfer, then the transfer may be blocked or the fund interest redeemed so that in no event will the 100-U.S. person threshold be approached. For a Section 3(c)(7) fund, the constituent documents should include similar restrictive provisions designed to block transfers to U.S. persons other than qualified purchasers and to give the fund the option to redeem any securities transferred in violation of these restrictions.

Rule 144A offerings and private placements with a single venture capital investment firm typically involve a securities purchase agreement in lieu of a subscription agreement. A securities purchase agreement generally requires the issuer to make a substantial number of representations, warranties and covenants to the underwriter or investor. The investment bank acting as the initial purchaser in a Rule 144A offering will typically also require indemnification provisions for losses arising out of material misstatements in the preliminary or final private placement memorandum.

[23] Restricted securities are often referred to as "letter stock" because of the investment letter requirement.

Gramm-Leach-Bliley and PATRIOT Act Issues. The Gramm-Leach-Bliley Financial Modernization Act of 1999 ("Gramm-Leach-Bliley") and the USA PATRIOT Act of 2001 ("Patriot Act"), intended to protect consumer privacy and prevent money laundering, among other things, may create enhanced compliance burdens for some offshore funds.

The privacy provisions of Gramm-Leach-Bliley[24] limit the uses that covered "financial institutions" may make of nonpublic personal information obtained from individuals they serve. Gramm-Leach-Bliley authorized the Federal Trade Commission ("FTC") to implement privacy rules with respect to entities, including most private offshore funds, that are excluded from the definition of "investment company" under Section 3(c)(1) or Section 3(c)(7) of the of 1940 Act.[25]

The FTC's final rule implementing these privacy provisions ("FTC Rule")[26] became effective on November 13, 2000, and covered financial institutions were required to come into full compliance by July 1, 2001. The FTC Rule applies only to the use by financial institutions of information of "customers" and "consumers." Under the FTC Rule, a consumer is an individual who "obtains or has obtained a financial product or service" from the financial institution "that is to be used primarily for personal, family, or household purposes," and a customer is a consumer who has a continuing relationship with the financial institution.[27] Because the FTC Rule applies only to *individuals*, legal entities such as corporations, partnerships, trusts and pension plans are not covered. With respect to customers, the FTC Rule requires a fund to limit its disclosures of "nonpublic personal information,"[28] give customers an opportunity to withhold consent to the disclosure of such information to non-affiliates, and notify customers of its policy and practices regarding the sharing of such information.

The limits on disclosure of nonpublic personal information imposed by Gramm-Leach-Bliley and the FTC Rule may not require any change in the policies and

[24] Public Law 106-102, codified at 15 U.S.C. §§ 6801-6810, 6821-6827, *inter alia*.

[25] Authority to implement privacy rules with respect to "investment companies" (including unregistered investment companies) was granted to the Securities Exchange Commission.

[26] 16 C.F.R. §§ 313. The analogous SEC rule is Regulation S-P, 17 C.F.R. § 248, the provisions of which are similar to those of the FTC Rule.

[27] 16 C.F.R. §§ 313.3(e)(1), (h). The FTC would likely deem the relationship between a typical fund and its investors to be "continuing," and we therefore discuss the requirements for "customers."

[28] For purposes of the FTC Rule, nonpublic personal information is defined as "(i) [p]ersonally identifiable financial information; and (ii) [a]ny list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available." 16 C.F.R. § 313.3(n)(1). Personally identifiable financial information, in turn, means "any information" a customer provides a financial institution in order to obtain a financial product or service or which the financial institution obtains because of or in connection with providing a financial product or service to that customer. 16 C.F.R. § 313.3(o)(1).

procedures of a typical private fund, since the typical private fund already protects that information jealously. Funds that do share nonpublic personal information about customers with non-affiliates must give each customer an opportunity to "opt out," that is, to instruct the fund not to share such information. This opt out right must be provided to each customer before the fund discloses any of that customer's nonpublic personal information. The opt out right does not pertain to cases where a fund shares information with an affiliate or with a service provider, such as an investment advisor or custodian, pursuant to a contractual agreement prohibiting the service provider from disclosing the information other than as necessary to perform its function. Finally, certain information such as account numbers may not be disclosed for marketing purposes to non-affiliated third parties other than service providers to the fund itself.

Whether or not a fund intends to disclose covered information, it must give customers a "clear and conspicuous notice that accurately reflects [the fund's] privacy policies and practices."[29] The initial notice must be given upon or before the establishment of a customer relationship - in the case of most funds, upon the submission of subscription documents. Thus, a fund may decide that it is easiest to include a notice in its U.S. offering memorandum or subscription agreement. In order to be clear and conspicuous, the notice must be "reasonably understandable and designed to call attention to the nature and significance of the information" it contains.[30] In addition to this initial notice, a fund must notify customers annually of its privacy policies and procedures, regardless of whether there has been any change. If there has in fact been a change, no disclosures of nonpublic personal information must be made until the customer in question has received a revised notice and a renewed opportunity to opt out.

Title III of the Patriot Act[31] includes two provisions of potential concern to funds: Section 326, regarding customer identity verification, and Section 352, requiring the establishment of an anti-money laundering program. Applicability of these provisions to private investment funds has been delayed, however, until the Department of the Treasury ("Treasury") issues final rules for these entities.[32] A proposed rule implementing Section 352 and applicable to such funds has been issued. No proposed rule implementing Section 326 has been issued.

---

[29] 16 C.F.R. § 313.4(a).

[30] 16 C.F.R. § 313.3(b)(1). The FTC Rule provides further guidance on the meaning of this phrase.

[31] Public Law 107-56, codified at 31 U.S.C. §§ 5318, *inter alia*.

[32] See Treasury's press release of October 25, 2002 (available at http://www.ustreas.gov/press/releases/po3580.htm), in which it announced interim final rules, which delay the applicability of § 352 to financial institutions other than those covered by its April 29, 2002 interim final rules. Investment companies other than mutual funds fall into this category. The October 25 press release indicates that final regulations under §§ 326 and 352 can be expected within the next 6 months.

Section 352 of the Patriot Act requires financial institutions, including investment companies, to establish anti-money laundering programs. On September 18, 2002, Treasury issued a proposed rule (the "Proposed Section 352 Rule") that would apply this section to (i) issuers that would be investment companies under the 1940 Act if not for Section 3(c)(1) or Section 3(c)(7) thereof, (ii) commodity pools, and (iii) companies investing primarily in real estate or interests therein. According to the proposal release, this includes "hedge funds, private equity funds, venture capital funds, commodity pools and real estate investment trusts."[33]

The Proposed Section 352 Rule has two major limitations that will exempt some funds, especially private equity and venture capital funds. Most importantly, the Proposed Section 352 Rule only applies to investment vehicles that permit an investor to redeem any portion of his interest within two years of purchase. Issuers of non-redeemable securities were excluded from the regulation on the rationale that illiquid investments are less useful to money launderers.

A typical private equity or venture capital fund does not permit investors to redeem any portion of their interests within two years of purchase and therefore would not be required to adopt an anti-money laundering program under the Proposed Section 352 Rule. The second major limitation is that the Proposed Section 352 Rule only would apply to a fund that is organized in the U.S., is organized, operated or sponsored by a U.S. person, or sells ownership interests to any "U.S. Person" as defined by Regulation S. *See* Chapter 5.

Funds subject to the Proposed Section 352 Rule are required to develop and implement a written anti-money laundering program. This program must be approved by the fund's board of directors or trustees, or, if it has none, then by its general partner, sponsor, organizer or similar person. At a minimum, an anti-money laundering program under Section 352 is required to:

- Establish and implement policies, procedures and internal controls reasonably designed to prevent the [fund] from being used for money laundering or the financing of terrorist activities;

- Provide for independent testing of the anti-money laundering program;

- Designate a person responsible for implementing and monitoring the anti-money laundering program; and

[33] Proposed Section 352 Rule, page 6.

- Provide ongoing training for appropriate persons.[34]

A Fund required by the Proposed Section 352 Rule to adopt such a program must file a prescribed form of notice with the Financial Crimes Enforcement Network (colloquially, "FinCEN") within 90 days of the fund's becoming subject to the rule. A fund must also notify FinCen if it ceases to be subject to the rule.

Section 326 of the Patriot Act requires financial institutions to adopt procedures for verifying the identity of new customers. Treasury and other agencies have issued proposed rules under Section 326 applicable to banks, trust companies, savings associations, credit unions, broker-dealers, mutual funds, futures commission merchants and futures introducing brokers.

While none of the foregoing proposed rules would apply to the funds under consideration in this Memorandum, such a rule that would apply to these funds may be proposed in the future. At this time, we do not suggest that offshore funds develop procedures that may not be required in any event. The proposed rules for the institutions named above do not require the collection of substantially more information about a customer than is collected in the ordinary course of dealing with such customer. In addition, the verification procedures required are no more than many such institutions perform already. Thus, it is not anticipated that, if Section 326 is made applicable to offshore funds, the marginal compliance burden would be severe.

Form of Securities and Legends. As noted above, an essential element of a private placement is the control of resales to ensure compliance with resale restrictions imposed by U.S. securities laws. Certificates should be clearly labeled and numbered in printed form and legended to indicate that the securities have not been registered for public distribution in the U.S. and are subject to strict resale restrictions. *See* Form 2 in the Appendix. The legend must draw the purchaser's attention to the possible prohibition on transfer or redemption of the fund securities or other interests if the requisite ownership threshold could be exceeded for a 3(c)(1) fund, or if transfers by the original U.S. purchasers to U.S. persons other than qualified purchasers are attempted for a 3(c)(7) fund. *See* Form 3 in the Appendix.

Registration Rights Provisions. Foreign reporting issuers will sometimes grant registration rights to investors in the subscription or securities purchase agreement or in a separate registration rights agreement. If the issuer grants the investors "demand" registration rights, the issuer agrees to prepare and file a registration statement with the SEC when the investor makes a requisite demand for registration, or the issuer will be required to file by a certain date, which generally ranges from as little as 45 to as long as 180 days after the closing date of the offering. As the registration statement will often be subject to full SEC review, if possible, foreign issuers should allow a substantial amount

[34] Proposed Section 352 Rule, § 103.132(c).

of time to prepare and file the registration statement and have it be declared effective by the SEC, particularly if the financial statements of the issuer or its subsidiaries will require reconciliation to U.S. GAAP.

If the issuer grants the investor "piggyback" registration rights, the issuer does not covenant to register the securities offered and sold by themselves, but agrees to include the investor's shares in registration statements that the issuer files with the SEC during an agreed-upon period (other than a registration statement for an exchange offer or for offers to employees of the issuer under an employee benefit plan). Both demand and piggyback registration rights agreements typically provide for indemnity and contribution provisions that allocate losses if the disclosure contained in the registration statement is, or is alleged to be, defective. Investors who resell their securities pursuant to an effective registration statement will be required to deliver a prospectus to the purchaser at the time of the resale and may have liabilities as underwriters of the securities sold.

Sales of Convertible Securities in the Private Placement. Investors may wish to invest in the issuer by purchasing preferred stock or debentures that are convertible into common equity and that carry a coupon or dividend payment and a liquidation preference. Offerings of these securities will, of course, require that counsel prepare a separate debenture document or certificate of designation for the preferred stock.

Also, as an incentive to investor participation, the issuer in a private offering of common equity will often create an offering "unit" by bundling some number of common shares with a warrant to purchase additional common shares at an exercise price that represents a premium to the then market price of the issuer's securities. The warrants will typically be the subject of a separate warrant agreement. The common equity underlying any convertible securities will also be covered by the investors' registration rights.

Compliance Requirements Under Antitrust Laws. If a single investor that is a substantial institution acquires more than $50 million of securities of an issuer, the investor and the issuer may need to make pre-merger notification filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"), which requires U.S. regulators to review certain mergers and acquisitions for possible antitrust violations. The HSR Act also requires the payment of a fee of at least $45,000.[35] U.S. regulators review the filings to determine whether the acquisition raises antitrust concerns. Although relatively small acquisitions generally are not questioned or blocked by regulators, issuers that are privately placing a substantial amount of securities with a single investor should address HSR Act issues early in the transaction since the review may take 45 days or longer and could conceivably delay the closing of the offering. In some cases, exemptions from the HSR Act relating to the acquisition of voting securities of a foreign issuer may apply to offshore funds.

[35] The filing fee is keyed to the value of the transaction, and can range from $45,000 to $280,000.

The Regulation D Exemptions from the Securities Registration Requirement

Introduction. Regulation D provides three non-exclusive safe harbors for private or limited public placements of securities. If a fund meets the requirements contained in the rules described below, the offer and sale of its securities are deemed to be transactions exempt from the securities registration requirement by virtue of Section 3(b) (an exemption for limited offerings of less than U.S. $5,000,000 if conditions prescribed by the SEC are met) or 4(2) of the 1933 Act.

Rule 504 provides an exemption from registration under Section 3(b) of the 1933 Act for offerings not exceeding U.S. $1,000,000 in any twelve-month period by non-reporting issuers that are not investment companies or development stage companies without specific business plans or purposes. Rule 504 permits general solicitation and imposes no limitation on the number of purchasers or restrictions on resale if the issuer complies with certain state laws regarding delivery of disclosure documentation.

Rule 505 provides an exemption under Section 3(b) of the 1933 Act for offerings not exceeding U.S. $5,000,000 in any twelve-month period by issuers (either reporting or non-reporting) that are not investment companies. Unlike Rule 504, Rule 505 does not permit any general solicitation and limits sales to "accredited investors" as defined below and up to 35 non-accredited investors.

Rule 506 provides an exemption under Section 4(2) of the 1933 Act. The exemption is available to any issuer and does not limit the dollar amount of the offering, prohibits any general solicitation in connection with the offering, and permits sales to an unlimited number of accredited investors and up to 35 non-accredited (but financially sophisticated) investors. As discussed in Chapter 2, although Section 3(c)(1) funds may have up to 100 U.S. investors who need only qualify as "accredited" or "financially sophisticated" for a Section 4(2) or Regulation D private placement, a Section 3(c)(7) fund must ensure that its U.S. investors not only are accredited or financially sophisticated but also are qualified purchasers.

Definition of "Accredited Investor." Regulation D defines "accredited investor" to include the following:

- banks and savings and loan associations;
- brokers or dealers registered with the SEC;
- insurance companies;
- investment companies registered under the 1940 Act;
- certain employee benefit plans;

- charitable organizations, partnerships and corporations with total assets in excess of U.S. $5,000,000;
- directors, executive officers or general partners of the issuer;
- persons whose individual net worth, or joint net worth with their spouse, at the time of purchase exceeds U.S. $1,000,000;
- persons who had an individual income in excess of U.S. $200,000 (or joint income with spouse in excess of U.S. $300,000) in each of the two most recent years and who reasonably expect an income in excess of such amount in the current year;
- entities in which all of the equity owners are accredited investors; and
- any trust not formed for the specific purpose of acquiring the securities offered with total assets in excess of U.S. $5,000,000, whose purchases are directed by a "sophisticated person."

Rule 506 and Blue Sky Requirements. As discussed in Chapter 6 below, the U.S. has a dual federal-state regulatory system applicable to offers and sales of securities. Accordingly, in addition to complying with federal securities laws concerning securities registration, issuers must generally also qualify for a state law exemption from state securities registration for any offer or sale of a security or else register the securities in that state. (Certain states have regulatory schemes that are exceptions to this general rule.)

There are currently two exemptions from state securities registration requirements that are normally available for private placements by foreign issuers: one available for sales to institutions and a second provided under NSMIA. The institutional investor exemption generally is automatic and requires no filing fees. The NSMIA exemption may be used for offers and sales pursuant to Rule 506 and, in general, an issuer using it is only required to make a one-time notice filing for the offering and pay a one-time fee to the state in which the investor resides (although offerings in New York may require additional compliance). These exemptions serve to reduce compliance burdens and thus hold down the costs of the offering.

Only Rule 506 and Rule 144A offerings (but not Rule 504 or 505 offerings or offerings under Section 4(2) of the 1933 Act) generally qualify for the NSMIA or institutional investor exemptions from *state law* registration requirements. In addition, most offshore funds will typically make substantial U.S. placements which will preclude the use of Rules 504 and 505 based on the offering amount limitations. Accordingly, we recommend, and this Memorandum will focus on, the use of Rule 506. The general

requirements for use of the Regulation D safe harbor under Rule 506 are discussed below.

No General Solicitation. To qualify for the Rule 506 safe harbor, neither the issuer nor any person acting on its behalf may offer or sell the securities by any form of general solicitation or general advertising. *See* "Publicity and Advertising" above. Normally, no general solicitation will be deemed to have occurred if there is a pre-existing relationship between the offeror (the issuer or its selling agent) and the offeree sufficient to permit the offeror to evaluate the financial sophistication of the offerees, although the absence of a pre-existing relationship is generally less problematic in the case of offers and sales to institutional investors.

Number of Investors and Their Financial Sophistication. Pursuant to Rule 506, sales may be made to an unlimited number of accredited investors, plus up to 35 persons who are not accredited investors, and each non-accredited investor must either alone or with such investor's representative have "such knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment, or the issuer must reasonably believe that such purchaser comes within this description." Although the federal securities laws do not specify the level of financial sophistication required of these so-called "sophisticated investors," case law indicates that previous investment experience in the same or a closely related line of business, general business experience, and the ability to understand financial information are important factors in making this determination.

Information Requirement. If any prospective purchasers are non-accredited investors, they must receive prior to the sale certain financial and non-financial information specified by Regulation D to the extent such information is considered "material to an understanding of the issuer." The amount and type of such information depends upon the size of the offering and whether or not the issuer is a reporting issuer. This requirement may pose a problem for offshore fund sponsors since the information will most likely need to include a reconciliation of the fund's financial statements to U.S. GAAP. Accordingly, it is generally recommended that offshore funds not solicit offers and sales to non-accredited investors. The issuer will generally furnish the same financial and non-financial information to accredited investors as well, in view of the antifraud provisions of the federal securities laws.

Resale Restrictions and the "Reasonable Care" Test. Securities offered and sold pursuant to Regulation D are *restricted* securities and thus subject to *resale* restrictions. The issuer must exercise reasonable care to ensure that the purchasers of the securities are not "underwriters" within the meaning of the 1933 Act;[36] that is, that they

[36] The term "underwriter" is defined in Section 2(11) of the 1933 Act as any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but the

are not purchasing the securities with the intent or effect of distributing them to the public. Regulation D identifies certain steps that a fund should consider implementing for this purpose, such as making a reasonable inquiry as to whether the purchaser is acquiring the securities for its own account or the account of another person, providing notice to purchasers that the securities have not been registered under the 1933 Act and may not be resold unless registered or offered and sold under an exemption from registration, and imprinting an appropriate legend on the securities certificates. Regulation D provides, however, that these steps are not the exclusive means of complying with the reasonable care test.

Integration Test. A Regulation D offering must meet certain requirements regarding the "integration" of public and private offerings to ensure that an issuer does not use a private placement to evade the 1933 Act registration requirements by separating a single non-exempt offering into several exempt offerings. Under the safe harbor provided by Regulation D, offers and sales that are made more than six months prior to a Regulation D offering or more than six months after its completion will not be considered part of that offering, as long as during such six-month periods there are no offers or sales of securities by or for the issuer that are of the same or similar class as those offered or sold under Regulation D, other than offers or sales of securities under an employee benefit plan.

Issues concerning integration of public and private offerings may also arise in the context of private offerings made pursuant to Section 4(2), Rule 144A or Regulation S. The integration concept may be applied by the SEC to private offerings and registered offerings to determine whether there are issues concerning unregistered sales, general solicitation or "gun-jumping" (making offers or sales before the filing of the 1933 Act registration statement). Rule 152 under the 1933 Act is a safe harbor for issuers making a registered offering subsequent to making a private placement. As interpreted by the SEC staff, under Rule 152, a completed private placement will not be integrated with a subsequently commenced registered offering.

Form D Filing Requirement. A notice of the offering on Form D must be filed with the SEC within fifteen days following the first sale of securities. Form D requires general information regarding the issuer, including the names of its executive officers, directors and beneficial owners of 10% or more of any class of its equity securities, as well as about the offering, such as the size of the minimum subscription amounts permitted, the jurisdictions in the U.S. where purchasers have been or will be solicited, persons receiving compensation for soliciting purchasers, the number of participating accredited and non-accredited investors, the aggregate size of their respective purchases and the proposed use of the offering's net proceeds.

---

term does not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commission.

If the offering meets the criteria outlined above, Regulation D provides a non-exclusive safe harbor from the 1933 Act registration requirement. As explained above, failure to comply with the safe harbor conditions of Regulation D, however, does not preclude a private placement from qualifying for another exemption, such as the Section 4(2) exemption.

Disclosure Documentation and Offering Procedures for Regulation D Private Placements. In placements made exclusively to investors meeting the accredited investor standard of Regulation D, other aspects of private placement procedure are fairly standard and closely track the requirements necessary to make a Section 4(2) offering, discussed above.

There is no formal requirement for furnishing information to accredited investors purchasing under Regulation D, although a disclosure document is often used by reason of industry practice and to minimize potential liability under Rule 10b-5, the general anti-fraud provision.

As under the Section 4(2) exemption, the private placement memorandum in a Regulation D offering should include appropriate disclosures, including financial information. In addition, investment letters are typically required to be executed by each purchaser in a Regulation D private placement. *See* "Investment Letter and Other Offering Documentation," above.

Regulation D private placements with institutions are often structured so that the securities are either denominated, or offered and sold, in large face amounts (in the hundreds of thousands or even millions of dollars). Such pricing is typical for institutional private transactions, but is not characteristic of public offerings to retail investors. Frequently, only institutional accredited investors will be permitted to purchase. As discussed above, the securities certificates should contain restrictive legends and be subject to stop transfer instructions to prevent unapproved resales.

The procedural steps necessary to meet the requirements of Regulation D for a 3(c)(7) fund which, as discussed in Chapter 2, may sell securities to individuals and certain trusts, are substantially similar, but relevant changes to the offering documents are necessary. Suggested models for an investment letter for 3(c)(1) and 3(c)(7) funds are contained in Forms 13 and 14, respectively, of the Appendix to this Memorandum.

Debt Offering Made Pursuant to Regulation D. Regulation D debt offerings are generally made by an investment bank on a best efforts basis and the sizes of the issuances typically range from U.S. $30 million to U.S. $300 million. The investors in Regulation D debt offerings are typically insurance companies or other institutional investors, who generally invest on a buy and hold basis. A rating of the issue generally is not required as institutional investors will make their own credit analyses of the issues. Maturity ranges and pricing of the debt offered will vary depending on the credit quality of the issuer, the seniority of the debt in the issuer's capital structure and the covenant

protection provided by the issuer. *See* also Chapter 3 under "Debt Offerings Under Rule 144A."

Potential Liability and Enforcement Actions Under U.S. Securities Laws. Although securities sold in a private placement are not registered with the SEC, the offering will be, as is any issuer of securities, subject to the general anti-fraud provisions of U.S. federal and state securities laws. An investor that purchases securities on the basis of a material misstatement or omission in the offering documents may file a claim for rescission or damages against the fund, its directors and other parties involved in the offering. Suits for such material misstatements or omissions are typically brought under Section 10(b) of the 1934 Act, and Rule 10b-5 thereunder, which is the "catch-all" anti-fraud rule under U.S. securities laws. A fund and its officers and directors may also face enforcement actions instituted by the SEC and state securities regulators. The risks of legal exposure are minimized by reasonable care in planning and effecting the offer and sale of fund securities. For a more extensive discussion of the enforcement of U.S. securities laws, *see* Chapter 8.

CHAPTER 4

RULE 144A OFFERINGS AND RESALES OF THE SECURITIES OF OFFSHORE FUNDS WITHIN THE UNITED STATES

While Section 4(2) and Regulation D provide issuers with the basis for exemptions from 1933 Act registration, they do not address whether or under what circumstances investors and underwriters in a private placement may resell securities purchased in a private placement. Securities issued in a U.S. private placement are subject to resale restrictions both in and outside the U.S. and such securities may be resold only pursuant to a registration statement filed with the SEC or pursuant to an exemption from the securities registration requirement.

Rule 144A provides a non-exclusive safe harbor exemption from the 1933 Act registration requirement for resales of eligible securities to U.S. qualified institutional buyers, known as “QIBs,” which generally include institutions that own and invest on a discretionary basis at least U.S. $100 million in securities of non-affiliated issuers. This resale exemption increases the liquidity and marketability of the Rule 144A eligible securities, but is only available for resales to the relatively narrow universe of QIBs.

Resales of restricted securities among broader groups of potential purchasers in the U.S. may also be made in private transactions under the so-called “Section 4(1½)” exemption, discussed below.

Resales of securities of certain issuers may be made to the U.S. public under Rule 144, which provides a non-exclusive safe harbor for resales of restricted securities and securities held by affiliates of the issuer.

Resales outside the U.S. may be made under the somewhat less restrictive provisions of Regulation S, discussed in Chapter 5 of this Memorandum.

Resales Under Rule 144A

Since its adoption, Rule 144A has proven to be extraordinarily popular, both as an exemption for the immediate resale by underwriters of securities purchased from issuers (sometimes called underwritten private offerings) and as an exemption for resale transactions, which facilitates a secondary market among substantial U.S. institutions.

Under Rule 144A, resales of eligible securities to QIBs are not subject to the 1933 Act registration requirement because there is deemed to be no “distribution” and the reseller is therefore not an “underwriter” within the meaning of the 1933 Act. Rule 144A

increases the liquidity of those securities and reduces or eliminates the discount typically associated with resales of restricted securities, because it provides an exemption from 1933 Act registration for resales among institutions. However, Rule 144A does not affect the need for compliance with all applicable state securities laws for resale transactions (although a QIB will be an institutional buyer, sales to which are commonly exempt from Blue Sky registration). *See* Chapter 6.

Most Rule 144A offerings are conducted on an underwritten basis, with investment banks initially negotiating the terms of the offering and purchasing the Rule 144A securities for immediate resale to QIBs. U.S. securities practitioners have developed standardized documentation and procedures for Rule 144A offerings and, in certain offerings, it is no longer considered necessary to require investment letters, large minimum denominations of securities and, in certain cases, legended securities.

Most Rule 144A offerings involve the use of preliminary private placement memoranda and road shows, and thus are similar in form to public offerings. Accordingly, the foreign issuer and its investment banks will typically enter into a securities purchase agreement similar to an underwriting agreement used in a registered offering as well as a registration rights agreement. A Rule 144A debt offering may also require the issuer to execute an indenture with the trustee for the holders of the debt securities. The purchase agreement and indenture will contain standard representations and covenant protection. QIBs generally will not be represented by individual counsel, and transactions will be effected by confirmations rather than by individual negotiated agreements. Frequently, institutional accredited investors that are not QIBs will be permitted to purchase a portion of the securities in reliance on an exemption other than Rule 144A.

Due Diligence in Rule 144A Offerings. Although the adoption of Regulation M, discussed below, and amendments to the rules of The Depository Trust Company, have facilitated trading of Rule 144A securities, offshore fund sponsors may find the accepted practices involved in a Rule 144A offering, such as allowing extensive due diligence by investment banks and providing required information in connection with secondary market transactions, to be onerous. The due diligence required by Rule 144A underwriters will vary depending on the credit quality and reporting status and seasoning of the issuer. In general, however, the underwriter will wish to conduct a comprehensive document review with a focus on financial information, meetings with officers and site visits. The underwriters may also require a comfort letter from the issuer's accountants. Nevertheless, Rule 144A offerings remain a popular means to raise substantial amounts of capital from institutional investors, and foreign reporting issuers have increasingly structured Rule 144A offerings using securities that are subsequently exchangeable for freely tradeable securities registered with the SEC (so-called A/B exchange transactions). *See* below under "Rule 144A Registered Exchange Offers."

Requirements of Rule 144A

Resales to QIBs. Rule 144A does not apply to offers or sales by issuers (except indirectly through underwritten private offerings). It provides a safe harbor only for resales made to QIBs. Thus, an issuer will need to use another exemption from 1933 Act registration, typically Section 4(2), for the initial offer and sale of the Rule 144A-eligible securities to underwriters or other initial purchasers.

Rule 144A defines a QIB to include the following institutions that own and invest on a discretionary basis at least U.S. $100 million of securities of issuers that are not affiliated with the issuer:

(i) any insurance company as defined in Section 2(13) of the 1933 Act;

(ii) any investment company registered under the 1940 Act or any business development company as defined in Section 2(a)(48) of the 1940 Act;

(iii) any investment adviser registered under Section 202(a)(22) of the Investment Advisers Act of 1940, as amended (the "Advisers Act");

(iv) any not-for-profit organization described in Section 501(c)(3) of the Internal Revenue Code, corporation (other than one described in (ix) below), partnership, or Massachusetts or similar business trust;

(v) any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;

(vi) any employee benefit plan within the meaning of Title I of ERISA;

(vii) any trust fund whose trustee is a bank or trust company and whose participants are exclusively plans of the types described in paragraphs (v) and (vi), except trust funds that include individual retirement accounts or Keogh plans;

(viii) any small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958;

(ix) any U.S. or foreign bank, or savings and loan, or equivalent institution with an audited net worth of at least $25 million as of a date not more than 16 months (domestic entities) or 18 months (foreign entities) preceding a Rule 144A resale;

(x) any entity all of the beneficial owners of which are qualified institutional buyers, acting for its own account or the accounts of other QIBs; and

(xi) any business development company, as defined in Section 202(a)(22) of the Advisers Act.

A securities dealer registered under the 1934 Act, acting for its own account or the accounts of other QIBs, is considered a QIB if it either (i) owns and invests on a discretionary basis at least U.S. $10 million in securities of non-affiliates, or (ii) is acting in a riskless principal transaction on behalf of a QIB (i.e., a simultaneous purchase and offsetting sale to a QIB). The $10 million dollar test does not include securities constituting the whole or part of an unsold allotment to or subscription by a dealer as a participant in a public offering.

For purposes of the QIB definition, to "own and invest on a discretionary basis" means that funds that are invested by a QIB for other QIBs on a discretionary basis may be considered in determining QIB status. However, for a resale to an investment adviser or other fiduciary acting with discretion on behalf of another institution, it is not sufficient that the adviser or fiduciary be a QIB; the underlying account must also be one. Investments in certain instruments and interests are excluded, such as bank deposit notes and CDs; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency, interest rate and commodity swaps. In addition, securities owned by an entity's consolidated subsidiaries do not count unless the investments of such subsidiaries are managed under the direction of the parent entity and, if the entity is itself a majority-owned subsidiary of another entity, such entity is a reporting issuer.

In general, all QIBs are accredited investors, but not all accredited investors are QIBs. While this may lead to the conclusion that the U.S. wrap need only conform to the standards needed for offerings to accredited investors, there are relevant distinctions to consider. QIBs are often accustomed to purchasing restricted securities under Rule 144A rather than as accredited investors, because they believe that they are less restricted in terms of resales.

For internal and certain regulatory purposes, some QIBs may categorize their holdings in securities acquired in a Rule 144A transaction differently from those acquired in a conventional private offering. For example, the board of directors of a QIB that is a registered investment company may determine that Rule 144A securities are not illiquid for regulatory purposes. For a broker-dealer QIB, such liquidity may be advantageous for purposes of net capital regulations. Thus, while the QIB language could be eliminated from a legal standpoint, its inclusion is rather conventional and its absence could conceivably hamper marketing efforts.

Moreover, under Blue Sky laws, sales to QIBs likely will be exempt from registration and other filing requirements by virtue of the exemption in most states for

offers and sales to institutional investors, while sales to non-institutional accredited investors, although exempt from state registration, are often subject to state notification requirements. *See* Chapter 6.

"Reasonable Belief" Requirement. To qualify under Rule 144A, the securities must be offered and resold only to QIBs or entities that the seller reasonably believes to be QIBs, and, as noted below, reasonable steps must be taken to ensure that the purchaser is aware that the seller may be relying on Rule 144A. In most cases, the seller's "reasonable belief" may be based on certain published financial information or on an officer's certificate. In marginal cases, reliance on published sources may be problematic, because financial statements do not generally disclose whether investments include U.S. government securities or other excluded investments, or whether investments of consolidated subsidiaries are managed by the purchaser.

Notice Requirement. Rule 144A requires the seller to take reasonable steps to ensure that the buyer is aware that the seller is relying on the rule. This requirement is typically met by including language in the private placement memorandum and the confirmation that the purchaser may rely on Rule 144A. The following legend has been used in a number of offerings:

> "WE HEREBY NOTIFY EACH PURCHASER THAT THE OFFER AND SALE OF THE SECURITIES OFFERED HEREBY MAY BE MADE IN RELIANCE UPON THE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT OF 1933 PROVIDED BY RULE 144A."

In addition, purchasers are often required to confirm in writing their awareness that the sale to them is being made in reliance on Rule 144A. (*See*, e.g., paragraph 2(ii) of Form 13). In a typical Rule 144A offering, the underwriters acting as initial purchasers will contractually commit to resell securities only pursuant to Rule 144A and the issuer will generally have a valid Section 4(2) exemption for the initial sale without the use of distribution investment letters or stop-transfer provisions. Use of legends restricting transfer is not, strictly speaking, required, but is recommended. However, if Rule 4(11/2) resales, discussed below, are permitted, resale restrictions for those transactions must be implemented.

Non-Fungible Securities. Securities that are eligible to be sold under Rule 144A are debt or equity securities other than securities of a class listed on a U.S. securities exchange or quoted on the Nasdaq Stock Market or securities "fungible" with those securities. This non-fungible securities requirement effectively limits the Rule 144A market for an offering of equity securities to securities of foreign issuers whose primary trading markets for those securities are outside the U.S.

A security's eligibility for trading under Rule 144A is determined as of the date of issuance. Listed or quoted American Depositary Receipts are considered fungible with

the underlying securities on deposit. Convertible securities are fungible with the underlying security where the conversion premium is less than 10%. Warrants are deemed fungible with the underlying security if the effective exercise premium is less than 10% or the exercise period of the warrant is less than three years. In general, equity securities will not be considered to be of the same class as outstanding securities if the securities differ as to dividend, liquidation or voting rights.

Information Requirement for Non-Reporting Issuers. For resales of securities of Non-Reporting Issuers, which will generally include most offshore funds, the holders and prospective purchasers of the Rule 144A securities must have a right to obtain, prior to the sale, certain information concerning the issuer of the securities. The information must include a "very brief" description of the issuer's business and the issuer's most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available).[37] Rule 144A specifies that information will be deemed to be satisfactory if it meets the timing requirements of the issuer's home country principal trading markets.

Securities sold under Rule 144A are subject to the same anti-fraud provisions of the 1933 and 1934 Acts as securities sold in Section 4(2) or Regulation D offerings. For this reason, notwithstanding the limited information-furnishing requirement of Rule 144A, issuers and underwriters in Rule 144A offerings frequently furnish investors with U.S. prospectus-type disclosures as a cautionary measure. As the information-furnishing requirement is expressly provided for in Rule 144A, a foreign issuer often undertakes in writing to satisfy these requirements to facilitate future sales by investors in Rule 144A securities. Typically, the foreign issuer agrees that, for as long as there are restrictions on transfer imposed by the 1933 Act and the foreign issuer is not a reporting issuer or a Rule 12g3-2(b) exempt issuer, it will furnish the information to facilitate further Rule 144A resales.

Foreign non-reporting issuers that make Rule 144A offerings should consider the advantages of voluntarily claiming the Rule 12g3-2(b) exemption. Rule 12g3-2(b) is an "information furnishing exemption" that exempts foreign private issuers from registering equity securities under the 1934 Act (and filing periodic reports and certain other

[37] The SEC did not specify in adopting Rule 144A whether the required information must be provided in English. It ought to be the case, however, that no special translations or English language versions of the information need be provided if not otherwise available. First, the premise of Rule 144A is that QIBs have sufficient financial sophistication and economic power to fend for themselves, including the ability to require the issuer to provide English summaries of any requested information. Second, in the context of Rule 12g3-2(b), the SEC expressly addressed the language issue by including a requirement that press releases and documents distributed directly to security holders be furnished to the SEC in English or that English language summaries or versions be supplied to the SEC. The SEC could have included, but did not include, a similar requirement in Rule 144A. In any event, no more than an English language summary of the document should be required.

obligations) if the foreign private issuer furnishes to the SEC the information (sometimes called "home country information"), that it (i) has made or is required to make public under the law of the country of its domicile or in which it is incorporated or organized; (ii) has filed or is required to file with a stock exchange on which its securities are traded and which was made public by such exchange; or (iii) has distributed or is required to distribute to its security holders. The exemption may be claimed on a voluntary basis by issuers who are not subject to the 1934 Act registration requirements.

The Rule 144A information furnishing requirement does not apply to foreign private issuers that claim the exemption set forth in Rule 12g3-2(b) under the 1934 Act. Voluntarily complying with Rule 12g3-2(b) may be preferable to furnishing Rule 144A information on a case-by-case basis. Anti-fraud considerations may require an issuer that furnishes Rule 144A information rather than claims the Rule 12g3-2(b) exemption to disclose information regarding business developments and operations which would not otherwise be required to be publicly disclosed in the fund's home country filings. If a fund may claim the Rule 12g3-2(b) exemption, the duty to supply information under Rule 144A no longer applies, and there is no obligation to update and keep current the information provided under Rule 12g3-2(b). In addition, a foreign private issuer will, at a minimum, need to claim the exemption under Rule 12g3-2(b) to establish an ADR program for Rule 144A securities.

No General Solicitation. General solicitation of offerees is not permitted because Rule 144A offerings are deemed to be private placements. Any publicly-related announcements should be made within the safe harbors of Rule 135c or Rule 135e under the 1933 Act.

Additional Considerations in a Rule 144A Offering

Research Reports. Offshore offerings typically are coordinated by a merchant bank and investment dealer or broker, which are sometimes different institutions, and the broker's research report is often considered an essential document in connection with the issuance, so that offshore fund sponsors often insist on the preparation and distribution of a broker's research report as a condition to the broker's engagement.

Employing a broker's research report in connection with a U.S. registered public offering is flatly at odds with the 1933 Act requirement that a U.S. registered offering be made only by a filed prospectus (use of such a report before filing the 1933 Act registration statement is commonly called "gun jumping"). In fact, it is common for a U.S. broker-dealer to be excluded from an underwriting syndicate if it has prepared a contemporaneous or even somewhat recent research report on the issuer. As securities laws prohibit the distribution of a broker's research report in conjunction with a 1933 Act registered offering, and the practice in the EU countries is almost consistently to the contrary, the question arises whether the offshore broker's research report may be distributed to QIBs in a Rule 144A resale transaction.

While the point is still subject to some debate among U.S. securities practitioners, the offshore broker's research report may, in most cases, be distributed to QIBs without violating U.S. securities laws. The essential predicate of Rule 144A is that a QIB is able to fend for itself and does not need the protections that the securities registration requirement ostensibly affords the public. Consequently, QIBs stand almost as an excluded subset from the list of protected purchasers in the U.S. and they may be provided with whatever information the fund and its advisers think fit in connection with a Rule 144A resale (provided, of course, that the information does not involve a material misstatement or omission). Nevertheless, U.S. counsel should be consulted prior to distributing a broker's research report, and particular care is needed so that the foreign broker, if not registered in the United States, remains in the limited safe harbor provided by Rule 15a-6. *See* Chapter 6 under "Federal Regulation of Broker-Dealers."

Applicability of Regulation M. The purpose of Regulation M under the 1934 Act is to prevent persons who have an interest in the outcome of an offering from manipulating the market to facilitate the completion of the distribution. Although transactions in securities eligible for resale under Rule 144A are exempted from Regulation M, offshore fund sponsors should be aware of the anti-manipulation provisions.

Regulation M prohibits a "distribution participant" in a securities offering (which includes an underwriter, broker, dealer, or any other person who has agreed to participate or who is participating in a distribution of securities, and issuers, selling security holders and their affiliated purchasers), from bidding for, purchasing, or attempting to induce any person to bid for or purchase, a security that is the subject of the distribution during a "restricted period." "Distribution" means any offering of securities, whether or not registered with the SEC, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods. The "restricted period" begins on the later of (i) five business days prior to the date on which the subject security's price is determined (one business day prior for heavily-traded securities), or (ii) the date on which the person becomes a distribution participant, and ends upon such person's completion of participation.

Regulation M expressly does not prohibit offers and sales to QIBs of securities eligible for resale under Rule 144A, and offers or sales to persons deemed not to be "U.S. persons" as defined in Regulation S. Also, if an affiliated purchaser of an issuer is a distribution participant, such as an employee of the issuer or an affiliate of the issuer, the affiliated person may use the Regulation M exemption available to underwriters for transactions that are not effected on a securities exchange.

These exceptions notwithstanding, distributions to U.S. accredited investors as defined in Regulation D who do not qualify as QIBs would not be exempted from

Regulation M during the restricted period.[38] Accordingly, issuers and underwriters must use caution not to bid for or purchase securities prior to completion of the distribution if offers or sales are being made to U.S. non-QIBs. Also, if an affiliated purchaser of an issuer is a distribution participant, such as an employee of the issuer, the affiliated person may use the Regulation M exemption available to underwriters for transactions that are not effected on a securities exchange.

Debt Offerings Using Rule 144A. Rule 144A debt offerings are generally underwritten transactions and the investors are typically mutual funds, money managers and insurance companies. These investors often make an investment decision based in part on the rating of the issuer, so ratings from two major rating agencies are often required. Rule 144A debt offerings usually require a minimum issue size of $100 million because a large issuance is needed to create secondary market liquidity. A Rule 144A debt offering may also require the preparation of an indenture in respect of the debt instrument.

Rule 144A Registered Exchange Offers. In a Rule 144A registered "A/B" exchange offer, a technique that is available for offerings of both debt and equity securities of a foreign issuer,[39] securities are offered and sold to institutional investors in a Rule 144A private placement, following which the 144A securities are exchanged for more or less identical securities that are freely tradeable. The investment bank involved is usually referred to as the initial purchaser and is not subject to liability as an underwriter under the 1933 Act. To use this technique the investors (i) may not be affiliated with the issuer; (ii) must acquire the securities during the ordinary course of business; and (iii) may not have an arrangement to distribute the securities received in the exchange.

The key advantages of a Rule 144A exchange offer over granting conventional registration rights are that the investors receive freely tradeable securities and generally need not deliver a prospectus when they resell the exchange securities. If the securities were resold pursuant to a registration statement filed in connection with conventional registration rights, the investor would need to deliver a resale prospectus with the sale and would be subject to certain liability provisions of the 1933 Act applicable to resales by prospectus. However, a broker-dealer who was holding the unregistered security for its own account as a result of market making or other trading activities may be deemed an underwriter of the registered security received in the exchange offer and, as such, must deliver the exchange offer prospectus in connection with any resale of such security.

[38] As applied to underwriters, special selling efforts and selling methods do not include the publication or dissemination of any information, opinion, or recommendation, if the conditions of SEC Rules 138 and 139 are met. This research activity exemption is not available to issuers, however.

[39] A domestic issuer may only use the Rule 144A registered exchange offer technique for offerings of nonconvertible debt and investment grade preferred stock.

Use of an ADR Program in a Rule 144A Offering. A foreign issuer may sponsor an ADR program to issue restricted ADRs in a Rule 144A offering. As noted in Chapter 1, such offerings may only be made by foreign reporting issuers or foreign non-reporting issuers that are exempt from reporting pursuant to Rule 12g3-2(b) under the 1934 Act.

Secondary Market Trading of Rule 144A Securities. The investment banks that act as initial purchasers of Rule 144A securities will often want to arrange for the securities to be transferable through book-entry transfer facilities such as DTC, which allow book-entry trading among QIBs. The NASD operates the Private Offering, Resale and Trading Through Automatic Linkages Market, also known as "PORTAL," which is a computerized, screen-based, trading market for Rule 144A eligible securities with facilities for clearance and settlement of transactions in Rule 144A securities through DTC or Clearstream, Luxembourg. However, the majority of Rule 144A resales occur through direct negotiations between buyers and sellers.

Application of Rule 144A

An enhanced distribution may be achieved in a traditional offering to foreign and U.S. persons or in an underwritten private offering under Rule 144A. As discussed in Chapter 3, an offshore fund sponsor may make a U.S. private placement of its securities directly with accredited investors (typically institutions) under the Section 4(2) or Regulation D exemption, in which a U.S. dealer (or group of dealers) acts as placement agent. Rule 144A enables the U.S. purchasers to immediately resell Rule 144A eligible securities to QIBs and those securities may be readily resold to other QIBs, or resold offshore pursuant to Regulation S. This increased liquidity may reduce the traditional discount applied to the purchase price of privately placed securities (sometimes called the "haircut"), increasing the proceeds to the fund.

As there is no limit on the number of U.S. persons who are qualified purchasers, and QIBs generally meet the definition of qualified purchaser, a 3(c)(7) fund may be used efficiently to achieve a broad distribution to institutions (provided that all purchasers are QIBs, a more stringent test than for qualified purchasers). Note, however, that although Rule 144A requires that broker-dealers own and invest on a discretionary basis at least $10 million in securities to qualify as QIBs, such dealers will need to own and invest $25 million of securities on a discretionary basis to be qualified purchasers. Also, self-directed employee benefit plans such as 401(k) plans, which may be QIBs, do not meet the requirements to be qualified purchasers.

If the Rule 144A offering is done concurrently with an offshore public offering, all participants in the offering should agree at a minimum not to offer or sell any of their unsold offshore allotment in the U.S. (other than in Rule 144A resales) and not to engage in any "directed selling efforts" in the U.S. in connection with the Rule 144A sales. These provisions help to ensure that the concurrent offshore offering will be considered

an "offshore transaction" for the purposes of Regulation S and thereby not require registration with the SEC. *See* Chapter 5.

Resales Under "Section 4(1½)"

The Section 4(2) and Regulation D exemptions are available only to issuers and thus are not available for private resales by purchasers who acquired their securities from the issuer in a private placement. Rule 144A is only available for resales that are made to QIBs that meet additional requirements of Rule 144A. Section 4(1) of the 1933 Act exempts from the registration requirements transactions by any person other than an issuer, underwriter or dealer.

Section 4(1) was intended to exempt only routine trading transactions between individual public investors for securities already issued, and a person reselling securities under Section 4(1) must sell in such limited quantities and in such a manner so as not to disrupt trading markets or such person may be deemed an "underwriter" ineligible to rely on Section 4(1). However, the parameters of Section 4(1) exemption are not always clear, so that the person making a private resale may not be sure that restricted securities have "come to rest" for a sufficient period of time to use Section 4(1).

Over the years the U.S. securities bar has developed an additional technique for the resale by purchasers of securities acquired in private offerings. This technique, sometimes called a "secondary private placement" has become known in the legal community as the "Section 4(1½)" exemption because it involves elements of both the Section 4(1) exemption (which exempts from the securities registration requirement transactions by any person other than an issuer, underwriter or dealer) and the Section 4(2) exemption (which exempts private offerings by issuers). It is predicated on the theory that a qualifying resale by the seller is not a "public offering" within the meaning of Section 4(2) and is not properly classified as a "distribution" and thus the seller is not an "underwriter" within the meaning of the 1933 Act. The Section 4(1½) exemption is recognized by the SEC, and Rule 144A is a partial codification of the exemption for resales to QIBs.

Resales under Section 4(1½) generally involve the same procedures as an offering under Section 4(2) and Regulation D. *See* Chapter 3. Thus, resales should be made only to accredited or otherwise qualified investors (preferably institutions) who must execute investment letters, and the certificates for the securities should contain a 1933 Act restrictive legend. In addition, the issuer typically should require an opinion of U.S. counsel to the effect that the resale does not require registration under the 1933 Act.

Resales to the U.S. Public Under Rule 144 Not Available to Offshore Funds

Rule 144 under the 1933 Act provides a safe harbor for resales of "restricted" and "control" securities to the U.S. public, provided that all of the conditions of Rule 144 are met. The Rule 144 conditions include applicable holding periods (at least one year), the availability of public information about the issuer, certain volume limitations and resales only in unsolicited brokers' transactions.

"Restricted" securities generally are securities acquired from the issuer or an "affiliate" of the issuer, such as an executive officer, director, or substantial shareholder who is in a control relationship with the issuer, in unregistered private placements, and "control" securities are securities (whether or not previously registered under the 1933 Act) held by affiliates of the issuer. An affiliate of an issuer is a person or entity that directly or indirectly controls, is controlled by, or is under common control, with the issuer.

In order to rely on Rule 144 for resales of restricted or control securities the following conditions must be met:

(i) There must be available adequate current public information with respect to the issuer. This condition is usually satisfied by any reporting issuer. Although Rule 144 does contain a provision under which a non-reporting issuer may satisfy this public information requirement, its parameters are not clear and it is unlikely that a non-reporting issuer could be certain that it is in compliance;

(ii) In the case of restricted securities, at least one year must elapse from the date on which the securities were acquired from the issuer or an affiliate of the issuer (or, if later, the date on which the full purchase price was paid to the issuer or selling affiliate) until the date of the Rule 144 resale;

(iii) The Rule 144 seller can sell no more than a specified amount of restricted and control securities in any rolling three-month period. Such amount is the greater of (a) 1% of the then outstanding shares or other units of the class of security being resold, or (b) an amount equal to the average weekly volume of trading in such security during a specified recent four-week period;

(iv) The securities may be resold only through ordinary unsolicited brokers' transactions or in transactions with a market maker. This condition generally requires that the resale take place on an exchange or in the OTC market; and

(v) If the amount of securities being sold under Rule 144 exceeds 500 shares or other units, or has an aggregate sales price of more than $10,000, a Form 144 must be filed with the SEC and the principal exchange on which the securities trade, disclosing certain information concerning the seller and the sale.

As the securities of a non-reporting issuer will not be publicly traded in the U.S. (unless they are traded in the pink sheets), the brokers' transaction requirement may effectively foreclose the possibility of relying on the Rule 144 safe harbor to resell securities of such issuer in the U.S. However, if a non-reporting issuer could satisfy the Rule 144 information requirement and such issuer's securities were listed on an offshore exchange, the securities could be freely sold under Rule 144 (without a legend) in a broker's transaction on the offshore exchange after a one-year holding period and subject to the volume limitations.[40] Selling security holders of foreign non-reporting issuers who cannot meet these conditions should rely on Rule 144A or Section 4(1½) as the appropriate exemptions for resales of restricted or control securities in the U.S.

Rule 144 resales by an affiliate (after the one-year holding period if the securities are restricted securities) will be subject to the volume limitations listed in (iii) above for as long as the holder remains an affiliate. However, after a two-year period, calculated as in (ii) above, a non-affiliate of the issuer who has been a non-affiliate for at least three months may resell restricted securities without complying with any of the other Rule 144 conditions. Non-affiliate purchasers of securities in a Rule 144 transaction receive nonrestricted securities. Thus, for resales of securities by non-affiliates it is appropriate to remove the restrictive legend on the securities. However, if the purchaser of Rule 144 securities is an affiliate of the issuer, such affiliate may only resell pursuant to a registration statement, Rule 144 or another applicable exemption from registration.

Accordingly, investors in an offshore fund might rather rely upon Rule 144A or Section 4(1½) as the appropriate exemptions for resales in the U.S. of securities purchased from an offshore fund. Offshore resales may be made pursuant to Regulation S. *See* Chapter 5.

[40] *See* Home Centers (DIY) Ltd., 1998 SEC No-Act. LEXIS 417 (March 17, 1998).

CHAPTER 5

SALES AND RESALES OF SECURITIES OF AN OFFSHORE FUND OUTSIDE THE UNITED STATES UNDER REGULATION S

Regulation S provides a safe harbor from 1933 Act registration for offshore securities transactions. As discussed in Chapter 1, the 1933 Act requires registration any time U.S. jurisdictional means are directly or indirectly used to offer or to sell a security. As the scope of U.S. jurisdiction is very broad, the registration requirements of the 1933 Act jurisdiction could be construed to apply to securities transactions even where there is only minimal contact with a U.S. person, such as a telephone call made as a part of a marketing effort.

Regulation S contains “issuer” and “resale” safe harbor provisions that, if complied with, afford assurances that a transaction will be deemed to have occurred outside U.S. jurisdiction and will not be subject to the securities registration requirement.

The Regulation S resale rules provide instant liquidity to U.S. investors in the securities of a foreign issuer. As discussed in Chapters 2 and 3, the securities acquired by U.S. investors in a private offering or Rule 144A transaction are restricted securities that may only be resold in the U.S. pursuant to an effective registration statement or an exemption from registration. Unless such securities are resold pursuant to Rule 144, only certain institutional or financially sophisticated U.S. investors may purchase the securities in a resale transaction. However, such securities may be resold *outside* the U.S. at any time pursuant to Regulation S without regard to the sophistication of the purchaser. The ability to sell securities offshore pursuant to Regulation S may reduce the pricing discount traditionally applicable to securities placed privately by reason of their illiquidity.

An important point concerning Regulation S is that it only applies to sales and resales outside of the U.S. Regulation S does not provide an exemption for resales back into the U.S., and a separate exemption from 1933 Act registration, such as Rule 144A, Section 4(1) or Rule 144, must be available for any resales made into the U.S.

Scope of Regulation S

The general statement of Regulation S, contained in Rule 901 under the 1933 Act, provides that any offer, offer to sell, sale, or offer to buy securities that occurs outside the U.S. is not subject to the registration provisions of the Securities Act.

Whether a transaction is outside the U.S. is determined by the facts and circumstances of that particular transaction. However, for a transaction to fall within the general statement both the offer and the sale must occur outside the U.S.

Rule 902 defines the terms used in Regulation S.

Rule 903, the "issuer safe harbor," provides a number of defined safe harbors from registration for offers and sales of securities by issuers, "distributors"[41] and their affiliates.

Rule 904, the "resale safe harbor," provides a safe harbor for resales of securities outside of the U.S. for offers or sales by any person other than those covered by Rule 903, and by affiliates of the issuer or a distributor who are affiliated to the issuer solely because they are its officers or directors.

Because the safe harbors of Rule 903 and Rule 904 are *non*-exclusive, it is possible to establish that, even though a given transaction does not fall within one of the safe harbors, it may nevertheless qualify for the Rule 901 general statement, or qualify for another exemption from registration.

Rule 905 provides that all equity securities placed offshore by domestic issuers under Regulation S are restricted securities within the meaning of Rule 144.

The ability of investors immediately to resell restricted securities outside the U.S. pursuant to Regulation S provides a significant source of liquidity for securities (particularly equity securities) of an offshore fund that are privately placed in the U.S. For example, securities of an offshore fund privately placed in the U.S. may be resold on or through the facilities of certain offshore exchanges without U.S. registration. Thus, securities that are part of the U.S. tranche of a global private placement may be resold through the same secondary market in which the securities that were originally sold outside the U.S. trade. This resale potential means that investors in the U.S. tranche of the global offering have essentially the same liquidity as offshore investors in those securities.

Effective April 27, 1998, the SEC adopted amendments to Regulation S with respect to offshore sales of equity securities by domestic issuers. As the amendments were primarily intended to curb abuses by U.S. domestic issuers involving resales into the U.S. of domestic equity securities sold offshore under Regulation S, the amendments generally do not have an impact on the private offerings of offshore funds. However, the amendments significantly impact foreign issuers that do not meet the definition of

[41] Regulation S defines "distributor" as any underwriter, dealer or other person who participates, pursuant to a contractual arrangement, in the distribution of securities offered or sold in reliance on Regulation S.

"foreign private" issuer because they are treated like domestic issuers for purposes of U.S. federal securities laws.

General Conditions Necessary to Use Either the Issuer or Resale Safe Harbor Under Regulation S

All transactions effected in reliance on the issuer safe harbor or the resale safe harbor are subject to the following two general conditions (the "General Conditions").

"Offshore Transaction" Condition. An offer or sale of securities pursuant to Regulation S must be made in an "offshore transaction", which is a transaction in which:

(i) the offer is not made to a person in the U.S.;[42] and

(ii) either:

(A) at the time the buy order is originated, the buyer is outside the U.S., or the seller and any person acting on its behalf reasonably believe that the buyer is outside the U.S.; or

(B) for purposes of:

(1) the *issuer* safe harbor (Rule 903), the transaction is executed on or through a physical trading floor of an established foreign securities exchange that is located outside the U.S.;[43] or

(2) the *resale* safe harbor (Rule 904), the transaction is executed on or through the facilities of a "designated offshore securities market"[44] and neither the seller nor any

---

[42] Offers and sales in the U.S. to certain U.S. fiduciaries acting with discretion for offshore investors are deemed to be offshore transactions. Offers and sales of securities specifically targeted at identifiable groups of U.S. citizens abroad, such as members of the U.S. armed forces, are not deemed to be made in offshore transactions.

[43] Some foreign securities exchanges, e.g., the London Stock Exchange, do not have or make significant use of a physical trading floor.

[44] Rule 902(b) defines "designated offshore securities market" to include the following:

(i) The Eurobond market, as regulated by the International Securities Market Association; the Alberta Stock Exchange; the Amsterdam Stock Exchange; the Australian Stock Exchange Limited; the Bermuda Stock Exchange; the Bourse de Bruxelles; the Copenhagen Stock Exchange; the European Association of Securities Dealers Automated Quotation; the Frankfurt Stock Exchange; the Helsinki Stock Exchange; The Stock Exchange of Hong Kong Limited; the Irish Stock Exchange; the Istanbul Stock Exchange; the Johannesburg Stock Exchange; the London Stock Exchange (including

person acting on its behalf knows that the transaction has been pre-arranged with a buyer in the U.S.

Condition that there be No "Directed Selling Efforts." The second General Condition applicable to both the issuer and resale safe harbors is that no "directed selling efforts" may be made in connection with an offer or sale of securities. Directed selling efforts are any activities undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the U.S. for any of the securities being offered in reliance upon Regulation S. The following activities are examples of directed selling efforts: mailing printed promotional materials to U.S. investors, conducting promotional seminars in the U.S., or placing advertisements with radio or television stations broadcasting in the U.S. or in "publications with a general circulation" in the U.S.[45]

For purposes of the issuer safe harbor, no directed selling efforts may be made by the issuer, a distributor, any of their respective affiliates, or any person acting on their behalf. For purposes of the resale safe harbor, this prohibition is limited to directed selling efforts by the seller, its affiliates, and any person acting on their behalf. Directed selling efforts by any other person will not affect the availability of the resale safe harbor.

Regulation S also enumerates specific activities that are deemed not to constitute directed selling efforts. These activities include the following: contacts with persons excluded from the definition of U.S. person;[46] certain advertisements required to be

---

SEAQ International); the Bourse de Luxembourg; the Mexico Stock Exchange; the Borsa Valori di Milano; the Montreal Stock Exchange; the Oslo Stock Exchange; the Bourse de Paris; the Stock Exchange of Singapore Ltd.; the Stockholm Stock Exchange; the Tel Aviv Stock Exchange; the Tokyo Stock Exchange; the Toronto Stock Exchange; the Vancouver Stock Exchange; the Warsaw Stock Exchange; and the Zurich Stock Exchange.

[45] A "publication with a general circulation" in the U.S. is defined as any publication that (i) is printed primarily for distribution in the U.S. or (ii) has had, during the preceding 12 months, an average circulation in the U.S. of 15,000 copies or more per issue. If a publication has a separate U.S. edition which meets such requirements, only the U.S. edition will be deemed to be a publication with a general circulation in the U.S.

[46] Under Regulation S, "U.S. person" means:

(i) any natural person resident in the U.S.;
(ii) any partnership or corporation organized or incorporated under the laws of the U.S.;
(iii) any estate of which any executor or administrator is a U.S. person;
(iv) any trust of which any trustee is a U.S. person;
(v) any agency or branch of a foreign entity located in the U.S.;
(vi) any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. person;
(vii) any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated, or (if an individual) resident in the U.S.; and

published under U.S. or foreign law;[47] certain tombstone advertisements in any publication with a general circulation in the U.S.;[48] bona fide visits to real estate, plants, or other facilities located in the U.S.; certain distributions in the U.S. of an offshore broker-dealer's quotations by a third-party system that distributes such quotations primarily in foreign countries; and notices, publications or press releases by an issuer in accordance with Rules 135 or 135c under the 1933 Act.[49] As discussed in Chapter 3

(viii) any partnership or corporation if it is:

(A) organized or incorporated under the laws of any foreign jurisdiction; and

(B) formed by a U.S. person principally for the purpose of investing in securities not registered under the 1933 Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501(a) of Regulation D) who are not natural persons, estates or trusts.

Additionally, the following are not "U.S. persons":

(i) Any discretionary account or similar account (other than an estate or trust) held for the benefit or account of a non-U.S. person by a dealer or other professional fiduciary organized, incorporated, or (if an individual) resident in the U.S.;

(ii) Any estate of which any professional fiduciary acting as executor or administrator is a U.S. person if:

(A) an executor or administrator of the estate who is not a U.S. person has sole or shared investment discretion with respect to the assets of the estate; and

(B) the estate is governed by foreign law;

(iii) Any trust of which any professional fiduciary acting as trustee is a U.S. person, if a trustee who is not a U.S. person has sole or shared investment discretion with respect to the trust assets, and no beneficiary of the trust (and no settler if the trust is revocable) is a U.S. person;

(iv) An employee benefit plan established and administered in accordance with the law of a country other than the U.S. and customary practices and documentation of such country;

(v) Any agency or branch of a U.S. person located outside the U.S. if:

(A) the agency or branch operates for valid business reasons; and

(B) the agency or branch is engaged in the business of insurance or banking and is subject to substantive insurance or banking regulation, respectively, in the jurisdiction where located; and

(vi) The International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies, affiliates and pension plans, and any other similar international organizations, their agencies, affiliates and pension plans.

[47] Advertisements "required to be published" by foreign or U.S. law or by a U.S. or foreign regulatory or self-regulatory authority will not be considered directed selling efforts provided that they contain no more information than is legally required and include a statement that the securities have not been registered under the 1933 Act and may not be offered or sold in the U.S. absent registration or an applicable exemption.

[48] Tombstone advertisements appearing in a publication with general circulation in the U.S. after the completion of the distribution and the applicable distribution compliance period will not constitute directed selling efforts.

[49] Rule 135 permits an issuer that proposes to make a public offering to publish a press release or notice without violating the prospectus delivery requirements of the 1933 Act, provided that the notice states that the offering will be made only by prospectus and states no more than the name of the issuer and

under "Publicity and Advertising," the SEC has adopted rules creating a safe harbor for certain offshore press conferences, offshore meetings with journalists and company representatives and press-related materials released offshore. Accordingly, press conferences, meetings and press releases that meet the conditions of Rule 135e will also not be deemed directed selling efforts. Legitimate selling efforts in the U.S. in connection with a U.S. private placement will generally not constitute directed selling efforts. Thus, offers or sales to U.S. persons made under an exemption from registration, particularly such as Rule 144A, are permitted in the initial offer and sale and during the distribution compliance period.

Regulation S Safe Harbors

Issuer Safe Harbor: Rule 903. The issuer safe harbor applies to offers and sales by issuers, distributors, their respective affiliates and persons acting on their behalf. The issuer safe harbor establishes three categories of securities offerings and applies a set of procedural safeguards to each category to assure that any securities offered or sold in reliance thereon will come to rest offshore.

In general, the restrictions under each category are least onerous for offerings by an issuer whose securities are least likely to flow into the U.S. following their distribution outside the U.S. ("Category 1"), and most restrictive for offerings by an issuer whose securities are likely to flow into the U.S. and about whom little information is publicly available in the U.S. ("Category 3"). "Category 2" encompasses offerings by issuers whose securities are also likely to flow into the U.S., but about whom sufficient information is deemed to be available. The majority of Regulation S offerings made by foreign private issuers will fall into either Category 1 or 2.

Category 1 Offerings. Category 1, effectively imposes no additional conditions on the offering aside from the General Conditions.

Category 1 is available for an offer or sale of securities if:

(i) The issuer is a foreign issuer[50] that reasonably believes at the commencement of the offering that there is no "substantial U.S. market interest" (defined below) in:

---

the purpose and basic terms of the offering (without naming the underwriters). *See* Chapter 3 under "Publicity and Advertising" for a discussion of Rule 135c.

[50] The first question is whether the issuer qualifies as a "foreign issuer." An issuer is not a foreign issuer if more than 50 percent of its outstanding voting securities are held of record by residents of the U.S. and any of the following factors is present: (i) the majority of the executive officers or directors are U.S. citizens or residents, (ii) more than 50 percent of the assts of the issuer are located in the U.S., or (iii) the business of the issuer is administered principally in the U.S. If a foreign-incorporated issuer is not a "foreign issuer" for Regulation S purposes, offers and sales if its securities will not qualify for Category 1

(A) the class of securities to be offered or sold (if equity securities are offered or sold);

(B) its debt securities (if debt securities are offered or sold);

(C) the securities to be purchased upon exercise (if warrants are offered or sold); and

(D) either the convertible securities or the underlying securities (if convertible securities are offered or sold); or

(ii) The securities are offered and sold in an "overseas directed offering;"[51] or

(iii) The securities are backed by the full faith and credit of a foreign government; or

(iv) The securities are offered and sold to employees of the issuer or its affiliates under an employee benefit plan established and administered in accordance with the law of a country other than the U.S. and customary practices and documentation of such country, subject to certain further conditions.

"Substantial U.S. market interest" is known in the trade as "SUSMI." With respect to a class of an issuer's equity securities, SUSMI means either: (i) the U.S. market for such security (which includes securities exchanges and inter-dealer quotation systems such as NASDAQ) in the aggregate was the single largest market for such class of securities in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation; or (ii) 20% or more of all trading in such class of securities took place through the facilities of securities exchanges and inter-dealer quotation systems in the U.S. and less than 55% of such trading took place in, on or through the facilities of securities markets of a single foreign country in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation.

---

and generally will need to comply with Category 3 procedures as a "U.S. Issuer" which does not file periodic reports with the Commission under the Exchange Act.

[51] "An overseas directed offering" includes two classes of securities offerings: (i) offerings of securities of a foreign issuer directed to residents of a single country other than the U.S. and made in accordance with local laws and customary practices and documentation of that country; and (ii) offerings of non-convertible debt securities, asset-backed securities and non-participating preferred stock of domestic issuers directed to residents of a single foreign country, provided the principal and interest of the securities are denominated in a currency other than U.S. dollars and such securities are neither convertible into U.S. dollar-denominated securities nor linked to U.S. dollars (other than through related currency or interest rate swap transactions that are commercial in nature) in a manner effectively converting the securities to U.S. dollar-denominated securities.

SUSMI with respect to an issuer's debt securities means: (i) its debt securities are "held of record" by 300 or more U.S. persons; and (ii) $1 billion or more of the principal amount of its debt securities, the greater of liquidation or par value of its non-participating preferred stock, and the principal amount of its asset-backed securities, in the aggregate, is held of record by U.S. persons; and (iii) 20% or more of the principal amount of its debt securities, the greater of liquidation preference or par value of its non-participating preferred stock, and the principal amount of its asset-backed securities, in the aggregate, is held of record by U.S. persons. For purposes of the calculation of principal amount, securities issued under the exemption provided by Section 3(a)(3) of the 1933 Act, principally certain offerings of commercial paper, are not counted.

Category 2 Offerings. The Category 2 safe harbor covers securities that are not eligible for Category 1 and that are equity securities of a foreign reporting issuer, or are debt securities of a reporting issuer (domestic or foreign) or of a foreign non-reporting issuer.

Securities that fall into Category 2 are subject to the General Conditions as well as the following additional conditions.

Category 2 is available if:

(i) Offering restrictions (defined below) are implemented;

(ii) The offer or sale, if made prior to the expiration of the 40-day "distribution compliance period" (discussed below), is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and

(iii) Each distributor selling securities to a distributor, a dealer or a person receiving a selling concession, fee or other remuneration in respect of the securities sold, prior to the expiration of the 40-day distribution compliance period, sends a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to a distributor.

The "distribution compliance period" for securities falling under Category 2 or 3 generally commences at the later of closing on the date the securities are first offered to persons other than distributors in reliance upon Regulation S. All offers and sales by a distributor of an unsold allotment are deemed to be made during the distribution compliance period. For a continuous offering of securities, subject to two exceptions, the

distribution compliance period commences upon completion of the distribution as certified by the lead manager.[52]

As used in Regulation S, for foreign issuers, "offering restrictions" means:

(iv) Each distributor agrees in writing that all offers and sales of the securities prior to the expiration of the distribution compliance period specified in Category 2 or 3, as applicable, shall be made only in accordance with the provisions of the issuer or resale safe harbor, pursuant to a registration statement filed under the 1933 Act or pursuant to an available exemption from the 1933 Act registration; and

(v) All offering materials and documents (other than press releases) used in connection with offers and sales of the securities prior to the expiration of the distribution compliance period specified in Category 2 or 3, as applicable, shall include statements to the effect that the securities have not been registered under the 1933 Act and may not be offered or sold in the U.S. or to U.S. persons (other than distributors) unless the securities are registered under the 1933 Act, or an exemption from 1933 Act registration is available. Such statements shall appear:

(A) on the cover or inside cover page of any prospectus or offering circular used in connection with the offer or sale of the securities;

(B) in the underwriting section of any prospectus or offering circular used in connection with the offer or sale of the securities; and

(C) in any advertisement made or issued by the issuer, any distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing. Such statements may appear in summary form on prospectus cover pages and in advertisements.

Category 3 Offerings. Category 3 encompasses all offerings not covered by Categories 1 and 2. Included in Category 3 are equity securities of any domestic issuers (reporting or non-reporting) and equity securities of foreign non-reporting issuers of a class for which there is SUSMI. Very few, if any, offerings by a foreign private issuer will fall into Category 3.

---

[52] In a continuous offering of securities to be acquired upon the exercise of warrants, the distribution compliance period commences upon completion of the distribution of the warrants, as determined and certified by the managing underwriter or person performing similar functions, subject to certain legending and certification requirements. In a continuous offering of non-convertible debt securities offered and sold in identifiable tranches, the distribution compliance period for each identifiable tranche of non-convertible debt securities being offered continuously commences upon completion of the distribution of the tranche as certified by the lead manager.

Category 3 is available for foreign issuers provided that:

(i) Offering restrictions (as defined above) are implemented; and

(ii) For debt securities:

(A) the offer or sale, if made prior to the expiration of a 40-day distribution compliance period, is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and

(B) the securities are represented upon issuance by a temporary global security which is not exchangeable for definitive securities until the expiration of the 40-day distribution compliance period and, for persons other than distributors, until certification of beneficial ownership of the securities by a non-U.S. person or a U.S. person who purchased securities in a transaction that did not require registration under the 1933 Act; or

(iii) For equity securities:

(A) the offer or sale, if made prior to the expiration of a one-year distribution compliance period, is not made to a U.S. person or for the account or benefit of a U.S. person (other than a distributor); and

(B) the offer or sale, if made prior to the expiration of a one-year distribution compliance period, is made under the following conditions:

(1) the purchaser of the securities (other than a distributor) certifies that it is not a U.S. person and is not acquiring the securities for the account or benefit of any U.S. person or is a U.S. person who purchased securities in a transaction that did not require registration under the 1933 Act;

(2) the purchaser of the securities agrees to resell such securities only in accordance with the provisions of Regulation S, under registration under the 1933 Act, or under an available exemption from registration, and agrees not to engage in hedging transactions with regard to such securities unless in compliance with the 1933 Act;

(3) the issuer is required, either by contract or a provision in its bylaws, articles, charter or comparable document, to refuse

to register any transfer of the securities not made in accordance with the provisions of Regulation S, under registration under the 1933 Act, or pursuant to an available exemption from registration; provided that if the securities are in bearer form or foreign law prevents the issuer of the securities from refusing to register securities transfers, other reasonable procedures (such as a legend) are implemented to prevent any transfer of the securities not made in accordance with the provisions of Regulation S; and

(iv) Each distributor selling securities to a distributor, a dealer or a person receiving a selling concession, fee or other remuneration, prior to the expiration of a 40-day distribution compliance period for debt securities or a one-year distribution compliance period for equity securities, sends a confirmation or other notice to the purchaser stating that the purchaser is subject to the same restrictions on offers and sales that apply to a distributor.

Note that Category 1 securities are not subject to the distribution compliance period.[53] However, any U.S. dealer selling securities issued pursuant to one of the Regulation S issuer safe harbors is subject to the dealer restrictions of Section 4(3)(A) of the 1933 Act, the exemption from 1933 Act registration for transactions by dealers. Section 4(3)(A) generally prohibits a dealer from trading in a security prior to the expiration of 40 days after the first day on which a security was offered to the public, except under an exemption from registration under the 1933 Act, such as Rule 144A. As a result, dealers, whether or not participating in the offshore offering, may violate the 1933 Act if they resell securities issued pursuant to the issuer safe harbor into the U.S. within 40 days after the offshore offer, unless such resales are made pursuant to Rule 144A.

Offers or sales of warrants under Category 2 or 3 must also comply with the following requirements:

(i) Each warrant must bear a legend stating that the warrant and the securities to be issued upon its exercise have not been registered under the 1933 Act and that the warrant may not be exercised by or on behalf of any U.S.

[53] In a continuous offering of securities to be acquired upon the exercise of warrants, the distribution compliance period commences upon completion of the distribution of the warrants, as determined and certified by the managing underwriter or person performing similar functions, subject to certain legending and certification requirements. In a continuous offering of non-convertible debt securities offered and sold in identifiable tranches, the distribution compliance period for each identifiable tranche of non-convertible debt securities being offered continuously commences upon completion of the distribution of the tranche as certified by the lead manager.

person unless registered under the 1933 Act or an exemption from registration is available;

(ii) Each person exercising a warrant is required to give:

(A) written certification that it is not a U.S. person and the warrant is not being exercised on behalf of a U.S. person; or

(B) a written opinion of counsel to the effect that the warrant and the securities delivered upon its exercise have been registered under the 1933 Act or are exempt from registration; and

(iii) Procedures are implemented to ensure that the warrant may not be exercised within the U.S., and that the securities may not be delivered within the U.S. upon exercise, other than in offerings deemed to meet the definition of "offshore transaction," unless registered under the 1933 Act or an exemption from registration is available.

It is important to note that the distribution compliance periods for Categories 2 and 3 are limitations on the Regulation S exemption; their expiration does not mean that the investor is then free to sell into the U.S. Rather, a separate exemption, such as Section 4(1), must be found for the U.S. resale.

Resale Safe Harbor: Rule 904. The resale safe harbor of Regulation S is available for offers and sales of securities by any person other than an issuer, a distributor, any of their respective affiliates (except any officer or director who is an affiliate solely by virtue of holding such position) or any person acting on behalf of any of the foregoing. In the case of sales by permitted affiliates, no selling concession, fee or other remuneration may be paid in connection with the offer other than the usual broker's commission.

The resale safe harbor is available for offshore resales of any securities (since there are no categories as under the issuer safe harbor) but does not cover resales back into the U.S. Thus, the resale safe harbor is available whether or not the securities were acquired in an offshore transaction and may be relied upon for offshore resales of restricted securities acquired in a private placement under Section 4(2), Regulation D or Rule 144A. Restricted securities that are equity securities of a domestic issuer will, however, under Rule 905, continue to be restricted notwithstanding their resale offshore pursuant to Regulation S and should be legended accordingly.

Transactions made in accordance with the resale safe harbor are subject to the two General Conditions discussed above, so that the offers and sales must be made in "offshore transactions" with no "directed selling efforts." In addition, for an offer or sale of securities prior to the expiration of the applicable distribution compliance period, if

any, by a dealer or a person receiving a selling concession, fee or other remuneration in respect of the securities offered or sold, the following two conditions must be met:

(i) Neither the seller nor any person acting on his behalf knows that the offeree or buyer of the securities is a U.S. person; and

(ii) If the seller or any person acting on the seller's behalf knows that the purchaser is a dealer, or is a person receiving a selling concession, fee or other remuneration in respect of the securities sold, the seller or a person acting on the seller's behalf sends to the purchaser a confirmation or other notice stating that the securities may be offered and sold during the distribution compliance period only in accordance with the provisions of Regulation S, pursuant to registration of the securities under the 1933 Act, or pursuant to an available exemption from registration. Persons other than dealers and persons receiving a selling concession, fee or other remuneration are subject only to the General Conditions.

Interaction of Regulation S with Rule 144A

The SEC adopted Regulation S concurrently with Rule 144A and, as anticipated by the SEC, Rule 144A and Regulation S are often used in tandem. The Regulation S safe harbor allows QIBs to immediately resell Rule 144A securities on certain designated offshore securities markets. In addition, securities purchased offshore in reliance upon Regulation S may be resold offshore and in the U.S. in reliance upon Rule 144A, increasing an investor's liquidity in such securities. Note also that Rule 144A increases the liquidity to offshore purchasers of Category 2 or 3 securities, despite the fact that such securities are otherwise subject to distribution compliance periods. If the offshore person making a resale of a Category 2 or 3 security meets the conditions of Rule 144A, such securities may be resold to U.S. QIBs before the expiration of the distribution compliance periods.

CHAPTER 6

BLUE SKY, BROKER-DEALER AND INVESTMENT ADVISER COMPLIANCE

Exemptions from Registration of the Securities of an Offshore Fund Under Blue Sky Laws and State Law Broker-Dealer Compliance

Introduction. As a general matter, the securities laws of the various states of the U.S., referred to in practice as "Blue Sky" laws, do not contain a regulatory structure that parallels the fund registration requirement under the 1940 Act. Thus, an offshore fund sponsor need not undertake any Blue Sky compliance measures to address regulation by states that would essentially duplicate the (federal) fund registration requirement.

However, a private placement by an offshore fund must conform not only to the exemptions from the federal securities registration requirement but must also comply with (or be exempt from) the securities registration requirements of the applicable Blue Sky laws. Accordingly, an offshore fund sponsor must qualify for a state law exemption from registration for any offer or sale of a security made to each investor in each state in which securities are sold or else register the securities in that state.

In the past, compliance with Blue Sky laws was burdensome. State legislation lacked uniformity and thus was costly for issuers. Although Blue Sky practice remains complicated, there are currently two exemptions from state securities registration requirements that are uniformly applicable to private placements by offshore funds: (i) the institutional investor exemption and (ii) the exemption provided under NSMIA. *See* Chapter 3 under "Rule 506 and Blue Sky Requirements." The significant distinction between the two exemptions concerns state regulation of offers or sales to non-institutional purchasers who are accredited investors under Regulation D. *See* Chapter 3 under "The Regulation D Exemptions from the Securities Registration Requirement."

In addition, fund sponsors should be aware of issues pertaining to federal and state broker-dealer and investment adviser compliance. There may also be state law issues for a fund that uses instruments involving futures contracts or commodities options.

The Institutional Investor Exemption from Blue Sky Registration. The securities laws of each state provide for an exemption from state securities registration for both sales and resales of securities to specified types of institutional investors. The institutional investor exemption in most states is self-executing, which means that no compliance measures, such as filings or fee payments, are needed to qualify for the exemption. Thus, if the investor to which the offshore fund is making an offer or sale

qualifies as an "institutional investor," as defined in that state's Blue Sky statute, the offshore fund is not required to pay any fees to, nor make filings with, the state securities regulators except for (where required) the filing of a Form U-2, the Uniform Consent to Service of Process.[54]

The breadth of the institutional investor exemption, however, varies from state to state. Generally, the exemption will cover any offer or sale of the fund's securities to a bank, savings institution, trust company, insurance company, registered investment company, pension or profit-sharing trust, "other financial institution or institutional buyer," or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity. Despite certain similarities between these institutions and "accredited investors" as defined in Regulation D, it should be noted that individuals, regardless of financial sophistication or assets held, are not covered by the exemption. The institutional investor exemptions for the states in which a majority of institutional investors are located are summarized below.

The Exemption from Blue Sky Registration Provided Under NSMIA. The second uniform exemption from Blue Sky registration is provided by Section 18 of the 1933 Act, which was added by NSMIA. Section 18 preempts the authority of the states to require qualification and review of offerings of "covered securities," which term includes, among other things, securities offered and sold under Rule 506 of Regulation D. As a result, offshore fund sponsors should ensure that their offers and sales comply with the requirements of Rule 506 so that the securities will have "covered security" status. Although Rule 506 is a non-exclusive exemption, offshore fund sponsors should note that reliance upon Section 4(2) of the 1933 Act alone will not result in a security qualifying as a covered security under NSMIA.

As discussed in Chapter 3, Rule 506 provides a safe harbor under federal securities laws for offers and sales of securities without regard to the dollar amount of the offering, and is always available for offshore fund sponsors who wish to make a private placement of securities in the U.S. Under NSMIA, if a U.S. private placement qualifies for the Rule 506 exemption from the securities registration requirement, each state may only require the following: (i) a notice filing on federal Form D[55] (which the fund will already be required to file for its federal exemption); (ii) the payment of filing fees, the amount of which depends on the state of filing as well as the size of the offering, and (iii) the filing of Form U-2. In reaction to the enactment of NSMIA, virtually every state has

---

[54] Form U-2 is a three page form, used in all states, that designates a state's Secretary of State or securities commissioner as the offshore fund's agent for service of process. Form U-2 must be manually signed by a person authorized to sign for the fund and must be notarized.

[55] New York State also requires the filing of a Notification Filing on Form 99 for Covered Securities under NSMIA ("Form 99"). Form 99 is substantially similar to the federal Form D, although Form 99 requires more information than Form D such as some biographical information concerning the fund's officers and directors and, in certain instances, disclosure regarding prior securities offerings.

adopted laws or regulations that provide for compliance through the filing of a federal Form D and the payment of a filing fee. Under Section 18, each state retains jurisdiction to investigate and prosecute fraud in connection with securities offerings.

Issuers should be aware that certain state statues may contain "bad boy" disqualification provisions that may preclude the issuer from selling securities in the state if the issuer or any of its officers or directors have been found to have violated specified laws. These disqualification provisions are also contemplated by the state section of Form D. The issuer should always discuss any securities law violations or pending proceedings with counsel handling the Blue Sky compliance for the offering.

Issuers also should note that other Blue Sky exemptions from registration may be available on a state-by-state basis but should be used only as a last resort, as the exemptions are not uniformly provided for in state statutes. Each state generally has one or more limited offering exemptions applicable to offers and sales made to a limited number of persons in the state during a specified period. Some states also have an isolated transaction exemption available when sales are made to only one or two persons in a particular state over a specified period of time.

Resales under Blue Sky Laws. The institutional investor exemption will typically apply to resales that qualify under Rule 144A. However, the NSMIA exemption does not extend to resale transactions under the Section 4(1½) exemption. Accordingly, resales to non-institutional accredited investors should be examined for Blue Sky compliance.

State Broker-Dealer Compliance. NSMIA does not preempt state regulation of broker-dealers as such regulations apply to the fund or to a fund's broker-dealer. Thus, notwithstanding that the institutional and NSMIA exemptions from the state securities registration requirements may be available under state law, the offshore fund sponsor still must comply with each state's laws applicable to the registration of broker-dealers.

In general, (i) the offshore fund may make the offer and sale through its officers or directors as most states have an issuer exemption from broker-dealer registration; (ii) the offshore fund sponsor may effect the sale through a broker-dealer registered in that state; or (iii) an unregistered broker-dealer must qualify for an exemption from broker-dealer registration that many states provide for offers or sales made to institutional investors.

Most states also exclude from the definition of "broker-dealer" and "agent" the employees of an issuer that sell the issuer's securities when the employee effects an exempt transaction under that state's Blue Sky law. Nevertheless, the determination whether an employee of a fund must register as an agent is often relatively complex, and U.S. counsel should be consulted if the issuer is contemplating making sales of its own securities. *See* also the discussion of regulation of broker-dealers by individual states under "Summary of Certain Blue Sky Statutes" below.

Blue Sky Compliance Strategy. Given the availability of the institutional investor and NSMIA exemptions, if an offshore fund sponsor (or purchaser of its securities) makes an offer, sale or resale of securities in a particular state only to institutional investors (as that term is defined in the relevant state's Blue Sky statute), then the institutional investor exemption is available and the sponsor or person or entity making such sale or resale need only file a Form U-2, if required. No other filings or fees generally are required to be submitted to the state securities regulators in connection with the offer, sale or resale. Also, if a holder of restricted securities is making a resale of the securities to a QIB under Rule 144A, the resale will typically fall within that state's institutional investor exemption.

If offers or sales are being made to individual accredited investors or non-accredited investors (Regulation D limits offers or sales to non-accredited investors to 35 persons) then the offshore fund sponsor or person making the offer or sale must use the exemption provided under NSMIA and should: (i) make a notice filing by submitting a photocopy of the federal Form D or other notification form, if applicable, with the appropriate state regulator; (ii) pay the appropriate fee, if required, after consulting the state statute as to whether the amount of the fee applies to the total amount of the offering or only the percentage amount of the securities sold in that state; and (iii) file the Form U-2, if required, with the state authority listed on pages 1 and 2 of the Form U-2.[56]

If an offshore fund sponsor should offer and sell securities to an individual accredited or non-accredited investor in reliance on a federal exemption other than Rule 506 (such as Rule 504 or 505 under Regulation D or Section 4(2)), then the exemption under NSMIA is not available, and the fund must either find another state exemption from registration or register the securities in that state.[57] Accordingly, an offshore fund that is not a reporting issuer should always seek to structure the offering under the exemption provided by Rule 506 to minimize Blue Sky compliance requirements.

If the offer, sale or resale in a particular state is being made only to institutional investors, and the state's Blue Sky statute contains an exemption from the broker-dealer registration requirement for offers or sales made to institutional investors, then the offshore fund sponsor, person making the resale, or a broker-dealer (some statutes require that the broker-dealer be registered under the 1934 Act) may make the sale directly to the U.S. institutional investor regardless of whether the sponsor or person making the resale

[56] The fund need only file a Form U-2 if a Form U-2 is not already on file with the state regulator. If the sponsor has previously filed a Form U-2, the cover letter for the notice filing should state that the fund already has a consent to service of process on file.

[57] The SEC has proposed (Release No. 33-8041) (Dec. 19, 2001) expanding NSMIA preemption of state Blue Sky laws. Under the proposed rule, offers to all "accredited investors" would be subject only to federal regulation. This would have the effect of bringing Rule 504 and Rule 505 offerings within NSMIA to the extent of sales to accredited investors.

is a registered broker-dealer in that state. The state's statute should, nevertheless, be consulted as to the laws applicable to an agent's registration.

If there is no applicable broker-dealer exemption, then the sale must be effected by the sponsor or through a broker-dealer registered in the state in which the offer or sale is made. Form D requires the fund to name the person or entity that will receive a commission in connection with the U.S. private placement, and state securities regulators routinely match the name of the person or entity stated in Form D to their state's list of registered broker-dealers. If the person or entity listed is not registered in that state, the state will often make an inquiry regarding broker-dealer and agent compliance.

Summary of Certain Blue Sky Statutes

The following summary sets forth and discusses the private placement provisions of Blue Sky laws of several states in which a significant percentage of private placement offers, sales and resales are made. The Blue Sky statute of the individual state in question should always be consulted prior to taking any action.

California. The text of the relevant California Blue Sky statute relating to institutional investors provides, in pertinent part, that the California registration provisions shall not apply to the following transactions:

> Any offer or sale (1) to a bank, savings and loan association, trust company, insurance company, investment company registered under the Investment Company Act of 1940, pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account), or other institutional investor or governmental agency or instrumentality that the [securities] commissioner may designate by rule, whether the purchaser is acting for itself or as trustee, or (2) to any corporation [that is a Reporting Issuer] or any wholly owned subsidiary of the corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer, provided the purchaser represents that it is purchasing for its own account (or for the trust account) for investment and not with a view to or for sale in connection with any distribution of the security.[58]

If the broker-dealer is registered under the 1934 Act, a broker-dealer exemption is available for sales made under the institutional investor exemption if the broker-dealer has no place of business in California and directs no offers to sell or buy securities to California other than to certain institutions.[59] A fund sponsor and its employees

---

[58] CAL. CORP. CODE §25102(i) (2002), CCH Blue Sky L. Rep ¶ 11,133 (2002).

[59] CAL. CORP. CODE § 25200 (2002), CCH Blue Sky L. Rep. ¶ 11,201 (2002).

(including officers and directors) who offer or sell securities of the issuer are exempt from broker-dealer and agent registration if the employees are effecting transactions that are exempt under the institutional investor or NSMIA exemptions.[60] No fees are payable if a NSMIA notice filing is required. A Form U-2 filing is required.

Connecticut. The text of the relevant Connecticut Blue Sky statute relating to institutional investors provides, in pertinent part, that the Connecticut registration provisions shall not apply to the following transactions:

> [A]ny offer or sale to a bank and trust company, a national banking association, a savings bank, a savings and loan association, a federal savings and loan association, a credit union, a federal credit union, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity.[61]

A broker-dealer exemption is available for sales made under the institutional investor exemption.[62] An offshore fund sponsor and its employees (including officers and directors) who offer or sell securities of the fund are exempt from broker-dealer and agent registration if the employees are effecting transactions that are exempt under the institutional investor or NSMIA exemptions.[63] If a NSMIA notice filing is required, the filing fee is $150 regardless of the amount of securities offered or sold. A Form U-2 filing is required.

Florida. The text of the relevant Florida Blue Sky statute relating to institutional investors provides, in pertinent part, that the Florida registration provisions shall not apply to the following transactions:

> The offer or sale of securities to a bank, or trust company, savings institution, insurance company, dealer, investment company as defined by the Investment Company Act of 1940, or pension or profit-sharing trust, or qualified institutional buyer as defined by rule of the department in accordance with [Rule 144A], whether any of such entities is acting in its individual or fiduciary capacity; provided that such offer or sale of securities is not for the direct or indirect promotion of any scheme or enterprise with the intent of violating or evading any provision of [the

[60] CAL. CORP. CODE § 25200 (2002), CCH Blue Sky L. Rep. ¶ 11,201 (2002); CAL. CORP. CODE § 25003 (2002), CCH Blue Sky L. Rep. ¶ 11,106 (2002).

[61] CONN. GEN. STAT. § 36b-21(b)(9) (2002), CCH Blue Sky L. Rep. ¶ 14,120 (2002).

[62] CONN. GEN. STAT. § 36b-3(5)(d) (2002), CCH Blue Sky L. Rep. ¶ 14,102 (2002).

[63] CONN. GEN. STAT. § 36b-3(5)(d) (2002), CCH Blue Sky L. Rep. ¶ 14,102 (2002); CONN. GEN. STAT. § 36b-3(1) (2002), CCH Blue Sky L. Rep. ¶ 14,102 (2002).

> Florida Blue Sky law]… The sale of securities from one corporation to another corporation provided that: (a) The sale price of the securities is $50,000 or more; and (b) The buyer and seller corporations each have assets of $500,000 or more.[64]

No filing fees or filings are required if either the institutional investor or NSMIA exemption applies. Thus, if a private placement qualifies for either the institutional investor exemption the exemption under NSMIA, no further action is necessary for offers or sales made to Florida residents.[65] This applies even if the offerees are individual accredited investors.

A broker-dealer exemption is available for sales made under the institutional investor and Florida limited offering exemption but not for the NSMIA exemption.[66] A fund and its employees are exempt from broker-dealer and agent registration requirements if the employees (including the sponsor's officers and directors) are effecting transactions that are exempt under the Florida limited offering exemption as long as the fund or the employees have not participated in the distribution or sale of any securities within the preceding 12 months and primarily perform duties for the fund other than marketing the fund's securities.[67] Florida takes the position that, if a fund wishes to use the NSMIA exemption instead of the Florida institutional investor or limited offering exemptions, then the fund and/or the sponsor will need to register in Florida as dealers.

Illinois. The text of the relevant Illinois Blue Sky statute relating to institutional investors provides, in pertinent part, that the Illinois registration provisions shall not apply to the following transactions:

> [A]ny offer, sale or issuance of securities to any corporation, bank, savings bank, savings institution, savings and loan association, trust company, insurance company, building and loan association, or dealer; to a pension fund, pension trust, or employees' profitsharing trust, other financial institution or institutional investor, any government or political subdivision or instrumentality thereof, whether the purchaser is acting for itself or in some fiduciary capacity; to any partnership or other association engaged as a substantial part of its business or operations in purchasing or holding securities; to any trust in respect of which a bank or trust company is trustee or co-trustee; to any entity in which at least [90%] of the equity is owned by persons [who are institutional investors, individual accredited investors, or officers or investors of the offshore fund issuer]; to any

[64] FL. STAT. ANN. §517.061(7), (8) (2002), CCH Blue Sky L. Rep. ¶ 17, 106 (2002).

[65] FL. STAT. ANN. §517.12(3) (2002), CCH Blue Sky L. Rep. ¶ 17,111 (2002).

[66] FL. STAT. ANN. §517.12(3) (2002), CCH Blue Sky L. Rep. ¶ 17, 111 (2002).

[67] FL. STAT. ANN. §517.021(6)(b)(6) (2002), CCH Blue Sky L. Rep. ¶ 17,102 (2002).

> employee benefit plan [under ERISA] if (i) the investment decision is made by a plan fiduciary… and such plan fiduciary is either a bank, savings and loan association, insurance company [or] registered investment adviser or an investment adviser registered under the [Advisers Act], or (ii) the plan has total assets in excess of $5,000,000, or (iii) in the case of a self-directed plan, investment decisions are made solely by persons [who are institutional investors, individual accredited investors, or officers or investors of the offshore fund issuer]; to any plan established and maintained by, and for the benefit of employees of, any state or political subdivision or agency or instrumentality thereof if such plan has total assets in excess of $5,000,000; or to any organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, any Massachusetts or similar business trust, or any partnership, if such organization, trust, or partnership has total assets in excess of $5,000,000.[68]

A broker-dealer exemption is available for sales made under the institutional investor exemption and the exemption under NSMIA.[69] An issuer and its employees (including its officers or directors) who offer or sell securities of the issuer are exempt from broker-dealer and agent registration if the employees are effecting transactions that are exempt under the institutional investor or NSMIA exemptions.[70] If a NSMIA notice filing is required, the filing fee is $100. No Form U-2 filing is required:

Massachusetts. The relevant Massachusetts Blue Sky statute relating to institutional investors provides, in pertinent part, that the Massachusetts registration provisions shall not apply to the following transactions:

> [A]ny offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profitsharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity.[71]

A broker-dealer exemption is available for sales made under the institutional investor exemption if such person has no place of business in Massachusetts.[72] An issuer and its employees (including the officers and directors of the issuer) who offer or sell

[68] 4 ILL. COMP. STAT. §4[5/4](C) (2002), CCH Blue Sky L. Rep. ¶ 22,123 (2002).

[69] 4 ILL. COMP. STAT. §8[5/8](A)(2002), CCH Blue Sky L. Rep. ¶ 22,127 (2002).

[70] 4 ILL. COMP. STAT. §8[5/8](A) (2002), CCH Blue Sky L. Rep. ¶ 22,127 (2002); 4 ILL. COMP. STAT. §2.9[5/2.9] (1997), CCH Blue Sky L. Rep. ¶ 22,111 (2002).

[71] MASS. GEN. LAWS Ch. 110A §402(b)(8) (2002), CCH Blue Sky L. Rep. ¶ 31,132(b)(8) (2002).

[72] MASS. GEN. LAWS Ch. 110A §401(c)(4)(iii) (2002), CCH Blue Sky L. Rep. ¶ 31,131 (2002).

securities of the issuer are exempt from agent registration if the employees are effecting transactions that are exempt under the institutional investor or NSMIA exemptions; however, Massachusetts provides no broker-dealer exemptions for sales made under the NSMIA exemption.[73] If a NSMIA notice filing is required, the filing fees range from $250 to $750, depending on the total amount of the offering. A Form U-2 filing is required.

New Jersey. The text of the relevant New Jersey Blue Sky statute relating to institutional investors provides, in pertinent part, that the New Jersey registration provisions shall not apply to the following transactions:

> Any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity.[74]

A broker-dealer exemption is available for sales made under the institutional investor exemption.[75] An issuer and its employees who offer or sell securities of the issuer are exempt from agent registration if such employees are effecting transactions that are exempt under the institutional investor or NSMIA exemptions.[76] An issuer is exempt from broker-dealer registration so long as the issuer has not effected more than 15 transactions with individual accredited investors during any consecutive 12-month period.[77] If a NSMIA notice filing is required, the filing fee is $250 regardless of the amount of the offering. A Form U-2 filing is required.

New York. In New York, offshore fund sponsors should be concerned primarily with the “dealer” registration requirements (also known as “issuer-dealer” registration). The text of the relevant New York Blue Sky statute relating to institutional investors provides in pertinent part that:

> No person, firm, association or corporation shall be deemed to be a “dealer” … solely by reason of selling or offering for sale any security or securities to any bank, corporation, savings institution, trust company, insurance company, investment company, as defined in the [1940 Act], pension or profit-sharing trust, or other financial institution or institutional buyer, whether the purchaser is acting for himself or itself or in some

---

[73] MASS. GEN. LAWS Ch. 110A §401(b) (2002), CCH Blue Sky L. Rep. ¶ 31,131 (2002).

[74] N.J. STAT. ANN. §49:3-50(b)(8) (2002), CCH Blue Sky L. Rep. ¶ 40,104 (2002).

[75] N.J. STAT. ANN. §49:3-49(c)(5)(iii) (2002), CCH Blue Sky L. Rep. ¶ 40,103 (2002).

[76] N.J. STAT. ANN. §49:3-49(b)(2) (2002), CCH Blue Sky L. Rep. ¶ 40,103 (2002).

[77] N.J. STAT. ANN. §49:3-56(b) (2002), CCH Blue Sky L. Rep. ¶ 40,121 (2002).

> fiduciary capacity, as part of a private placement of securities… A "bank" shall mean and include a state or national bank, trust company or savings institution incorporated under the laws and subject to the examination, supervision and control of any state or of the United States or of any insular possession thereof.[78]

The institutional investor exemption is self-executing. If the offshore fund sponsor offers or sells securities to any accredited investors, the offshore fund sponsor should make a NSMIA notice filing on Form 99 in addition to Form D. An offshore fund sponsor must also file an additional notice called a State Notice and Further State Notice for each class of securities being sold, as well as a Form U-2, with the New York State Department of State. An issuer and its employees (including its officers and directors) are exempt from registration requirements for both the institutional and NSMIA exemptions.

However, New York does not exempt broker-dealers and their employees from broker-dealer and salesperson registration requirements for offers or sales made under either the institutional investor or NSMIA exemption. Accordingly, if a broker-dealer effects the offer or sale to New York residents, the broker-dealer must be registered in New York.

The filing fee is $800 if more than $500,000 in securities are offered or sold to New York resident investors under Rule 506 and $200 if less than $500,000 in securities are offered or sold to New York resident investors. The issuer must also pay $150 per share class for the State Notice and Further State Notice (combined), and $35 for the filing of the Form U-2. Due to the relative complexity of New York Blue Sky laws, sponsors should consult New York counsel prior to making offers or sales of securities to New York resident investors.

Pennsylvania. The text of the relevant Blue Sky statute relating to institutional investors provides in pertinent part that the Pennsylvania registration provisions shall not apply to "[a]ny offer or sale to an institutional investor or to a broker-dealer, whether the buyer is acting for itself or in some fiduciary capacity."[79]

If the broker-dealer is registered under the 1934 Act, a broker-dealer exemption is available for sales made under the institutional investor exemption if the broker-dealer

[78] N.Y. GEN. BUS. L. §359-e(1)(a), (e) (McKinney 2002), CCH Blue Sky L. Rep. ¶ 42,128 (2002).

[79] "'Institutional investor' means any bank, insurance company, pension or profit-sharing plan or trust, investment company, as defined in the Investment Company Act of 1940, or any person, other than an individual, which controls any of the foregoing, the Federal Government, state or any agency or political subdivision thereof, except public school districts … or any other person [designated by regulation]." 70 PA. CONS. STAT. § 203(c) (2002), CCH Blue Sky L. Rep. ¶ 48,113 (2002); 70 PA. CONS. STAT. § 102(k) (2002), CCH Blue Sky L. Rep. ¶ 48,102 (2002).

has no place of business in Pennsylvania.[80] An offshore fund sponsor and its employees (including its officers and directors) who offer or sell securities of the fund are exempt from broker-dealer and agent registration if the employees are effecting transactions that are exempt under the institutional investor or NSMIA exemptions.[81] If a NSMIA notice filing is required, the filing fee is $500. No Form U-2 filing is required.

Texas. The text of the relevant Texas Blue Sky statute relating to institutional investors provides, in pertinent part, that the Texas registration provisions shall not apply to the following transactions:

> The sale of any security to any bank, trust company, building and loan association, insurance company, surety or guaranty company, savings institution, investment company as defined in the Investment Company Act of 1940, small business investment company as defined in the Small Business Investment Act of 1958, as amended, or to any registered dealer actually engaged in buying and selling securities.[82]

Broker-dealer and agent exemptions are available for sales made under the institutional investor and NSMIA exemptions.[83] If a NSMIA notice filing is required, the filing fee is 1/10 of 1% of the aggregate amount of the offering, up to a maximum of $500. A Form U-2 filing is required.

Additional Blue Sky Considerations

Anti-Fraud Provisions. The anti-fraud and civil liability provisions of Blue Sky statutes duplicate the federal structure and prohibit the making of material misstatements and material omissions. Therefore, although a sponsor may not be required to file a copy of its private placement memorandum with state securities regulators, the sponsor is subject to state liability for material misstatements and omissions. All states have provisions which are similar to SEC Rule 10b-5, the federal catch-all anti-fraud rule (discussed in Chapter 8), which may be enforced through administrative action or civil injunction and may be the basis of a criminal action. Investors who make securities purchases based on material misstatements or omissions may bring lawsuits for return of the purchase price and other damages.

Legends. Following the enactment of NSMIA, state-specific legends should no longer be necessary. Nevertheless, some states still have provisions in their Blue Sky laws requiring state-specific legends. After NSMIA, it is no longer recommended that

---

[80] 70 PA. CONS. STAT. §302(a) (2002), CCH Blue Sky L. Rep. ¶ 48,122 (2002).

[81] 70 PA. CONS. STAT. §102(c) (2002), CCH Blue Sky L. Rep. ¶ 48,102 (2002).

[82] TEX. CODE ANN. §581-5(H) (2002), CCH Blue Sky L. Rep. ¶ 55,105 (2002).

[83] TEX. CODE ANN. §581-4(C) (2002), CCH Blue Sky L. Rep. ¶ 55,104 (2002).

such legends be included in the fund's offering documentation. However, in addition to the required 1933 Act and 1940 Act legends, an offshore fund that sells securities to individual accredited investors who reside in Florida and that uses the Florida limited offering exemption should include a legend required by Florida in its private placement memorandum.

The Florida statute provides that when sales are made to five or more Florida persons using the Florida limited offering exemption (but not the NSMIA or Florida institutional investor exemptions), any sale in the state is voidable by the purchaser within the first three days following the first tender of consideration by the purchaser to the issuer or within the three days following the communication of the availability of that right to the purchaser, whichever occurs later.[84] An effective communication of this withdrawal right is the inclusion of a legend in the private placement memorandum. A suggested form of the Florida legend is set forth below and in Form 4 of the Appendix to this Memorandum:

> NOTICE TO FLORIDA RESIDENTS:
>
> PURSUANT TO SECTION 517.061(11)(a)(5) OF THE FLORIDA SECURITIES ACT, YOU HAVE THE RIGHT TO RESCIND YOUR SUBSCRIPTION BY GIVING NOTICE OF SUCH RESCISSION BY TELEPHONE, TELEGRAPH OR LETTER WITHIN THREE DAYS AFTER YOU FIRST TENDER CONSIDERATION TO THE ISSUER. IF NOTICE IS NOT RECEIVED BY SUCH TIME, THE FOREGOING RIGHT OF RESCISSION SHALL BE NULL AND VOID.

As the Florida legend requirement addresses rescission of a sale of securities and not merit regulation, the legend requirement is most likely not preempted by NSMIA.

State Regulation of Commodity Pool Operators and Commodity Trading Advisers. States have certain regulatory authority over commodity pool operators and commodity trading advisers, the subjects of Chapter 7. *See* Chapter 7 under "State Regulation."

Federal Regulation of Broker-Dealers

In addition to broker-dealer compliance under Blue Sky laws, discussed above, offshore funds should be aware of the requirements for federal broker-dealer compliance. Under the 1934 Act, anyone who is engaged in the business of effecting securities transactions in the U.S. for the account of others must register with the SEC as a broker. If an offshore fund sponsor seeks to sell its own securities in the U.S., the fund does not fall within the definition of "broker" under the 1934 Act and need not register at the

[84] FL. STAT. ANN. §517.061(11)(a)(5)(2002), CCH Blue Sky L. Rep. ¶ 17,106 (2002).

entity level. However, employees of the fund who offer or sell securities of the issuer may need to register with the SEC as brokers depending on several factors such as the employee's commission structure and the amount of the employee's time spent on selling activities. Generally a fund's employees would not be considered brokers where they are not employed primarily to market the fund's securities and their compensation is not linked to the sale of the fund's securities.

Although determining whether an offshore fund and its employees must register as "dealers" under the 1934 Act is more complicated than the "broker" inquiry, most offshore funds and their employees will not fall under the definition of "dealer." The SEC has generally interpreted the definition of dealer to exclude investors even if their securities activities are large enough to make them active traders.

However, if the fund sponsor or manager regularly purchases or sells securities as principal from or to customers rather than from or to only brokers or dealers, renders incidental investment advice, or extends or arranges for the extension of credit to others in connection with securities transactions, then the sponsor or manager should consult U.S. counsel regarding federal dealer compliance. Often, the U.S. affiliate of an offshore broker-dealer will act as agent for an offshore broker-dealer, and under the 1934 Act only the U.S. affiliate must be registered as a broker-dealer.

Rule 15a-6 under the 1934 Act provides a limited exemption from the broker-dealer registration requirements for offshore broker-dealers that comply with certain conditions. Under Rule 15a-6, unregistered offshore broker-dealers may, among other things, (i) effect unsolicited transactions with U.S. persons; (ii) solicit and effect transactions with registered broker-dealers, supranational agencies such as the IMF, foreign persons temporarily present in the U.S. with whom the offshore broker-dealer had a pre-existing relationship and U.S. entities or persons abroad, provided that the transactions occur outside the U.S.; and (iii) provide research reports, without involvement of a U.S. registered broker-dealer, to major U.S. institutional investors (such as certain QIBs) and effect the associated trades, subject to certain conditions such as that the research reports do not recommend the use of the offshore broker-dealer and the offshore broker-dealer does not initiate contact to follow-up on the research reports.

Rule 15a-6 also permits an unregistered offshore broker-dealer that has a "chaperoning" relationship with a registered broker-dealer to solicit transactions with U.S. institutional investors by a variety of specified means (including specified telephone contacts and personal visits) provided that the registered broker-dealer accepts responsibility for the contacts and all resulting transactions are effected by the registered broker-dealer. Other conditional exemptions also are available to offshore broker-dealers under Rule 15a-6.

State regulation of broker-dealers and agents is discussed in detail above.

Regulation of Investment Advisers

Federal Regulation of Investment Advisers. An offshore fund may have a single investment adviser or a number of advisers, each with responsibility for a different portion of the fund's portfolio. A fund may also have one or more sub-advisers.

The Advisers Act is the primary federal statute regulating investment advisers. Any person who, for compensation, engages in the business of providing advice to others or issuing reports or analyses regarding securities must register with the SEC or with one or more states. Although the registration process for investment advisers is not particularly onerous, the Advisers Act contains numerous substantive regulations applicable to registered investment advisers, including requirements regarding the delivery of disclosure documents, compensation, and the disclosure of capacity (and the obtaining of client consent) when the investment adviser is acting as principal or broker in certain circumstances. Registered advisers are also subject to anti-fraud provisions under the Advisers Act as well as SEC oversight and recordkeeping requirements.

The SEC is the primary regulator of investment advisers who have assets under management of $25 million or more or who are advisers to a registered investment company, and states regulate those with less than $25 million under management. The definition of "assets under management" focuses upon whether an adviser "provides continuous and regular supervisory or management services." There is no requirement that an adviser have actual custody of a client portfolio of securities for those securities to count towards the $25 million threshold.

An offshore adviser should be aware that registration under the Advisers Act may subject the adviser to SEC regulation of all of its activities, not just those involving U.S. clients. The anti-fraud provisions of Section 206 of the Advisers Act are applicable to unregistered as well as to registered advisers.

Several Advisers Act considerations may affect the structuring of disclosure given to U.S. investors in an offshore fund. In order to prohibit advisers from taking undue risks with client funds, registered investment advisers are prohibited from receiving performance fees except under certain circumstances. Under Rule 205-3 of the Advisers Act, registered investment advisers may receive performance fees only if all clients paying the fee have either a net worth at the commencement of the engagement of $1,500,000 (the net worth of a natural person may include assets held jointly with such person's spouse) or $750,000 in assets under management of the subject investment adviser or are "qualified purchasers" under the 1940 Act.

Registered advisers must provide clients with a brochure that describes their fee arrangements. Advisers also should disclose that the proposed performance fee arrangement will give the adviser an incentive to engage in riskier transactions. "Knowledgeable employees" of registered investment advisers may also enter into

performance fee arrangements with investment advisers. Knowledgeable employees will include executive officers, directors, trustees, general partners and advisory board members of sections 3(c)(1) or 3(c)(7) funds. The rule includes employees of the fund or its management affiliate who have participated in investment activities for at least a year.

In addition, special requirements apply under Rule 205-3 to determine the eligibility of an entity-level investor to ensure that the assets of smaller, otherwise ineligible clients are not pooled to circumvent the eligibility standards for receiving performance fees noted above. An entity that satisfies the dollar requirements above is an eligible client, unless it is:

(i) A private investment company, such as a 3(c)(1) or 3(c)(7) fund;

(ii) An investment company registered under the 1940 Act; or

(iii) A business development company (as defined in Section 202(a)(22) of the Advisers Act),

in which cases the entity is not an eligible client unless each of its equity owners is a natural person or entity who satisfies the $1.5 million/$750,000 net worth/assets test or is a qualified purchaser.[85] The SEC has denied no-action relief where non-U.S. investors in an advised fund did not meet the "eligible" client requirements of Rule 205-3. According to the SEC, Rule 205-3 was not designed solely for U.S. investors.

NSMIA amended the Advisers Act to allow registered investment advisers to receive performance fees under advisory contracts with 3(c)(7) funds and persons who are not residents of the U.S. In addition, NSMIA authorized the SEC to exempt other persons from the prohibition against performance fees if the SEC determines that the proposed investors are capable of fending for themselves. To enable the SEC to monitor and enforce a registered offshore adviser's performance of its obligations to its U.S. clients and to ensure the integrity of the U.S. markets, a registered offshore adviser must comply with certain Advisers Act recordkeeping requirements and provide the SEC with access to offshore personnel for all of its activities since they may have a significant effect on U.S. clients or markets.

The SEC staff will also allow offshore advisers not registered under the Advisers Act greater flexibility in establishing U.S. registered subsidiaries provided that:

(i) They are separately organized (i.e., two distinct entities);

(ii) The registered subsidiary is staffed with personnel (whether physically located in the U.S. or abroad) who are capable of providing investment advice;

[85] *See* Advisers Act §205(b)(4), (5).

(iii) All persons that provide advice to U.S. clients or have access to any information concerning which securities are recommended to U.S. clients prior to the effective dissemination of the recommendations are deemed to be "associated persons" of the U.S. subsidiary; and

(iv) The SEC has access to trading and other records of affiliates involved in, or having access to, U.S. advisory activities, and to the U.S. affiliates' personnel, to the extent necessary to monitor and police conduct that may harm U.S. clients or markets.[86]

The Advisers Act also provides an exemption from registration for a private investment adviser if the adviser had fewer than 15 clients during the preceding 12 months, does not advise any registered investment companies or companies electing to be regulated as business development companies, and does not hold itself out to the public as an investment adviser. The SEC counts a fund as a single client for purposes of the exemption (rather than looking through the fund and counting each investor) so long as the adviser manages the fund as a single account, without regard to the tax issues, risk tolerance, and other characteristics of any individual investor.[87] Offshore clients of U.S. advisers are counted as clients for purposes of this exemption. In the case of an offshore adviser, only U.S. clients are counted. Advisers who rely on this exemption should carefully limit their public statements in the U.S., and especially their Internet websites, to ensure that they do not "hold themselves out to the public" as an investment adviser.

State Regulation of Investment Advisers. As noted above, investment advisers with less than $25 million in assets under management are subject to state regulation. Most states generally follow the federal regulatory scheme and provide for similar exemptions from registration requirements and prohibitions on performance-based fees. Those advisers with less than $25 million in assets under management must register with their home state and any other state where they solicit or advise clients unless an exemption from registration is available.

Generally, all states that regulate investment advisory operations require that an adviser file a consent to service of process for state securities law violations. Certain states impose minimum capital requirements which may not be satisfied through the posting of a bond or the maintenance of insurance. These requirements are typically applicable to advisers with custody of client funds or securities. The majority require that the adviser post a surety bond or otherwise maintain professional liability insurance with respect to its operations. However, states may not impose recordkeeping, minimum net capital, and bonding requirements on an adviser that differ from those imposed by the

[86] *See* Uniao de Bancos de Brasileiros S.A., SEC No-Act. LEXIS 817 (July 28, 1992).

[87] The SEC has proposed modifying this rule to require advisers to private investment vehicles, including hedge funds, to look through a fund to the number of individual investors therein when determining the number of the adviser's clients. *See* Rel. IA-2266 (July 20, 2004).

state where it maintains its principal place of business. Many states also require that persons employed by registered investment advisers be separately registered as agents or representatives. State statutes must contain a "*de minimis*" standard under which states may not require registration of any adviser that does not have a place of business in the state and has fewer than six clients in the state during the previous 12-month period. Under NSMIA, the states retain their authority to investigate and bring enforcement actions with respect to fraud claims against all advisers and their associated persons.

CHAPTER 7

U.S. REGULATION UNDER THE COMMODITY EXCHANGE ACT: REGISTRATION OF COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISERS

Introduction. An offshore fund may be subject to the provisions of the U.S. Commodities Exchange Act (the "CEA") and the rules and regulations of the Commodity Futures Trading Commission ("CFTC") if the fund's hedging strategies employ, or investments include, commodities subject to CFTC jurisdiction.

Under the CEA, the CFTC has, subject to certain exceptions, jurisdiction over transactions involving contracts of sale of a commodity for future delivery,[88] that are traded or executed on a contract market, derivatives transaction execution facility or any other board of trade, exchange or market.[89]

Thus, although typically straightforward, a threshold determination regarding the application of the CEA to a particular market instrument will always be whether the instrument is a futures contract or commodity option.

In addition, the CEA has a general exclusion for transactions involving certain derivatives, called "excluded commodities," that are entered into by "eligible participants," if certain additional conditions are met.

If market instruments used by the fund are subject to the CFTC's jurisdiction, applicable regulations may require registration of the sponsor, the investment manager or the officers or directors of the offshore fund with the CFTC as a "commodity pool operator" ("CPO") and "commodity trading adviser" ("CTA"). Unlike the 1940 Act, which contains the 3(c)(1) and 3(c)(7) exclusions from the fund registration requirement, the CEA and applicable regulations contain no exclusions or exemptions from the CPO and CTA registration requirements that are applicable to the types of offshore funds under consideration in this Memorandum.

---

[88] In general, a futures contract is an agreement to buy or sell a specific amount of a commodity or financial instrument at a particular price on a stipulated future date. The price is established between buyer and seller on the floor of a commodity exchange. A futures contract obligates the buyer to purchase the underlying commodity and the seller to sell it, unless the contract is sold to another before settlement date, which may happen if a trader wants to take a profit or cut a loss. This contrasts with options trading, in which the option buyer may choose whether or not to exercise the option by the exercise date.

[89] A futures market is a commodity exchange where futures contracts are traded. Different exchanges specialize in particular kinds of contracts.

However, CFTC rules provide an exemption for registered CPOs and CTAs from some of the relatively onerous filing and other compliance requirements if interests in the pool are offered and sold only to pool participants who generally qualify as "accredited investors" under Regulation D (although the CFTC requirements are more restrictive) and meet certain other conditions.

Nevertheless, if interests in the pool are offered to U.S. persons who do not meet the CFTC standards for investor qualification and the pool instruments are subject to CFTC regulation, generally the offshore fund will be required to comply with all applicable CFTC registration, reporting, recordkeeping, and disclosure rules, discussed below.

Thus, it is generally recommended that the sponsors of offshore funds that trade in futures contracts offer and sell interests in the fund only to U.S. investors who meet the qualification standards of CFTC rules. CPO and CTA registration may not be necessary if no U.S. investors are permitted as participants.

Commodity Pools and Commodity Pool Operators

The CFTC takes the position that even a relatively limited amount of trading in commodities may cause a collective investment vehicle such as an offshore fund to be considered a "commodity pool." If the fund is marketed as a commodities trading vehicle or if commodities trading is of strategic importance for fund profits or growth, then the fund will most likely be considered a commodity pool, as opposed to merely using commodities instruments as a hedge against a decline in asset values.

There is no bright-line test to determine whether a fund's commodities trading activities will cause the fund to constitute a commodity pool, thus a fund sponsor should consult U.S. counsel on this issue if contemplating trading in commodities for hedging purposes.

The CEA requires that each operator of a collective investment vehicle who solicits, accepts or receives from others funds or property for the purpose of trading in futures contracts, options on futures contracts and commodity options that are traded on a U.S. or non U.S. exchange, register with the CFTC and join the National Futures Association (the "NFA")[90] unless the CPO is able to qualify for an exemption or an exclusion from such registration requirement under CFTC rules or regulations.

Thus, if an offshore fund trades commodity interests, the operator of the fund will be subject to CPO registration if the fund's investors or the operator itself is a U.S. person.

---

[90] The NFA is a self-regulatory organization to which the CFTC has delegated, among other things, the duty of registering CPOs.

The CPO entity that is required to register is not the fund entity itself, but is the person or entity responsible for the operational management of the commodity pool, such as the general partners of a partnership, the officers and directors of a corporation or the trustee of a trust.

It is not always clear from CFTC pronouncements which persons or entities associated with a commodity pool must register as a CPO. In general, the CFTC requires that the persons or entity with responsibility for day-to-day operation of the commodity pool register as a CPO. If more than one person or entity associated with the fund may be subject to CPO registration, it may be possible to designate a single person or entity to register as the CPO and to be responsible for associated CEA compliance.

As noted above, in contrast to the 1940 Act, which provides the 3(c)(1) and 3(c)(7) private investment fund exclusions from the fund registration requirement, the CEA provides no exemption from the CPO registration requirement based upon whether the fund is private or the resources of the fund's investors, although some exemptive relief is available as to ongoing compliance requirements for those pools whose investors fall into a narrow category similar to the accredited investor standards of Regulation D (discussed further below). Accordingly, any operator of an offshore fund that uses futures contracts or commodity options and offers shares or other interests in such fund to U.S. resident investors must register as a CPO even if the fund offers those interests exclusively to financially sophisticated investors.

Registration of a CPO with the CFTC and the concomitant membership with the NFA typically requires six to ten weeks. Compliance with the on-going regulatory requirements may impose a significant burden on an offshore fund. Also, interests in a commodity pool constitute securities under the CEA and the 1933 Act, and a sponsor's registration as a CPO does not alleviate its other compliance obligations such as the securities registration requirement under the 1933 Act and applicable compliance with the 1940 Act.

A non-U.S. operator of an offshore fund that has no U.S. investors will generally not be required to register as a CPO, even if the offshore fund executes transactions in commodities interests, or employs a U.S. investment adviser, a CTA (the CEA functional equivalent of an investment adviser, discussed further below) or a futures commission merchant (the CEA functional equivalent of a securities broker).

The manager of a fund which is organized, administered and managed outside the U.S. is exempt under CFTC Rule 30.4(c) from registration as a CPO if no more than 10% of the fund's participants are U.S. residents and no more than 10% of the fund's assets are held on behalf of U.S. residents, provided that the following additional conditions are met: (i) the fund trades only foreign futures contracts and foreign commodity options; (ii) the fund is registered or exempt from registration under the 1940 Act; and (iii) the securities of the fund are registered or exempt from registration under the 1933 Act.

In at least one interpretative letter, the CFTC has granted relief from CPO registration to an operator of an offshore fund that would accept significant U.S. participation, but on conditions that, among other things, investors would be QIBs under Rule 144A of the 1933 Act, and the level of commodities activity, in proportion to the assets of the fund, would be severely limited. Without such restrictions, the CFTC generally has required the complete absence of participation by U.S. investors to grant exemptive relief. As a condition of an exemption from CPO registration granted to another offshore fund, the CFTC prohibited the offer or sale of fund interests to entities organized under the laws of a foreign jurisdiction which have any U.S. citizens or residents holding beneficial interests. This restrictive position may make it difficult for a fund operator that trades in U.S. futures contracts and commodities options to avoid CPO registration.

A fund operator that must register as a CPO must become a member of the NFA and comply with a number of substantive CFTC rules and regulations, discussed below. Also, any "associated persons" of a registered CPO must register with the NFA. An associated person of a CPO is any natural person performing the function of a partner, officer, employee, consultant or agent (or any natural person occupying a similar status or performing a similar function) in any capacity involving (i) the solicitation of funds, securities, or property for participation in a commodity pool or (ii) the supervision of any person so engaged. CPO applicants and the CPO's associated persons must, among other things, pass a NASD-administered proficiency examination on futures markets and regulations and be subject to screening for past disciplinary violations.

In addition to those requirements discussed above, unless an exemption from certain of the CEA's disclosure, reporting and recordkeeping requirements is available under CFTC Rule 4.7(b), discussed below, a registered CPO must deliver a disclosure document to prospective pool participants and file such document with the CFTC and the NFA, file annual and periodic reports with the CFTC, and maintain records in compliance with CFTC regulations.

CFTC Rule 4.7(b) and 4.12(b) Exemptions from Certain Compliance Requirements. Rule 4.7(b) provides an exemption for registered CPOs from some of the specific disclosure, reporting and recordkeeping requirements in connection with the operation of commodity pools offered and sold exclusively to "qualified eligible persons" ("QEPs"). CFTC Rule 4.7(b) does not provide an exclusion or exemption from CPO registration, so associated persons of CPOs will be subject to the requirements discussed above, whether or not the CPO is able to claim the Rule 4.7(b) exemption.

The following classes of persons are QEPs:

(i) Certain investment professionals, including registered futures commission merchants, brokers or dealers, investment advisers and CPOs or CTAs who have been active as such for two years and who operate pools (or provide advice to accounts) with aggregate assets in excess of $5,000,000;

(ii) Persons who (A) own securities and investments with an aggregate value in excess of $2 million, or have had at least $200,000 on deposit with a futures commission merchant (at any time in the preceding six months) to cover exchange-specified initial futures margin and commodity option premiums, or meet some percentage of each of these two requirements, such that the total of the two percentages is at least 100%; and (B) fall within one of several enumerated categories, which parallel the categories of "accredited investors" under Regulation D;

(iii) A "qualified purchaser" under the 1940 Act or a "knowledgeable employee" of the exempt pool or its CPO or CTA;

(iv) The CPO, CTA or investment adviser of the exempt pool, and certain of their principals and affiliates;

(v) A person that is not a U.S. person; and

(vi) Any entity in which all the owners or participants (with the exception of the exempt CTA) are persons listed in paragraphs (i) through (v) above.

The Rule 4.7(b) exemption applies to a registered CPO no matter how many participants there are in a qualified pool, though sponsors of funds should be cognizant of the limitations on the number of investors under Section 3(c)(1) of the 1940 Act and under the 1934 Act. The CFTC has also taken a no-action position with respect to certain pools to claim the Rule 4.7(b) exemption (under very limited circumstances) notwithstanding that all pool participants were not QEPs. However, due to the strict limitations involved it is recommended that sponsors offer interests in the pool only to QEPs.

A registered CPO must file a notice of claim for the Rule 4.7(b) exemption with the CFTC for each pool before it solicits or accepts investments in the pool. Under the Rule 4.7(b) exemption, a registered CPO may claim an exemption from the requirement that a disclosure document be delivered to prospective participants or be filed with the CFTC; however, if any offering memorandum is distributed to prospective participants, the CPO must ensure that the document contains no misleading information and displays a legend that the document has not been filed with the CFTC. The CPO may also claim an exemption under Rule 4.7(b) from the periodic and annual reporting requirements; however, a registered CPO must distribute a quarterly statement to pool participants specifying the net asset value of the pool and the change from the prior quarter and an abbreviated annual report (which must be filed with the CFTC) with a statement of financial condition and an income statement presented in accordance with or reconciled to U.S. GAAP.

CFTC Rule 4.12(b) provides an exemption from some of the CFTC compliance requirements for pools that are primarily engaged in securities transactions. The Rule

4.12(b) relief is available to pools that: (i) are offered and sold under an exemption from the 1933 Act securities registration requirement, (ii) are generally engaged in securities transactions, (iii) do not commit more than 10% of the market value of the pool's assets to establish commodity futures and options positions and (iv) trade commodities futures or options in a manner solely incidental to the pool's securities trading. If the Rule 4.12(b) exemption is available, the CPO will generally be subject to the more limited compliance requirements available under the Rule 4.7(b) exemption, discussed above.

Commodity Trading Advisers

Introduction. The CEA requires that any person who provides investment advice that involves exchange-traded futures contracts or exchange-traded or off-exchange-traded commodity options register as a CTA, even if the advice is rendered incidentally in connection with general securities advice. The CFTC definition of CTA encompasses both natural persons and legal entities. In general, if a domestic or offshore adviser provides commodities-related advice to any U.S. person, the adviser will be subject to regulation as a CTA.

The regulatory structure applicable to CTAs parallels the structure applicable to CPOs, discussed above. Unless an investment adviser of an offshore fund using futures and commodities instruments qualifies for the *de minimis* exemption from CTA registration discussed below, such investment adviser will be required to register as a CTA and certain persons will be required to register as associated persons of the CTA. Also, like the CPO regulatory structure, CFTC rules contain an exemption for registered CTAs from certain of the substantive filing and other compliance requirements in connection with clients who are "qualified eligible clients."

Exemptions. The CEA contains a *de minimis* exemption for any adviser "who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading adviser." In contrast to the *de minimis* exemption under the Advisers Act, the CEA does not require registration of a person solely because that person provides advice to investment companies registered under the 1940 Act, business development companies or commodity pools. If advice is provided to a client solely incidentally to the rendering of advice regarding general securities, such person is not counted for purposes of the exemption. However, CFTC precedents are not clear on other issues regarding the counting of clients for purposes of the *de minimis* exemption, such as whether a pool counts as one client and if whether both U.S. resident and offshore clients should be counted. Accordingly, U.S. counsel should be consulted if a fund's investment manager or adviser intends to use the *de minimis* exemption from the CTA registration requirements.

The CEA also exempts from the registration requirement any CTA that is a registered investment advisor, whose business does not consist "primarily" of acting as a

CTA, and that does not act as a CTA to a collective investment entity that is engaged "primarily" in commodity trading. Registered CPOs are exempt from CTA registration for advice provided to commodity pools for which the CPO is registered. Also, registered associated persons of a CPO are exempt from CTA registration if the advice is provided solely in connection with the associated person's employment or business with the CPO. Certain exemptions are also available to foreign advisers who provide advice solely regarding foreign futures contracts and foreign commodity options.

If no exemption from registration is available to a commodities investment adviser, the adviser will be required to register with the CFTC as a CTA and join the NFA. Also, any persons associated with a registered CTA must register with the CFTC and the NFA as associated persons. An associated person is an individual who solicits orders, customers, or customer funds (or who supervises persons so engaged) on behalf of a CTA.

CFTC Rule 4.7(c) Exemption from Certain Compliance Requirements. As in the case of CPOs, registered CTAs are subject to substantial disclosure and recordkeeping requirements. CFTC Rule 4.7(c) provides an exemption for registered CTAs from certain of the substantive compliance requirements with respect to the accounts of qualified eligible persons, as defined above.

CTAs who qualify for the exemption under Rule 4.7(c) must file a "Notice of Eligibility for Exemption" with the CFTC and obtain the consent of clients for which the Rule 4.7(c) exemption is claimed. Rule 4.7(c) provides an exemption for CTAs from some of the more onerous disclosure requirements. However, if the CTA distributes a disclosure document, the CTA must include adequate information to make any statements made not misleading and must include a legend stating that the disclosure document has not been registered with the CFTC. Rule 4.7(c) also provides an exemption from the specific recordkeeping regulations applicable to registered CTAs, although the CTA must maintain any records prepared in connection with accounts exempt under Rule 4.7(c) and must make the records available upon request.

A number of other substantive regulations apply to CTAs (whether or not exempt under Rule 4.7) including prohibitions on certain types of trading and fraudulent or deceptive practices. Fund sponsors should also be aware that states may bring actions for fraud or for failing to register as a CPO or a CTA, and that criminal and private actions may be brought for violations of the CEA. *See also* Chapter 8.

State Regulation. The CEA generally grants the CFTC exclusive jurisdiction over futures and commodities trading. Accordingly, the CEA will generally preempt state laws that regulate transactions subject to the CEA. However, the CEA limits the effect of this preemptive authority by permitting state regulators to bring actions in state court based on a violation of the state's general civil or criminal anti-fraud statutes. The CEA also provides that the CEA does not preempt the application of any federal or state statute, rule or regulation, to any person required to be registered under the CEA who

fails to register. Failure to register may thus subject the non-compliant CPO or CTA to state enforcement action.

States that have adopted the commodity pool registration requirements of the Model State Commodity Code require the following: the registration of commodity pools; compliance with substantive regulatory obligations and investor suitability requirements by fund sponsors; limitations on fees, compensation and expenses paid by a commodity pool; certain rights for investors regarding governance, reporting and transfers; compliance with standards of fiduciary obligations owed to investors; and marketing and other disclosures.

CHAPTER 8

ENFORCEMENT OF U.S. SECURITIES LAWS

This chapter addresses the enforcement of the U.S. securities laws as such laws relate to offshore funds.

As discussed throughout this Memorandum, the U.S. has a complex system of securities regulation and offshore fund sponsors and directors are encouraged to consult U.S. counsel early in the planning stages of a U.S. private offering of the fund's securities. Although an offshore fund sponsor should be aware of the securities law enforcement process, the likelihood of it impacting the fund, its officers and directors and agents should also be kept in perspective. Offshore fund sponsors may minimize the risks of legal exposure by using reasonable care in planning and effecting the offer and sale of fund securities. Furthermore, as discussed below, the legal standards to impose liability under U.S. securities laws are higher in the context of a private offering as compared to registered public offerings. Of course, compared with the potential for liability discussed in this chapter, operating and marketing considerations always provide the greatest incentive for a fund to comply with all registration requirements and to produce complete and accurate disclosure documents.

The penalties and sanctions for violations of U.S. securities laws may arise through civil litigation, administrative enforcement proceedings or criminal prosecution. Civil litigation may be brought in private actions by the investors in an offshore fund to recover damages allegedly caused by the fund or to prevent the fund sponsor or manager from acting in an illegal manner in the future.

The SEC may also bring civil actions for disgorgement of illegal profits or for civil monetary penalties. The SEC may bring administrative proceedings against an issuer to impose civil penalties and fines, or to obtain cease and desist orders, which may mandate that the issuer immediately cease any improper conduct.

Criminal proceedings may be brought by the U.S. Department of Justice for willful violations of federal securities laws, typically upon referral from the SEC. The breadth of its prosecutorial authority notwithstanding, the vast majority of SEC enforcement actions are settled prior to litigation. Actions for civil and criminal penalties may also be brought by state regulators under the Blue Sky statutes of each state, which generally duplicate the federal enforcement scheme.

Liabilities for Failure to Register and Report

As discussed in detail above, U.S. securities laws require full compliance with both the fund and securities registration requirements. The failure to register or report,

when required, constitutes a violation for which civil and criminal penalties may be imposed.

Failure to Register Under the 1940 Act. Under the 1940 Act, if (i) a 3(c)(1) or 3(c)(7) fund makes a public offering of securities, or (ii) a 3(c)(1) fund exceeds the 100-U.S. person limitation in a private placement, or (iii) a 3(c)(7) fund sells securities in a private placement to U.S. persons who are not qualified purchasers, then the fund is subject to the fund registration requirement, and the fund's controlling persons risk liability for violating Section 7(d) of the 1940 Act by virtue of Section 48, the control person provision of the 1940 Act. "Control (or controlling) persons" of the fund are persons or entities who must have exercised control over the fund in general and possessed the power to control the specific transaction which gave rise to the violation. Control persons of the fund will generally include the fund's sponsor and/or manager, officers and directors.

A violation of Section 7 of the 1940 Act may result in an SEC investigation, an injunction, a cease and desist order, and civil and criminal penalties and fines. Also, purchasers of an offshore fund securities may have a right of rescission and other private damages for violations of Section 7. Any agreement to waive compliance with the 1940 Act is void.

Failure to Register Under the 1933 Act. If a fund sponsor fails to comply with the securities registration requirement under the 1933 Act, i.e., the fund fails to register securities that should have been registered, the SEC may bring a lawsuit for disgorgement of illegal profits and for penalties ranging from $55,000 to $550,000, depending on the seriousness of the alleged conduct.

The fund may also be subject to private suits brought by any purchasers of the securities for failure to register. Private actions may be brought under Section 12(1) of the 1933 Act for the remedy of rescission, the purchase price of the securities plus interest. Under Section 12(1), if the investor-plaintiff can show that the securities offered and sold were subject to registration but unregistered, the fund will be strictly liable for rescission, notwithstanding that the fund made no materially misleading disclosures in any offering documentation. The 1933 Act also establishes control person (joint and several) liability for violations relating to the failure of the fund to register securities. However, a controlling person may avoid liability by proving that he had no knowledge of, or reasonable grounds to believe in, the existence of the facts by reason of which the liability of the controlled person is alleged to exist, which is essentially a negligence-based standard.

It is also unlawful to sell unregistered securities, absent an exemption, under Blue Sky laws. As discussed in Chapter 6, the institutional investor and NSMIA exemptions should be available to offshore funds. State securities laws contain similar provisions that duplicate the scheme under Section 12(1) of the 1933 Act.

Failure to Register and Report Under the 1934 Act. Issuers of securities registered under the 1934 Act are generally required to file certain periodic reports with the SEC. However, foreign private issuers, such as offshore funds, that are not listed on a U.S. stock exchange or on Nasdaq will generally be exempt from 1934 Act reporting if they have fewer than 300 security holders resident in the U.S. *See* Chapter 2. Since under Section 3(c)(1) of the 1940 Act, offshore funds should take steps to limit the number of U.S. residents who purchase securities in the original private placement to less than 100 (and not facilitate sales to U.S. persons beyond the limitation in any event), the 1934 Act's threshold for reporting of 300 U.S. resident holders should not be implicated. However, this threshold should be noted by sponsors that structure 3(c)(7) funds, which are not subject to a limit on the number of U.S. persons who are qualified purchasers. The SEC may initiate an administrative proceeding for failure to comply with the registration and reporting requirements of the 1934 Act. Section 20(a) of the 1934 Act contains a control person provision, subjecting a fund's control persons to joint and several liability with the fund in the event of 1934 Act violations. A willful violation of the 1934 Act registration and reporting requirements is a criminal offense and may subject a violator to substantial fines and imprisonment.

Liabilities Relating to Disclosure in Private Offerings

An exclusion or exemption from the fund and securities registration requirements or 1934 Act reporting requirements does not exempt an offshore fund from the anti-fraud provisions of the U.S. securities laws. Under current law, the two statutory provisions that apply to disclosure violations in private offerings are Rule 10b-5 under the 1934 Act and Section 17 of the 1933 Act.

Rule 10b-5. Rule 10b-5, which is promulgated under Section 10(b) of the 1934 Act, is known as the "catch-all" anti-fraud provision of the U.S. securities laws, and is the provision most commonly used by private plaintiffs and the SEC to enforce violations of federal securities laws relating to improper disclosures.

There are several elements that are necessary to make a Rule 10b-5 claim. Rule 10b-5 prohibits the making of material misstatements to investors or omitting information that makes the information disclosed misleading and is applicable to the purchase as well as the sale of securities (but does not cover offers). Information disclosed to investors is "material" if there is a substantial likelihood that a reasonable investor would consider the information important in deciding whether to purchase or sell a security. A plaintiff must show that the material misstatements were made with "*scienter*," which means that the seller of the security intended to defraud or deceive the purchaser, although some courts have also held that recklessness (but not mere negligence) in making disclosures is sufficient to satisfy the *scienter* element. An investor-plaintiff in a private action under Rule 10b-5 must also show that he relied on the seller's wrongful conduct, although proof of materiality may give rise to a presumption of reliance. If there is an active trading market for the fund's securities, there is a presumption of reliance if the market price of

the security drops after it is disclosed that the securities were sold based on material misstatements or omissions.

The Private Securities Litigation Reform Act of 1995 (the "Reform Act") sought to reduce the number of frivolous lawsuits filed by investors (and the plaintiffs' securities bar) by making it more difficult for shareholders to bring derivative suits based merely on allegations that subsequent securities prices were lower than predicted. The Reform Act made a number of substantive changes relating to pleading, discovery, liability, and the awarding of fees and expenses in cases brought under the federal securities laws. In general, the Reform Act favors defendants as it heightened the standards to plead fraud under federal securities laws.

The 1934 Act also imposes control person liability for disclosure violations. Under Section 20(a) of the 1934 Act, if an offshore fund can be shown to have violated Rule 10b-5, the fund's control persons may be liable to the same extent as the fund, unless the control person shows that he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." Thus, as opposed to the 1933 Act negligence standard to avoid control person liability, the 1934 Act requires the defendant, assuming he did not induce the prohibited Act, only prove that he acted in good faith.

The SEC is authorized to bring an action for an injunction against persons who "aid and abet" a Rule 10b-5 violation. Aiders and abettors are persons that render substantial assistance to the primary violator of Rule 10b-5, and could include the placement agent and the fund's law and accounting firms. Private plaintiffs, such as the fund's investors, are precluded from suing aiders and abettors for Rule 10b-5 violations. Under the Reform Act, the SEC may bring a civil action for injunctive relief based on an aiding and abetting claim. The SEC may refer a criminal action for aiding and abetting to the Department of Justice although the relevant standard requires conduct beyond recklessness.

Private parties who prevail in a Rule 10b-5 action may sue for rescission of the transaction or damages equaling the difference between the purchase price of the security and the value of the security purchased in light of the disclosure violation. The SEC may bring suit for an injunction against a violator of Rule 10b-5 or to temporarily or permanently prohibit a violator from acting as an officer or director of a U.S. public company, if the SEC can show that the defendant's conduct demonstrates substantial unfitness to serve as an officer or director. The SEC may bring suit against a Rule 10b-5 violator for civil penalties up to $110,000 for natural persons and ranging from $55,000 to $550,000 for entities, depending on the egregiousness of the conduct. The U.S. Department of Justice may bring criminal actions for willful violations of Rule 10b-5, including fines and imprisonment for natural persons.

Potential liability under Rule 10b-5 may also arise in connection with the issuing of research reports that contain materially misleading statements or omissions.

Projections in a research report (or made orally or in any offering document) regarding the future performance of the fund's securities, if inaccurate, may give rise to liability under Rule 10b-5. The Reform Act also created a safe-harbor for "forward-looking statements," such as projections, such that a Reporting Issuer will not be subject to liability for making forward-looking statements if (i) the statements are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement or (ii) the plaintiff in the action is unable to prove that the statement was made with actual knowledge that the statement was false or misleading. Since the safe harbor is only available to Reporting Issuers, fund sponsors should use caution when making forecasts and projections. Nevertheless, if projections are to be made during the offering, whether written or oral, offshore fund sponsors should seek to comply with the Reform Act safe harbor, as sponsor compliance might be persuasive to a court in litigation involving a private placement. Accordingly, forward-looking statements should be identified as such and accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from projected results. *See* annexed Forms 2 and 7.

Section 17(a) of the 1933 Act. Section 17(a) of the 1933 Act also contains a broad anti-fraud provision which is similar to Rule 10b-5 under the 1934 Act, but is limited to the sale or offer for sale of securities. Although the focus of the 1933 Act is on the regulation of new public offerings, Section 17(a) has been held to apply to private offerings as well. Unlike Rule 10b-5, most actions under Section 17(a) do not require *scienter*, but only require negligence in making disclosures. However, a majority of courts have limited the impact of this lower standard by holding that Section 17(a) does not allow for private lawsuits, which essentially means that only the SEC may enforce its provisions.

Liabilities Under Blue Sky Laws. State securities laws are another source of liability for offshore funds for violations relating to disclosure documents used in private placements. Each state's securities laws essentially duplicate the federal scheme discussed above for violations relating to registration and material misstatements or omissions, although a number of states have a lower threshold for liability based on the negligence of the fund in connection with disclosure (as opposed to recklessness or *scienter*) such that the fund may be held liable if the fund sponsor fails to use reasonable care in its disclosure to investors. Civil litigation under Blue Sky laws has taken on increased importance due to the passage of the Reform Act, which has heightened pleading standards for fraud cases brought under federal securities laws and thus may lead to a greater number of cases in state courts.

Liabilities Relating to Disclosure Violations in Secondary Market Transactions. An offshore fund, and a broker-dealer that executes a secondary market transaction for a purchaser of the fund's securities, may also be subject to liability for disclosure violations made in connection with secondary market transactions under Rule

10b 5 of the 1934 Act and Section 17(a) of the 1933 Act. The fund may be liable for material misstatements about the fund's securities in connection with a secondary market transaction, such as misleading information provided in press releases issued by the fund. Broker-dealers may be liable for material misstatements or omissions such as misrepresentations relating to the quality of the fund's securities or false or misleading information contained in a research report.

Additional Enforcement Considerations

Jurisdiction and Extraterritorial Application. For any litigation under the U.S. securities laws to take place in the U.S., the plaintiff will have to establish that the U.S. court has both subject matter and personal jurisdiction over the fund and/or its directors. U.S. courts generally will have jurisdiction over matters arising under federal securities laws (subject matter jurisdiction) involving U.S. residents, whether or not acts (or failure to act) of material importance occurred in the U.S. (personal jurisdiction). Thus, offers and sales to U.S.-resident investors will generally be sufficient to establish jurisdiction over the fund and its controlling persons. The doctrine of *forum non conveniens* may arise in litigation involving an offshore fund, which permits a U.S. court to dismiss an action if it deems that the U.S. forum, i.e., the situs of the litigation, would be unduly burdensome to the offshore defendant. If the plaintiff is a U.S. citizen, however, there is a strong presumption in favor of his choice of forum.

Fund sponsors and directors should also be aware of the U.S. system of pre-trial discovery, which can be onerous and can apply to foreign as well as domestic defendants in suits involving U.S. securities laws. U.S. plaintiffs' lawyers may request a wide array of information from defendants through expensive and time-consuming procedures such as oral depositions, demands for production of documents and written interrogatories. Defendants' lawyers often claim that plaintiffs' securities lawyers will file a frivolous lawsuit and then make voluminous discovery demands as a means to force defendants to settle rather than incur the costs of litigating, even if there was no credible evidence of wrongdoing by the defendant. Although certain blocking statutes and treaties may serve to restrain over-zealous discovery requests, U.S. court jurisdiction over a foreign defendant will typically require full compliance with discovery proceedings.

If, after trial, a plaintiff obtained a judgment in a U.S. court against the fund or its controlling persons and the fund or such controlling persons owned assets subject to the jurisdiction of the U.S. courts, which generally means the assets must be present in the U.S., then the plaintiff could seek to execute on the judgment and attach the assets. Assuming the fund or controlling persons had no assets within U.S. jurisdiction, the plaintiff must then attempt to execute the judgment in a foreign court. Whether a foreign court would recognize a U.S. judgment is complicated and should be addressed with U.S. and local counsel. A plaintiff could always initiate an original action in a foreign court, but a plaintiff suing to enforce U.S. securities laws has no guarantee that the laws will

apply since the forum jurisdiction's choice-of-law rules may preclude the application of the U.S. securities laws.

Enforcement Issues for Broker-Dealers. The 1934 Act gives the SEC broad powers to inspect and investigate broker-dealers. The SEC may also investigate broker-dealers on the request of a foreign securities regulator, even though no violation of U.S. law has been committed. The SEC is also authorized to sanction broker-dealers for any violation of U.S. securities laws or the rules and regulations promulgated thereunder. Foreign branch offices of registered broker-dealers (including any offices where dual employees of a U.S. broker-dealer and a foreign broker-dealer are employed) are subject to examination and must make their records available for inspection by U.S. regulators.

Civil actions for fraud may be brought against broker-dealers under Section 17 of the 1933 Act and Rule 10b-5 of the 1934 Act (among other provisions). The NASD and other self-regulatory organizations are authorized to discipline member firms and any associated persons with a censure, fine, suspension, expulsion from membership and other sanctions. In addition, any contract made in violation of the 1934 Act may be held to be void.

Although state laws applicable to broker-dealers vary from federal law and from state to state, state securities regulators may be quite aggressive in seeking fines or other disciplinary actions against a foreign broker-dealer for egregious conduct. However, the most common issue concerning offshore funds is the state registration of offshore broker-dealers. State regulators routinely check the section in the Form D relating to commissions (filed with states in a NSMIA notice filing) and compare the entities enumerated to its list of registered broker-dealers. If the name of the person receiving a commission in connection with the sales of the fund's securities does not appear on the list, the regulators typically send out a letter of inquiry. These types of inquiries are generally very low-level and are usually satisfied by claiming an exemption from registration such as the exemption for sales to institutional investors.

Enforcement Issues for Investment Advisers. Section 206 of the Advisers Act contains an anti-fraud provision similar to Rule 10b-5, making it unlawful for any investment adviser to engage in fraudulent practices, such as the failure to disclose a material fact. The SEC has imposed liability on investment advisers under Section 206 for actions inconsistent with the adviser's relationship and duties to its client, regardless of whether those actions involve the purchase or sale of a security and in some cases regardless of whether the adviser acted with *scienter*. Investment advisers have been held liable in SEC actions for conduct such as recommending purchases of a security that the adviser purchased for its own account shortly before making the recommendation or receiving both an advisory fee and a fee for advising an investment company in which its clients invest. Although private litigants cannot sue for damages under Section 206, they may seek rescission and restitution of advisory fees.

State law enforcement relating to investment advisers parallels the scheme under the Advisers Act. For example, most states impose prohibitions against an adviser's engaging in trading that is excessive in size or frequency in view of the financial resources and character of a client's account. States may also require that an adviser have reasonable grounds to believe that an investment recommendation is suitable for a client. As in the case of current federal law, many states do not provide for any express private right of action for damages against investment advisers.

Enforcement Issues Under the Commodities Exchange Act. The CEA makes it a felony punishable by a fine of not more than $1,000,000 (or $500,000 in the case of an individual) or imprisonment for not more than five years, or both, together with the costs of prosecution, for any person to commit enumerated types of malfeasance such as embezzlement, price manipulation, or making false statements in required documents. However, no person may be subject to imprisonment for the violation of any rule or regulation if the person proves that he had no knowledge of the rule or regulation.

The CFTC may seek a civil penalty against any person found to have violated the CEA up to $100,000 or triple the monetary gain to the person, whichever is greater, for each violation. The CEA expressly creates a private right of action against any person who violates the CEA or who willfully aids, abets, counsels, induces, or procures the commission of a violation of the CEA. This right of action is potentially available to any person who purchases an interest in a commodity pool from a CPO and who suffers a loss caused by the CPO's failure to register with the CFTC or other breaches of its obligations under the CEA. Similarly, a private right of action is available against any CTA for failure to register or for breach of its obligations under the CEA. Recovery is limited to actual damages. Private actions under the CEA must generally be brought in a U.S. district court although the CEA permits the parties to agree in advance to submit such actions to another forum, including to arbitration. *See also* Chapter 7.

CHAPTER 9

U.S. TAX CONSIDERATIONS FOR AN OFFSHORE FUND

For U.S. income tax purposes, an offshore fund will be classified either as a corporation or as a partnership. Historically, most funds the interests in which are readily tradable have been automatically classified as corporations. Under the "check-the-box" regulations however, it is generally possible, and sometimes desirable, for certain offshore funds that would otherwise be classified as corporations for U.S. tax purposes to elect to be classified as tax partnerships.

A tax partnership is almost perfectly "transparent" for U.S. income tax purposes. That is, the partnership itself pays no tax, and the partners must include, on their annual tax returns, their share of the partnership's income, gains, losses and credits. In the present context, the principal advantages of the partnership form are the ability of the partners to utilize their share of any tax losses of the fund and the ability to claim U.S. foreign tax credits for non-U.S. income taxes imposed on the fund. In addition, to the extent that the offshore fund invests in U.S. equity securities, U.S. withholding tax on dividends should be avoided with respect to the U.S. partners. There are disadvantages, however, in addition to the administrative cost of compliance. For example, the ability of U.S. individual investors to deduct their share of the fund's expenses, including investment management fees, is limited. In addition, U.S. tax-exempt investors may be subject to taxation if the fund utilizes leverage. Finally, possible imposition of U.S. estate and gift tax with respect to nonresident aliens of the U.S. should be considered.

In contrast, a corporation is generally treated as a taxpayer independent from its shareholders. One consequence is that the shareholders may not claim their share of any losses or credits of the corporation. The principal advantage of a corporation, the deferral of a shareholder level tax to the time when profits are actually distributed, is effectively neutralized for offshore funds under the passive foreign investment company rules discussed below.

Offshore funds not electing partnership status are generally "passive foreign investment companies" ("PFICs") under the U.S. tax code. The basic taxing regime applicable to U.S. shareholders of PFICs is that there is no taxation except on dividends received and gain on the sale of the shares. However, both "excess distributions," defined as distributions in excess of 125% of the average annual distributions in the three preceding taxable years, and gains on the disposition of the shares are allocated ratably over the shareholder's holding period for the shares, taxed at the highest tax rate applicable for that year, and an interest charge is imposed for the deemed benefit of the tax deferral. This regime can be quite punitive in its operation.

Alternatively, a U.S. shareholder of the offshore fund may make a "qualified electing fund" ("QEF") election with respect to its investment. Under this election, a shareholder is taxed on its pro rata share of the fund's ordinary earnings and capital gains on an annual basis, whether or not such income is distributed. Subject to certain limitations and the imposition of an interest charge, a shareholder may elect to extend the time for paying the tax liability resulting from a QEF election until the time that distributions are actually received or the shares are sold. Such an election is usually attractive to U.S. shareholders, particularly for a fund that distributes most of its income currently in any event. However, in order for a shareholder to make this election, the fund must provide the shareholder with certain information prepared on the basis of U.S. tax accounting rules. For some purposes, e.g., determining the cost of securities sold, U.S. tax accounting rules may differ from the fund's general accounting methods, entailing some additional expense. U.S. investors may request a formal commitment from the offshore fund to provide the QEF information. A suggested form of this commitment is in the Appendix to this Memorandum. *See* annexed Form 17. The tax issues multiply if the fund invests in securities of companies that are themselves PFICs.

In certain very limited circumstance, a U.S. shareholder may make a "mark to market" election with respect to its investment, rather than a QEF election. Under this election, a shareholder is required to include in income (as ordinary income) the excess of the fair market value of the shares at the close of each tax year over its adjusted basis in the shares. Because this election is allowed only if the shares are regularly traded on a recognized securities exchange, it will generally not be available to shareholders in off-shore funds. In any event, because any gain recognized is considered ordinary income, it is far less attractive to individual shareholders than the QEF election.

Because of the likely adverse impact of U.S. tax rules, U.S. tax disclosure is recommended in any U.S. offering. A sample form of disclosure is contained in the Appendix annexed to this Memorandum. *See* annexed Form 9.

An offshore fund and its non-U.S. investors will generally be exempt from U.S. federal tax on trading profits, but not from the 30% withholding tax on dividends paid by U.S. portfolio companies. Many offshore funds have utilized various derivative products to avoid this withholding tax. With the advent of trading in single security futures, withholding tax will be even easier to avoid.

CHAPTER 10

ISSUES CONCERNING INVESTMENTS BY PENSION PLANS IN OFFSHORE FUNDS

This chapter summarizes some of the significant risks and consequences in the event that the underlying assets of an offshore fund (i.e., the securities or other assets owned by the offshore fund) are characterized as " plan assets" of a pension plan under the U.S. Department of Labor (the "DOL") regulations adopted under ERISA. The term "plan assets" means assets belonging, or treated as belonging, to an employee benefit plan which is subject to the requirements of ERISA (an "ERISA Plan")[91]

Under DOL regulations, assets of any fund, including an offshore fund in which an ERISA Plan has invested, are considered to be plan assets if 25% or more of any class of equity interest in the offshore fund is held by benefit plan investors in the aggregate. For this purpose, the term "benefit plan investors" includes ERISA plans, arrangements such as IRAs and Keogh plans, and entities such as collective trusts, insurance company separate accounts and, in certain cases, insurance company general accounts, and funds and limited partnerships holding assets that are deemed to be plan assets.

There are exceptions to the 25% rule if (i) the fund is a U.S. mutual fund (i.e., a fund registered under the 1940 Act); (ii) the fund's equity securities held by ERISA Plans are registered under the 1933 Act and held by at least 100 shareholders; or (iii) the fund is an "operating company," as described in the DOL regulations. Because few offshore funds wish to undertake the expense of becoming a U.S. mutual fund or 1933 Act registrant, the operating company exception is the primary alternative to adhering to the 25% rule. It is explained in more detail at the end of this discussion.

The conclusion of this chapter discusses some possible strategies that offshore fund sponsors should consider to avoid potential ERISA liability. As discussed below, since there may be substantial penalties assessed against an offshore fund and its manager for violations of ERISA, an offshore fund sponsor should consider restricting ERISA Plan participation in the fund and in any event should consult U.S. counsel if the sponsor is contemplating sales of securities to an ERISA Plan.

Consequences to the Offshore Fund Manager. If the assets of an offshore fund are characterized as plan assets, then, assuming the manager has discretion over the

[91] For purposes of this Memorandum, the term "ERISA Plan" will include any entity whose assets are deemed to include "plan assets" of an ERISA Plan under the DOL regulations. Note that some employee benefit plans, such as government plans, are not subject to ERISA, but are subject to federal U.S. state laws which limit or preclude investments in offshore funds.

investment of the fund's assets, the offshore fund manager would become a fiduciary in respect of the plan assets under ERISA with certain obligations to the plan and its participants. As an ERISA fiduciary, the offshore fund manager must, among other things, invest the plan assets (i) solely in the interest of, and for the exclusive purpose of providing benefits to, plan participants, (ii) with the care, skill, prudence and diligence of a prudent man acting in like circumstances, (iii) by diversifying the investments so as to minimize the risk of large losses unless it is clearly not prudent to do so, (iv) in accordance with the plan's liquidity needs and governing instruments, and (v) without engaging in any "prohibited transactions" (discussed further below).

In addition, an ERISA fiduciary must be bonded and must hold plan assets in trust and maintain the indicia of ownership of plan assets (e.g., stock certificates or depositary securities), subject to certain limited exceptions, within the U.S.

The foregoing will be referred to generally as the "ERISA Fiduciary Duties." ERISA does not contain any per se prohibition against the investment by ERISA Plans in foreign assets such as the securities of an offshore fund. However, in making any investment of an ERISA Plan's assets, whether in offshore assets or otherwise, the investing fiduciary must satisfy the ERISA Fiduciary Duties.

Under ERISA, if the assets of the offshore fund are deemed to be plan assets, the offshore fund manager could be personally liable to any ERISA Plan investors in the fund, or possibly to the participants of such plans, for damages in the amount of any losses of the offshore fund caused by the offshore fund manager's imprudent investments, failure to diversify the investments or other failure to comply with the ERISA Fiduciary Duties. In the absence of instructions from another ERISA fiduciary, an investment solely in securities issued by persons that reside in a single foreign nation is likely to fail the diversification requirement. Furthermore, if the offshore fund manager is required to pay any such damages under a settlement agreement with the DOL or a court order resulting from a suit brought by the DOL, the DOL could impose a penalty on the offshore fund manager equal to 20% of the amount paid.

Among the ERISA Fiduciary Duties noted above, there is the duty to avoid a broad range of transactions ("prohibited transactions") involving the assets of an ERISA Plan[92] and persons having a specified relationship to the plan (a "party in interest"),[93] such as loans, sales, leases, or extensions of credit to a party in interest, using the assets of the plan for the benefit of a party in interest. Thus, if the assets of the offshore fund are deemed to be plan assets, the offshore fund manager may charge the offshore fund reasonable fees for managing and investing the offshore fund's assets, but to the extent

[92] Similar rules apply under the U.S. Internal Revenue Code of 1986, as amended, to ERISA plans and certain other benefit plan investors.

[93] For example, a party in interest may be a broker-dealer that provides services to the ERISA Plan investor and also does business with the offshore fund.

that such fees are "unreasonable," the manager could be determined under ERISA to be using plan assets for its own benefit. Also, if the offshore fund manager lends the assets of the offshore fund to, or purchases an asset from, any party in interest, such as another fiduciary, service provider or employer sponsor of an investing ERISA Plan, a prohibited transaction could result. Engaging in a prohibited transaction could subject the offshore fund manager to lawsuits under ERISA seeking its removal as manager and require the restitution to the plan of unreasonable fees paid to the manager. Also, the offshore fund manager could be subject to imposition of the 20% penalty by the DOL based on the amount of such fees or other amount involved in the prohibited transaction, or to a nondeductible excise tax equal to 15% or, if the prohibited transaction is not corrected after the imposition of the initial 15% tax, 100% of the fees or other amount involved. Thus, rescission of the investment may be necessary.

It is uncertain whether the DOL, a plan participant or any other party would be able to obtain a judgment for an ERISA violation against an offshore fund manager with no U.S. presence or enforce any judgment obtained. Moreover, the tax penalties described above would apply only to U.S. taxpayers. Nevertheless, and as discussed further below, an offshore fund sponsor should be cognizant of the legal regime that must be accommodated to attract ERISA Plan investors.

Consequences to Fiduciaries of ERISA Plans Investing in an Offshore Fund. To avoid violating its ERISA Fiduciary Duties, a fiduciary of an ERISA Plan may seek to invest in a fund that is an operating company or in which ownership of any class of equity interests by benefit plan investors in the aggregate is certain to be less than 25%. In such case under DOL regulations, the equity interests of the offshore fund owned by the ERISA Plan, but not the underlying assets of the offshore fund, are treated as plan assets. As such, the acquisition of an interest in the fund by the fiduciary should comply with the ERISA Fiduciary Duties if (1) investing in such securities is prudent, (2) such securities (or certificates or depository receipts evidencing such securities) are held in the U.S., (3) diversification requirements are satisfied, and (4) the acquisition or holding of an interest in the fund does not constitute a prohibited transaction.

If the fiduciary of an ERISA Plan invests in an offshore fund, the assets of which constitute plan assets under DOL regulations, then the fiduciary of the ERISA Plan could be directly and personally liable to the plan, or possibly the plan's participants, under ERISA for actual damages, including the amount of any losses to the plan resulting from the offshore fund manager's imprudent or undiversified investment of plan assets or other failure to comply with the ERISA Fiduciary Duties, or the amount of any unreasonable fees paid to the offshore fund manager. In addition, the 20% penalty described above could be imposed on the fiduciary with respect to the amounts for which it becomes personally liable to the plan or its participants.

Consequences to the Placement Agent. A placement agent does not violate ERISA by distributing securities of an offshore fund to an ERISA Plan merely because

the offshore fund's assets constitute plan assets. Of course, the placement agent should insist that the ERISA risks be fully disclosed to such investors. The placement agent should be aware of the prohibited transaction rules in the event the fund's assets are considered to be plan assets.

Possible Strategies to Address Risks of Offshore Fund Assets Being Characterized as Plan Assets

As the foregoing discussion makes clear, there are substantial risks associated with allowing an ERISA Plan to invest in the securities of an offshore fund. Accordingly, a fund sponsor should approach with caution sales of interests in an offshore fund to an ERISA Plan. Based on the discussion above, an offshore fund is generally left with four possible strategies to address the risks of characterization of the offshore fund's underlying assets as plan assets and associated consequences.

Exclude ERISA Plans as Investors. This strategy allows the offshore fund to avoid having its assets characterized as plan assets. This strategy means that ERISA Plans should not be eligible to subscribe for securities in the offshore fund, and secondary sales of the securities to ERISA Plans should be prohibited. To implement this strategy, the offshore fund sponsor must exert control, through the private placement memorandum and the investment letter, over the initial and secondary sales of the offshore fund securities to ensure that no ERISA Plan actually acquires any interest in the offshore fund. Also, provisions regarding the prohibition of initial and secondary sales of securities to ERISA Plans should be included in the offshore fund's governing documents. This is the approach taken in the models in the Appendix annexed to this Memorandum. See annexed Forms 11, 13 and 14. Note that employee benefit plans not subject to ERISA, e.g., U.S. government plans or plans maintained by non-U.S. employers, are permitted to invest.

Limit Participation by Benefit Plan Investors to Less than 25%. This strategy will likewise allow the offshore fund to avoid having its assets characterized as plan assets. Like the strategy excluding ERISA Plans, the offshore fund sponsor must monitor and control both the initial and secondary market sales of the offshore fund securities to ensure that the 25% limit is not reached. The offshore fund must have provisions concerning the restrictions on investment by all benefit plan investors in its governing documents, the private placement memorandum and the investment letter. The private placement memorandum and the investment letter should disclose that the offshore fund may limit benefit plan investors' participation and that the fund has the right to reject the attempted acquisition of an interest in the offshore fund by any benefit plan investor.

In addition, although the offshore fund may actively attempt to limit benefit plan investor participation to less than 25%, there is the possibility that, for example, due to error or time lag in discovering that securities in the offshore fund are owned by a plan, benefit plan investors' ownership will nevertheless reach or exceed the 25% limit.

Therefore, the offshore fund should make a disclosure advising potential investors of the risk that, even though the offshore fund will undertake to limit employee benefit plan ownership to less than 25%, there is nevertheless a possibility that this threshold could be reached or exceeded and the offshore fund could be deemed to hold plan assets. *See* annexed Form 11 in the Appendix to this Memorandum.

Determine if the Offshore Fund Qualifies as an Operating Company. The offshore fund may be an "operating company," or may qualify as such with some restructuring. The DOL regulations define an "operating company" as one of three entities: (1) an entity primarily engaged directly or through a majority-owned subsidiary, in the production or sale of a product or service other than the investment of capital, (2) an entity that invests at least 50% of its assets in "venture capital investments," (a "venture capital operating company" or "VCOC"), or (3) an entity that invests at least 50% of its assets in real estate which is managed or developed (a "real estate operating company" or "REOC").

For these purposes, a venture capital investment is an investment in an operating company other than a venture capital operating company, which investment affords the investor contractual rights to participate substantially in or influence the management of the portfolio company. Similarly, a REOC must also obtain by its investment in the portfolio real estate the right to participate directly in management or development activities with respect to the property. Both venture capital and real estate operating companies must, in fact, exercise the management rights obtained over their portfolio investments.

The timing of VCOC and REOC investments is specifically prescribed under the DOL plan asset regulations. Moreover, VCOCs and REOCs must evaluate their investment portfolios for conforming investments annually during a valuation period, and must be prepared to evidence the actual exercise of management rights during the year. Overall, the DOL regulations contain a number of traps for the unwary that complicate qualifying as a VCOC or REOC.

Do None of the Above, But Disclose the Risks. Assuming that the offshore fund manager is prepared to accept the risks described above, then equity interests in the offshore fund could be offered to ERISA Plans provided the risks are adequately disclosed. Accordingly, a disclosure in the private placement memorandum should be included. *See* annexed Form 11.

CHAPTER 11

CONCLUSION

The United States securities laws can impose a heavy regulatory burden on offshore funds, despite their being organized outside of the U.S. This Memorandum explains, in broad terms, the relevant laws and regulations and their potential application to offshore funds. In addition, this Memorandum explains the means by which an offshore fund may exempt its U.S. operations from several such laws. While complying with these restrictions may not be ideal, it is typically more cost-effective than full registration with the SEC.

The laws most important to structuring a U.S. offering of interests in an offshore fund are the 1940 Act (discussed in Chapter 2) and 1933 Act (Chapter 3). Registration under either of these acts is an expensive proposition, and one which the manager of most any offshore fund wishes to avoid. In addition, this Memorandum discusses resale restrictions under the 1933 Act (Chapter 4), sales outside the U.S. (Chapter 5), state Blue Sky laws (Chapter 6), the requirements of the Commodities Exchange Act (Chapter 7), enforcement of U.S. securities laws (Chapter 8), tax considerations for U.S. investors (Chapter 9), and issues raised by pension plan investments in an offshore fund (Chapter 10).

The application of all of the foregoing areas of United States law should play a significant role in determining whether (and to what extent and in what manner) an offshore fund will make sales to U.S. residents. This determination will vary with the particulars of each fund and should be undertaken only with the guidance of experienced U.S. counsel.

PRIVATE SECURITIES OFFERINGS

IN THE UNITED STATES

BY OFFSHORE INVESTMENT FUNDS

APPENDIX

Copyright 2003 Carter Ledyard & Milburn LLP
All rights reserved. No part of this document may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, facsimile, recording or otherwise, without the prior permission of the Copyright owner.
1134934.3

PRIVATE SECURITIES OFFERINGS

IN THE UNITED STATES

BY OFFSHORE INVESTMENT FUNDS

Carter Ledyard & Milburn LLP Model Forms

The model forms included in this Appendix are for illustrative purposes only and should not be relied upon without the advice of U.S. counsel. The provisions in the model forms are intended as a general guide only and will require adaptation to the specific terms of the offering. Accordingly, references herein to "Company" may be substituted with "Fund", and references to "Shares" may be substituted with "Units" or the applicable interest which is the subject of the offering. The terms "Private Placement Wrap" and "Private Placement Memorandum" are used interchangeably in this Appendix.[1]

United States Private Placement Memorandum and Related Forms **Page**

Form 1:	Cover Page	App-1
Form 2:	Legends Relating to Securities Laws	App-3
Form 3:	Restrictive Transfer Legend	App-4
Form 4:	Required Blue Sky Legend	App-5
Form 5:	Table of Contents and General Considerations	App-6
Form 6:	Foreign Judgment and Service of Process Disclosures	App-8
Form 7:	1933 and 1940 Act Disclosures	App-9
Form 8:	Restrictions on Transfer Disclosures	App-11
Form 9:	Tax Considerations	App-12
Form 10:	ERISA Considerations	App-16
Form 11:	Red Herring Language and Printing Instructions	App-19

[1] These forms do not provide for or take into account investment by "knowledgeable employees" under Rule 3c-5 under the 1940 Act (discussed in Chapter 2 of the CL&M Memorandum). Sponsors wishing to include knowledgeable employees as investors should make appropriate adjustments to the U.S. documentation.

Form 12: Form of Investment Letter for a Section 3(c)(1) Fund........ App-20

Form 13: Form of Investment Letter for a Section 3(c)(7) Fund........ App-29

Form 14: Suggested Provisions for Certificate of Incorporation or Other Organizational Documents of the Company............. App-39

Suggested Provisions for the Placement Agent's Agreement

Form 15: Form of Provisions for Placement Agent's Agreement...... App-42

Form 16: Provisions Regarding Company's Obligation to Provide Information for QEF Election.. App-46

U.S. Private Placement Memorandum: Model Form 1

Cover Page

Memorandum Identification No. _______

CONFIDENTIAL UNITED STATES
PRIVATE PLACEMENT MEMORANDUM

[NAME OF COMPANY]

[insert structure of the issuing entity as appropriate, i.e.,
A Contractual Securities Investment Trust, or, A Company Incorporated
With Limited Liability and Registered under the Laws of [•]]

Managed By
[•]

PRIVATE PLACEMENT

of up to [•] [Shares]

at a price of U.S. $[•] per Share

Minimum subscription: [•] Shares

[Name of Company](the "Company"), acting through [•](the "U.S. Placement Agent"), is making a private placement of shares of the Company (the "Shares") to certain United States institutional accredited investors [or qualified purchasers], subject to the terms and conditions stated in this Confidential Private Placement Memorandum (the "Memorandum") and the attached form of Investment Letter. The U.S. Placement Agent does not guarantee the accuracy or completeness of this Memorandum.

THE SHARES OFFERED HEREBY ARE HIGHLY SPECULATIVE AND INVOLVE A HIGH DEGREE OF RISK.

IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE COMPANY AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THE SHARES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND

EXCHANGE COMMISSION (THE "COMMISSION") OR ANY STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. THE COMMISSION OR ANY SUCH REGULATORY AUTHORITIES HAVE NOT PASSED UPON OR ENDORSED THE MERITS OF THIS OFFERING OR THE ACCURACY OR ADEQUACY OF THIS MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

U.S. Placement Agent:
[•]
[Date]

U.S. Private Placement Memorandum: Model Form 2

Legends Relating to Securities Laws

THE SHARES [AND ANY INTERESTS REPRESENTED THEREBY][2] MAY NOT BE OFFERED, SOLD, TRANSFERRED OR DELIVERED, DIRECTLY OR INDIRECTLY, IN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT IN CERTAIN TRANSACTIONS EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE 1933 ACT AND STATE OR OTHER SECURITIES LAWS. TERMS USED IN THE PRECEDING SENTENCE HAVE FOR THE PURPOSES OF THIS MEMORANDUM, THE MEANINGS GIVEN TO THEM BY REGULATION S UNDER THE 1933 ACT. THE SHARES [AND ANY INTERESTS REPRESENTED THEREBY] ARE SUBJECT TO RESTRICTIONS ON TRANSFER AND RESALE. SEE "RESTRICTIONS ON TRANSFER."

THE COMPANY IS A FOREIGN INVESTMENT COMPANY AND IS NOT REGISTERED UNDER THE U.S. INVESTMENT COMPANY ACT OF 1940, AS AMENDED (THE "1940 ACT") [if appropriate, insert as applicable, AND THE PLACEMENT AGENT AND THE INVESTMENT ADVISER ARE NOT REGISTERED AS INVESTMENT ADVISERS UNDER THE U.S. INVESTMENT ADVISERS ACT OF 1940, AS AMENDED.] PROSPECTIVE INVESTORS SHOULD BE AWARE THAT THEY DO NOT HAVE THE BENEFITS OF THE PROTECTIONS AFFORDED BY SUCH ACT[S] AND THE RULES PROMULGATED THEREUNDER BY THE COMMISSION.

THIS MEMORANDUM CONTAINS "FORWARD-LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE 1933 ACT AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. SUCH FORWARD-LOOKING STATEMENTS INVOLVE KNOWN AND UNKNOWN RISKS AND UNCERTAINTIES THAT MAY CAUSE THE ACTUAL RESULTS, PERFORMANCE, LEVELS OF ACTIVITY, OR ACHIEVEMENTS OF THE COMPANY, TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE, LEVELS OF ACTIVITY, OR ACHIEVEMENTS OF THE COMPANY EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE, BUT ARE NOT LIMITED TO, GENERAL AND ECONOMIC BUSINESS CONDITIONS AND THE ABILITY OF THE COMPANY TO IMPLEMENT ITS BUSINESS STRATEGY.

[2] This clause should be included where applicable if the offering involves securities with underlying interests, such as units or warrants.

U.S. Private Placement Memorandum: Model Form 3

Restrictive Transfer Legend

[THE ARTICLES OF ASSOCIATION OF THE COMPANY][3] GIVE POWER TO THE COMPANY'S [DIRECTORS] TO REQUIRE THE TRANSFER OR REDEMPTION OF SHARES OWNED OR WHICH APPEAR TO BE OWNED DIRECTLY OR INDIRECTLY BY ANY PERSON WHO, BY VIRTUE OF HIS HOLDING, MAY IN THE OPINION OF THE [DIRECTORS] CAUSE OR BE LIKELY TO CAUSE THE COMPANY OR SHAREHOLDERS OF THE COMPANY SOME [LEGAL, REGULATORY, PECUNIARY, TAX OR MATERIAL ADMINISTRATIVE DISADVANTAGE][4] OR CAUSE OR BE LIKELY TO CAUSE THE ASSETS OF THE COMPANY TO BE CONSIDERED "PLAN ASSETS" WITHIN THE MEANING OF THE REGULATIONS ADOPTED UNDER THE U.S. EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED, OR WHICH HOLDING WOULD OR MIGHT RESULT IN [if a Section 3(c)(1) entity, insert: THE COMPANY HAVING MORE THAN [EIGHTY] BENEFICIAL OWNERS OF SHARES (WHETHER DIRECTLY OR BY ATTRIBUTION) WHO ARE U.S. PERSONS] [if a Section 3(c)(7) entity, insert: THE BENEFICIAL OWNERSHIP OF SHARES OF THE COMPANY BY ANY U.S. PERSON WHO IS NOT A "QUALIFIED PURCHASER," AS DEFINED IN SECTION 2(a)(51)(A) OF THE 1940 ACT.] THE RELEVANT PROVISIONS OF THE COMPANY'S [ARTICLES OF ASSOCIATION] ARE SUMMARIZED IN THE MEMORANDUM UNDER THE HEADING "[•]".

---

[3] All references to "Articles of Association" throughout this Appendix may be replaced with the appropriate name of the document containing the restrictions on sale and transfer of the securities which are the subject of the offering.

[4] The wording of the provision will vary according to the wording actually contained in the Articles of Association. It is recommended that the Articles of Association give the directors the power to require transfer or redemption for each of the above-described situations.

U.S. Private Placement Memorandum: Model Form 4

Florida Blue Sky Legend
for use in connection with an offering using
the Florida Limited Offering Exemption

NOTICE TO FLORIDA RESIDENTS:

PURSUANT TO SECTION 517.061(11)(a)(5) OF THE FLORIDA SECURITIES ACT, YOU HAVE THE RIGHT TO RESCIND YOUR SUBSCRIPTION BY GIVING NOTICE OF SUCH RESCISSION BY TELEPHONE, TELEGRAPH OR LETTER, WITHIN THREE DAYS AFTER YOU FIRST TENDER CONSIDERATION TO THE ISSUER. IF NOTICE IS NOT RECEIVED BY SUCH TIME, THE FOREGOING RIGHT OF RESCISSION SHALL BE NULL AND VOID.

U.S. Private Placement Memorandum: Model Form 5

Table of Contents and General Considerations

TABLE OF CONTENTS

Page

General Considerations

Private Placement in the United States

Restrictions on Transfer

Risk Factors

Certain United States Tax Considerations

Certain ERISA Considerations

APPENDIX

I. Form of Investment Letter

GENERAL CONSIDERATIONS

This Memorandum is confidential and has been prepared and submitted for use solely in connection with the offer of the Shares to a limited number of U.S. institutional accredited investors [or U.S. qualified purchasers who are also accredited investors] in a private placement of securities. The use of this Memorandum for any other purpose is not authorized and it may not be reproduced, transferred to any other person, or used for any other purpose without the consent of the Company and the U.S. Placement Agent. Each prospective investor, by accepting delivery of this Memorandum, agrees to return it and all related documents to the U.S. Placement Agent in the event such prospective investor does not purchase any Shares.

No person has been authorized to give any information or to make any representations other than those contained in this Memorandum and the Placement Agent's Agreement in connection with the offering and sale of the Shares, and, if given or made, such information and representations must not be relied upon as having been authorized by the Company or the U.S. Placement Agent. The allotment or issue of the Shares shall not under any circumstances create any implication that there has been no change in the affairs of the Company since the date hereof.

The contents of this Memorandum should not be considered to be legal or tax advice and each prospective investor should consult with its own legal counsel and advisers as to all matters concerning an investment in the Shares. The investor must rely on its own evaluation of the investment and the terms of the offering, including the merits and risks involved, in making an investment decision with respect to the Shares.

This Memorandum does not constitute an offer to sell or the solicitation of an offer to buy the Shares in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction. In addition, this Memorandum constitutes an offer only if a Memorandum Identification Number appears in red ink in the appropriate space on the cover hereof.

Neither the delivery of this Memorandum nor the issuance of the Shares shall, under any circumstances, create any implication that any information contained herein or therein is correct as of any time subsequent to the respective dates hereof and thereof.

The Shares are being offered subject to prior sale and to withdrawal, cancellation or modification of the offering. The Company and the U.S. Placement Agent reserve the right to accept or reject any offer to purchase the Shares at any time prior to the termination of the offer.

The investment in Shares should be viewed as a long-term investment, suitable only for sophisticated investors who can fully evaluate the risks involved. Prospective investors' attention is drawn to the discussion of risk factors in the [Prospectus] under the heading ["Risk Factors"].

U.S. Private Placement Memorandum: Model Form 6

Foreign Judgment and Service of Process Disclosures

The Company is a [insert structure of issuing entity] [incorporated] [organized] under the laws of [•]. Its Fund Manager (the "Manager") is incorporated under the laws of [•] and its Investment Adviser is incorporated under the laws of [•]. [Certain] [All] of the directors of the Company, the Manager and the Investment Adviser, are not U.S. residents. Such entities and persons are located outside of the U.S., and all or a substantial portion of the assets of the Company and such persons are located outside of the U.S. As a result, it may be difficult for purchasers of the Shares offered hereby to effect service of process within the U.S. upon the Company, its directors, the Manager, the Investment Adviser or other associated persons or entities, or to realize civil liabilities against them under U.S. securities laws. Moreover, there is no assurance that courts outside the U.S. would enforce judgments of U.S. courts predicated solely on U.S. securities laws or would entertain actions brought before them in the first instance on the basis of liabilities predicated solely upon such laws.

U.S. Private Placement Memorandum: Model Form 7

1933 and 1940 Act Disclosures

PRIVATE PLACEMENT IN THE UNITED STATES

Securities Act of 1933 and State Securities Laws

The Company, through the U.S. Placement Agent, is making a private placement of the Shares to a limited number of U.S. institutional investors that are (a) "accredited investors" within the meaning of Rule 501(a) of Regulation D under the 1933 Act (an "Accredited Investor") or (b) reasonably believed by the U.S. Placement Agent to be "qualified institutional buyers" within the meaning of Rule 144A under the 1933 Act (a "QIB") and are also Accredited Investors, on the terms contained herein and in the Investment Letter (See Appendix I hereto).[5]

[Or, for a 3(c)(7) fund, use the following paragraph:] [The Company, through the U.S. Placement Agent, is making a private placement of Shares to a number of U.S. investors that are (a) "accredited investors" within the meaning of Rule 501(a) of Regulation D under the 1933 Act (an "Accredited Investor") and (b) that are also "qualified purchasers" within the meaning of Section 2(a)(51)(A) of the 1940 Act (a "Qualified Purchaser"), on the terms contained herein and in the Investment Letter (See Appendix I hereto).]

No sale of the Shares will be made in the U.S. or to any U.S. person (as such terms are defined in Regulation S under the 1933 Act) who does not execute and deliver, for the benefit of the Company and the U.S. Placement Agent, an investment letter in the form attached hereto (the "Investment Letter") completed in a manner acceptable to the Company and the U.S. Placement Agent.

[The Memorandum refers to an offering which may involve a public offering outside the U.S. to investors who are not U.S. persons.] The offering of the Shares in the U.S. will not be registered under the 1933 Act or under any of the securities laws of any state or other political subdivision of the U.S. and is made in reliance upon applicable exemptions from registration as a private placement. Accordingly, the Shares are being offered only to investors who are believed to have the qualifications necessary to permit the Shares to be sold in reliance on such private placement exemptions. Each purchaser of the Shares together with the purchaser's representatives, if any, must have such knowledge and experience in business and financial matters as will enable it to evaluate the merits and risks of a proposed investment in the Shares and to bear the economic risk of the investment. Each investor must confirm in the Investment Letter that it is purchasing the

---

[5] The first paragraph of this form should be used for an offering made by 3(c)(1) funds to institutional investors only and not individuals or trusts for the benefit of individuals. If individual purchasers are contemplated in a 3(c)(1) offering, adjustments to the form are required.

Shares for investment purposes only and not with a view to, or for resale in connection with, any distribution or other disposition of the Shares and must represent that it is [if a 3(c)(1) fund: an Accredited Investor or a QIB that is also an Accredited Investor] [if a 3(c)(7) fund: an Accredited Investor that is also a Qualified Purchaser] and must make certain other representations as to its status.

Transferability of the Shares will be subject to the restrictions contained in the Investment Letter, [if applicable add: and in the Articles of Association of the Company] and certificates representing the Shares, if any, will contain a restrictive legend to such effect. Generally, such provisions state that no sale or other transfer of Shares may be made by an investor unless such sale or other transfer is exempt from registration under the 1933 Act and other applicable laws [and that the consent of the Company will be required for any such sale or other transfer].

Investment Company Act of 1940

[For a 3(c)(1) offering, use the following paragraph:] [The Company is not registered under the 1940 Act. Based on interpretations of the 1940 Act by the Commission staff, if the Company has more than 100 beneficial owners who are U.S. persons, it may become subject to registration under the 1940 Act. The Directors of the Company intend to restrict the number of U.S. persons who may invest in the Shares to [80].] [If applicable add: The relevant provisions of the Company's Articles of Association are summarized in the Prospectus under the heading "[•]".]

[Or, for a 3(c)(7) fund, use the following paragraph:] [The Company is not registered under the 1940 Act. If any Shares are owned by a person who is not a Qualified Purchaser, the Company may become subject to registration under the 1940 Act. The directors of the Company intend to restrict the ownership of Shares to Qualified Purchasers. [If applicable add: The relevant provisions of the Company's Articles of Association are summarized in the Prospectus under the heading "[•]".].

U.S. Private Placement Memorandum: Model Form 8

Restrictions on Transfer Disclosures

RESTRICTIONS ON TRANSFER

The Shares have not been and will not be registered under the 1933 Act or the securities laws of any state, and the Company has not been registered, nor will it be registered, under the 1940 Act. The purchaser must agree in the Investment Letter that it will not re-offer, resell, pledge, hypothecate or otherwise transfer or dispose of any Shares (or any certificates that may be received in replacement thereof or in exchange therefor) except in accordance with the Articles of Association and either: (i) pursuant to an offer and sale outside the U.S. meeting the requirements of Regulation S; or (ii) (A) to an institution that the seller reasonably believes is a "QIB" in a transaction meeting the requirements of Rule 144A; or (B) to an Accredited Investor within the meaning of Rule 501(a) of Regulation D [if a 3(c)(7) fund, add: who is also a Qualified Purchaser within the meaning of Section 2(a)(51)(A) of the 1940 Act], provided that the purchaser shall execute and deliver to the [Manager] of the Company an Investment Letter substantially in the form of the Investment Letter contained in Appendix I attached hereto, and, if requested by the [Manager], shall furnish an opinion of counsel acceptable to the [Manager] to the effect that such offer, sale, pledge, hypothecation, transfer or disposition (x) is in compliance with the registration requirements of the 1933 Act, [if employee benefit plans are excluded as investors:] (y) is not being made to an employee benefit plan or other plan which is subject to, or to any entity the assets of which are considered to be "plan assets" of any employee benefit plan or other plan under, the U.S. Employee Retirement Income Security Act of 1974, as amended, or Section 4975 of the United States Internal Revenue Code of 1986, as amended (the "Code"), and (z) will not result in the Company being required to register as an investment company under the 1940 Act. The [Manager] may restrict transfers or require redemptions of the Shares in order to comply with the 1933 Act, the 1940 Act or other applicable laws. The Share certificates (and any certificates issued in replacement thereof or in exchange therefor), if any, will bear a legend to the foregoing effect.

U.S. Private Placement Memorandum: Model Form 9

Tax Considerations

CERTAIN UNITED STATES TAX CONSIDERATIONS

The following is a summary of certain U.S. federal income tax considerations relating to the acquisition, ownership, and disposition of Shares. For purposes of this summary, a "United States person" generally is any U.S. citizen or resident individual, any corporation or partnership organized under U.S. law, any estate (other than an estate the income of which, from sources outside the U.S. that is not effectively connected with a trade or business within the U.S., is not includible in its gross income for U.S. federal income tax purposes), and any trust if a court within the U.S. is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. The term "U.S. Shareholder" means any Shareholder that is a United States person (and, unless the context otherwise requires, includes any United States person that holds Shares in the Company through one or more partnerships or other entities treated as transparent for U.S. federal income tax purposes), and the term "Non-U.S. Shareholder" means a Shareholder that is not a United States person.

Classification and Taxation of the Company

The Company will [elect to] be treated as an association taxable as a corporation for U.S. federal tax purposes. The Company would be subject to regular U.S. corporate income tax on any income that is effectively connected with the conduct of a U.S. trade or business. It is not expected, however, that the Company will be engaged in a U.S. trade or business. The Company could also be subject to 30% U.S. withholding tax on any U.S. source dividend or interest income, or other "fixed or determinable annual or periodical" income.

U.S. Taxation of Taxable U.S. Shareholders

Taxation of Distributions

Subject to the passive foreign investment company rules discussed below, a U.S. Shareholder will be required to include in gross income as ordinary income the amount of any distribution, to the extent the distribution is paid out of the Company's current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Such dividends will not be eligible for the dividends-received deduction otherwise allowed to U.S. corporations in respect of dividends received from other U.S. corporations.

To the extent that the amount of any distribution exceeds the Company's current and accumulated earnings and profits, it will be treated first as a tax-free return of the U.S.

Shareholder's tax basis in its Shares to the extent thereof, and then as capital gain. [The Company will not maintain calculations of earnings and profits in accordance with U.S. federal income tax principles.]

Dispositions of the Shares

If a U.S. Shareholder sells or otherwise disposes of the Shares, including on liquidation of the Company, such U.S. Shareholder will recognize gain or loss for U.S. Federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and their adjusted tax basis in the Shares. Subject to passive foreign investment company rules discussed below, such gain or loss generally will be capital gain or loss and will be long term capital gain or loss if the Shares were held for more than one year at the time of the sale or other disposition. Deduction of capital losses is subject to certain limitations under the Code. If, on liquidation, securities are distributed in kind, U.S. Shareholders would generally recognize gain or loss in an amount equal to the difference between the fair market value of such securities on the date of liquidation, plus any cash distributed, and their adjusted tax basis in the Shares.

Passive Foreign Investment Companies

For U.S. Federal income tax purposes, the Company will be considered a passive foreign investment company ("PFIC") for any taxable year in which either (1) 75% or more of its gross income is passive income, or (ii) at least 50% of the average value of all of its assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets which produce passive income. BASED ON THE COMPANY'S PROJECTED INCOME, ASSETS AND ACTIVITIES, IT IS LIKELY THAT THE COMPANY WILL BE TREATED AS A PFIC.

If the Company is a PFIC for any taxable year, then, unless the U.S. Shareholder elects to treat its Shares as an investment in a "qualified electing fund" (a "QEF election"), as described below,

- such U.S. Shareholder would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of Shares ratably over the holding period for such Shares,

- the amount allocated to each year during which the Company is considered a PFIC other than the year of the dividend payment or disposition would be subject to tax at the highest individual or corporate tax rate, as the case may be, and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year, and

- gain recognized upon the disposition of the Shares would be taxable as ordinary income.

If a U.S. Shareholder made a timely QEF election in respect of its Shares, such U.S. Shareholder would not be subject to the rules described above. Instead, the U.S Shareholder would be required to include in its income for each taxable year its pro rata share of the Company's ordinary earnings as ordinary income and its pro rata share of the Company's net capital gain as long term capital gain, whether or not such amounts are actually distributed. U.S. Shareholders generally may elect to defer the payment of this tax until distributions are received or the Shares are sold, subject to the imposition of an interest charge on such deferral. [The Company intends to comply with all accounting, recordkeeping and reporting requirements necessary for U.S. Holders to make QEF elections.]

Assuming that the Company is a PFIC, U.S. Shareholders will be required to file IRS Form 8621 with their annual income tax return.

Possible Application of Foreign Personal Holding Company Rules

No assurance can be given that the Company will not become a "foreign personal holding company" within the meaning of Section 552 of the Code. If five or fewer individuals who are citizens or residents of the United States own directly or by attribution more than 50%, by vote or value, of the Company, the Company may become a foreign personal holding company. In such event, each U.S. Shareholder that holds the Shares, directly or indirectly, on the last day of any taxable year in which the Company is a foreign personal holding company, must include in its income for that year such U.S. Shareholder's pro rata share of the Company's "undistributed foreign personal holding company income." In the event that a U.S. Shareholder is required to include amounts in its income under this rule, such amounts will not be required to be included a second time under the PFIC rules as part of an "excess distribution" if subsequently distributed.

Possible Application of Controlled Foreign Corporation Rules

No assurance can be given that the Company will not become a "controlled foreign corporation" within the meaning of Section 957 of the Code. If U.S. Shareholders that own directly or by attribution 10% or more of the voting power of the Company (each treated as a "U.S. Ten-percent Holder") collectively were to own directly or by attribution more than 50%, by vote or value, of the Company's outstanding Shares, the Company would be deemed a controlled foreign corporation.

If the Company became a controlled foreign corporation, each U.S. Shareholder treated as a U.S. Ten-percent Holder would be required to include in income each year such U.S. Ten-percent Holder's pro rata share of the "Subpart F income". For this purpose, Subpart F income generally would include interest, original issue discount, dividends, net gains from the disposition of stocks or securities, net gains on forward and option contracts, receipts with respect to securities loans and net payments received with respect to equity swaps and similar derivatives. To the extent that a U.S. Shareholder were required to include amounts in income under the controlled foreign corporation rules, such amounts generally could be distributed tax-free (and, to the extent not distributed, would be added to the tax basis of the U.S. Ten-percent Holder's Shares) and

would not also be included in income currently under the foreign personal holding company or PFIC rules described above.

A U.S. TEO Shareholder (as defined below) should able to treat its pro rata share of the Subpart F income as a dividend and, provided that the Shares do not constitute debt-financed property, such dividend should not be taxable to the U.S. TEO Shareholder.

U.S. Taxation of U.S. Tax-Exempt Shareholders

The Shares may be sold to U.S. tax-exempt organizations ("U.S. TEO Shareholders") including employee benefit plans which are exempt from federal income tax under Sections 401(a) and 501(a) of the Code. A U.S. TEO Shareholder generally will not be subject to U.S. income tax on income realized from its investment in the Company, except to the extent such U.S. TEO Shareholder has debt-financed Shares. A U.S. TEO Shareholder whose Shares constitute debt-financed property will to that extent be subject to U.S. federal income taxation under rules summarized above. A U.S. TEO Shareholder is urged to consider with its tax adviser the possible application of these rules.

Certain Reporting Requirements

In general, U.S. Shareholders will be required to report to the Internal Revenue Service transfers of property or cash to the Company. In addition, U.S. Shareholders who acquire a 10% or greater interest in the Company (by vote or value) must report acquisitions or dispositions of, or proportional changes of, their Shares in the Company.

Basis for Description of Tax Consequences

The description of U.S. tax consequences set forth above is based on current U.S. federal income tax law, U.S. income tax regulations, judicial and administrative interpretations of the law and regulations, the provisions of the Company's [operative documents], the description of proposed activities of the Company set out in the [Prospectus], and certain assumptions. No rulings have been or will be requested from the Internal Revenue Service, and no assurance can be given that the Internal Revenue Services will agree with the description of U.S. federal income tax taxes.

Consultation with Advisors

This description of U.S. tax matters does not address all of the U.S. federal income tax consequences to investors in the Company, and does not address any of the foreign, state or local tax consequences of such investment to any investor. Each prospective investor is advised to consult its own tax counsel as to the U.S. federal income tax consequences of an investment in the Company and as to applicable state, local and foreign taxes. The effect of existing U.S. income tax laws and treaties, the tax laws of other jurisdictions to which an investor may be subject, and possible changes in such laws and treaties (including proposed changes which have not yet been adopted) will vary with the particular circumstances of each investor.

U.S. Private Placement Memorandum: Model Form 10

ERISA Considerations

CERTAIN ERISA CONSIDERATIONS[6]

The U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and/or Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code") govern the investment of the assets of employee benefit plans of U.S. employers, certain other plans and arrangements, including individual retirement accounts, and certain collective investment funds or insurance company general or separate accounts in which such plans or arrangements are invested ("U.S. Plans"). Fiduciaries of U.S. Plans are strongly urged to consult their own legal advisors regarding the consequences of any investment in the Company.

The U.S. Department of Labor (the "DOL") has issued regulations, Section 2510.3-101 (the "Regulations"), defining "plan assets" of a U.S. Plan that is subject to ERISA. The Regulations would generally classify as plan assets of a U.S. Plan the assets of a corporation, partnership or other entity that is a pooled investment vehicle (such as the Company) in which a U.S. Plan invests if (i) the investment is an equity interest that is neither a widely-held security registered in the U.S. nor a security issued by an investment company registered under the 1940 Act, and (ii) equity participation in the entity by "benefit plan investors" is "significant." Such equity participation would be considered "significant" if 25% or more of the value of any class of equity interests in the entity (excluding any such equity interest held by a person who has discretionary authority or control over such entity's assets or by an affiliate of such person) is held by "benefit plan investors," as defined in the Regulations, a term that includes U.S. Plans. As a result of the Regulations, if any U.S. Plan invests in the Company, and if equity participation in the Company by benefit plan investors is significant, the assets of the Company may be deemed to be plan assets.

[The Company has not, and will not, undertake any action to limit the holdings in the Company by U.S. or other Plans, either on initial issuance or by secondary purchases, and such holdings are expected to be substantial. Further, [although the Company may limit the holdings in the Company by U.S. Plans for various reasons (ERISA, tax, or other),] the Company will not specifically review the ownership of interests in the Company by Plans to determine whether such ownership equals or exceeds the 25% threshold, and therefore, there is no assurance that equity participation in the Company by Plans will not be significant.] *alternative* [The Company will endeavor to restrict direct and indirect investments by benefit plan investors and the resale of investment to the extent required to ensure that such investments do not equal or exceed the 25% threshold referred to in

---

[6] This section should be included only if the offering contemplates purchases by employee benefit plans subject to ERISA. It is generally recommended that the fund sponsor exclude such investors.

the preceding paragraph, but cannot guarantee that participation by benefit plan investors in the Company will not be significant or that the Company's assets will not be deemed to be "plan assets". In this regard, the Company reserves the right to restrict the level of investment in the Company by benefit plan investors at any time.]

If the Company's assets are considered to be plan assets of any U.S. Plan, the Manager would be considered a fiduciary subject to ERISA. Under certain circumstances, the fiduciaries of any U.S. Plans responsible for such Plans' investment in the Company could be liable for any ERISA violations by the Manager, including (i) losses due to imprudent or undiversified investment of Company assets, or holding Company assets outside the U.S. in a manner contrary to the Regulations, or in any other manner which is not solely in the interest of, and for the exclusive purpose of providing benefits to, plan participants, or (ii) the receipt of management fees in excess of those permitted under ERISA and the Regulations.

Any fiduciary of a U.S. Plan should consult with its legal adviser concerning the ERISA considerations discussed above before making an investment in the Company. In addition, the fiduciary of a U.S. Plan who is responsible for making such investment should carefully consider, taking into account the facts and circumstances of the U.S. Plan, whether such investment is consistent with the fiduciary responsibility requirements of ERISA, including, whether (a) such investment is consistent with prudence and diversification requirements of ERISA, taking into account, among other things, the U.S. Plan's need for sufficient liquidity to pay benefits when due given that there may not be a ready market in which to sell or otherwise dispose of holdings in the Company; (b) the fiduciary has authority to make such investment under the appropriate governing instrument; (c) such investment is made solely in the interest of the participants and beneficiaries of the U.S. Plan, and (d) the acquisition and holding of any interest in the Company does not result in a non-exempt "prohibited transaction" under Section 406 of ERISA or Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code").

ERISA and the Code generally prohibit certain transactions involving the assets of a U.S. Plan and persons who have certain specified relationships to the U.S. Plan ("parties in interest" as defined in ERISA or "disqualified persons" as defined in the Code). Regardless of whether the assets of the Company are considered to be "plan assets", the acquisition of an interest in the Company by a U.S. Plan could, depending on the facts and circumstances of such acquisition, be a prohibited transaction if the Company or any of its affiliates is a disqualified person with respect to the U.S. Plan. However, such prohibited transaction may be treated as exempt under ERISA and the Code if the interest in the Company was acquired pursuant to and in accordance with one or more "class exemptions" issued by the DOL, such as Prohibited Transaction Exemption ("PTE") 84-14 (a class exemption for certain transactions determined by independent qualified professional asset managers), PTE 90-1 (a class exemption for certain transactions involving insurance company pooled separate accounts), PTE 91-38 (a class exemption for certain transactions involving bank collective investment funds), PTE 95-60 (a class exemption for certain transactions involving insurance company general accounts), or PTE 96-23 (a class exemption for certain transactions effected by specific in-house asset

managers). If the purchase of an interest in the Company were to be a non-exempt prohibited transaction, the purchase might have to be rescinded.

In this regard, any potential investor that is an insurance company investing assets from its general account should consider the United States Supreme Court's decision in John Hancock Mut. Life Ins. Co. v, Harris Trust and Sav. Bank, 510 U.S. 86 (1993), which holds that in certain circumstances an insurance company's general account may be deemed to include assets of the U.S. Plan investing in the general account, as through the U.S. Plan's purchase of an annuity contract. Such insurance company could, therefore, be treated as a party in interest with respect to the U.S. Plan by virtue of this investment. Additionally, any insurance company investor should also consider Section 401(c) of ERISA and any applicable regulations issued thereunder.

The Company will require fiduciaries of a U.S. Plan proposing to invest in the Company to represent that they have been informed of and understand the Company's investment objectives, policies and strategies, that the decision to invest U.S. Plan assets in the Company was made with appropriate consideration of relevant investment factors with regard to the U.S. Plan and is consistent with the duties and responsibilities imposed upon fiduciaries with regard to their investment decisions under ERISA, and that the investment in the Company will not constitute or otherwise result in a non-exempt prohibited transaction under ERISA or the Code.

U.S. Private Placement Memorandum: Model Form 11

Red Herring Language and Printing Instructions

The following preliminary legends should appear on the cover page of the Memorandum only on the red herring or pathfinder, and should be deleted when the final Memorandum is printed.

On the top left corner of the cover page:

> Preliminary Confidential United States Private Placement Memorandum
> Dated [day] [month] [year]
> Subject to Completion.

Along the left margin:

> This document is a Preliminary Confidential United States Private Placement Memorandum. The information contained herein is subject to completion. This document does not constitute or form part of an offer for, or invitation to acquire, the Shares described herein.

Model Form 12: Form of Investment Letter for a Section 3(c)(1) Fund

FORM OF INVESTMENT LETTER[7]

THE SHARES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "1933 ACT"), OR THE LAWS OF ANY STATE, AND MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT IN CERTAIN TRANSACTIONS EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE 1933 ACT AND ANY APPLICABLE STATE LAWS.

[Name and address of [Name and Address of
the Company] U.S. Placement Agent]

Re: Private Placement of Shares
of [•] (the "Company")

Ladies and Gentlemen:

This letter relates to the private placement in the United States ("U.S.") of Shares of [•] (the "Company"). We hereby confirm our acceptance of your offer of the Shares of the Company on the terms and conditions set out in the Company's Confidential United States Private Placement Memorandum dated [•] (the "Memorandum").

In connection therewith, we also confirm that:

1. We understand and acknowledge that neither the Shares nor any interest therein has been or will be registered under the 1933 Act, or the securities laws of any state or other political subdivision of the U.S. and that the Company has not been registered, nor will it be registered, under the U.S. Investment Company Act of 1940, as amended (the "1940 Act").

2. We confirm also that we are an [institutional] "accredited investor" within the meaning of Rule 501(a) of Regulation D under the 1933 Act (an "[Institutional] Accredited Investor"), and have accurately indicated the basis for such accreditation on Attachment A hereto, (the "Accredited Investor Qualification"), are either purchasing Shares for our own account or for the account of one other [Institutional] Accredited Investor for which we are acting as agent with complete investment discretionary authority and power to bind, and we (and, if applicable, such institution) (A) have sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks

[7] The form of this letter contemplates that no purchaser will be an individual (or a trust for an individual's benefit), as is permitted in a 3(c)(7) fund. As discussed in the CL&M Memorandum, it is recommended that 3(c)(1) funds only accept purchasers that are institutional accredited investors. However, it is possible to have individuals or trusts for the benefit of individuals invest in a 3(c)(7) fund. The inclusion of such investors requires additional modifications to the U.S. documentation.

of the purchase of the Shares, (B) are prepared to bear the economic risk of investing in and holding such Shares, and (C) are not acquiring the Shares with a view to any public resale or distribution thereof.

3. We further confirm, on behalf of ourselves, and, if applicable, the other Institutional Accredited Investor for which we are acquiring the Shares, that:

(i) We will not re-offer, resell, pledge, hypothecate or otherwise transfer or dispose of any Shares (or the Shares represented by certificates that may be received in replacement thereof or in exchange therefor) except in accordance with the Articles of Association of the Company and either: (A) pursuant to an offer and sale meeting the requirements of Regulation S under the 1933 Act or (B) to an [Institutional] Accredited Investor, provided that the purchaser shall execute and deliver to the [Manager] of the Company an Investment Letter substantially in the form of this letter, and, if requested by the [Manager], shall furnish an opinion of counsel acceptable to the [Manager] to the effect that such offer, sale, pledge, hypothecation, transfer or disposition (x) is in compliance with the registration requirements of the 1933 Act, [if employee benefit plans are excluded as investors] (y) is not being made to an employee benefit plan or other plan which is subject to, or to any entity the assets of which are considered to be "plan assets" of any employee benefit plan or other plan under, the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or Section 4975 of the U.S. Internal Revenue Code of 1986, as amended, and (z) will not result in the Company being required to register as an investment company under the 1940 Act. We acknowledge that the [Manager] may restrict transfers or require redemptions of Shares in order to comply with the 1933 Act, the 1940 Act or other applicable laws. We acknowledge that each Share purchased hereunder (and any Shares represented by certificates issued in replacement thereof or in exchange therefor) shall bear restrictive legends in substantially the following form [if a Share offering, insert: and that an appropriate stop transfer order implementing the same shall be lodged with the Registrar for the Shares:]:

THE SHARES REPRESENTED HEREBY AND ANY INTEREST HEREIN OR THEREIN HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "1933 ACT"), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE ISSUER OF SUCH SHARES HAS NOT BEEN REGISTERED, AND WILL NOT BE REGISTERED, UNDER THE U.S. INVESTMENT COMPANY ACT OF 1940, AS AMENDED (THE "1940 ACT"). AT NO TIME MAY MORE THAN 100 U.S. PERSONS (FOR PURPOSES OF THE 1940 ACT) OWN BENEFICIALLY AN INTEREST IN THE SHARES, AND NO INTEREST HEREIN OR THEREIN MAY BE RE-OFFERED, RE-SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE

TRANSFERRED OR DISPOSED OF EXCEPT IN ACCORDANCE WITH THE ARTICLES OF ASSOCIATION OF THE COMPANY AND EITHER: (i) PURSUANT TO AN OFFER AND SALE MEETING THE REQUIREMENTS OF REGULATION S UNDER THE 1933 ACT OR (ii) TO AN [INSTITUTIONAL] "ACCREDITED INVESTOR" WITHIN THE MEANING OF RULE 501(a) OF REGULATION D UNDER THE 1933 ACT, PROVIDED THAT IN CONNECTION WITH ANY SALE REFERRED TO IN CLAUSE (ii) THE PURCHASER SHALL EXECUTE AND DELIVER TO THE [MANAGER] OF THE COMPANY AN INVESTMENT LETTER AND, IF REQUESTED BY THE [MANAGER], SHALL FURNISH AN OPINION OF COUNSEL ACCEPTABLE TO THE [MANAGER] TO THE EFFECT THAT SUCH OFFER, SALE, PLEDGE, HYPOTHECATION, TRANSFER OR DISPOSITION (X) IS IN COMPLIANCE WITH THE REGISTRATION REQUIREMENTS OF THE 1933 ACT, [IF EMPLOYEE BENEFIT PLANS ARE EXCLUDED AS INVESTORS] (Y) IS NOT BEING MADE TO AN EMPLOYEE BENEFIT PLAN OR OTHER PLAN WHICH IS SUBJECT TO, OR TO ANY ENTITY THE ASSETS OF WHICH ARE CONSIDERED TO BE "PLAN ASSETS" OF ANY EMPLOYEE BENEFIT PLAN OR OTHER PLAN UNDER, THE U.S. EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED, OR SECTION 4975 OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED, AND (Z) WILL NOT RESULT IN THE ISSUER OF SUCH SHARES BEING REQUIRED TO REGISTER AS AN INVESTMENT COMPANY UNDER THE 1940 ACT.

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO COMPULSORY TRANSFER OR REDEMPTION IN CERTAIN CIRCUMSTANCES PURSUANT TO THE PROVISIONS OF THE ARTICLES OF ASSOCIATION OF THE COMPANY, A COPY OF WHICH MAY BE OBTAINED FROM THE COMPANY UPON REQUEST MADE TO IT AT ITS REGISTERED OFFICE OR TO [ITS MANAGER] [insert name and address of manager]. IN ADDITION, SUCH SHARES MAY NOT BE SOLD OR OTHERWISE TRANSFERRED UNLESS THE PURCHASER OR OTHER TRANSFEREE SHALL FURNISH TO THE REGISTRAR OF SUCH SHARES A CERTIFICATE IN FORM SATISFACTORY TO SUCH MANAGER TO ENABLE THE COMPANY TO DETERMINE THAT IMMEDIATELY FOLLOWING SUCH SALE OR TRANSFER CIRCUMSTANCES WOULD NOT EXIST WHICH WOULD ENABLE THE COMPANY TO REQUIRE THE COMPULSORY TRANSFER OR REDEMPTION OF SUCH SHARES.

(ii) We constitute a single beneficial owner for purposes of Sections 7(d) and 3(c) of the 1940 Act because (A) we are not acquiring beneficially, directly or indirectly, 10% or more of the aggregate amount of outstanding Shares issued by the Company and (B) we are not an

investment company registered under the 1940 Act, or a company exempt from registration under the 1940 Act by virtue of Sections 3(c)(1) or 3(c)(7) of the 1940 Act.

(iii) We will not acquire any additional Shares issued by the Company unless (A) after giving effect to such acquisition we (or, if appropriate, such other Qualified Institutional Buyer or [Institutional] Accredited Investor) would beneficially own less than 10% of the aggregate amount of outstanding Shares issued by the Company or (B) at the time of such acquisition, such Shares and any Shares issued by the Company that we own would be deemed to be beneficially owned by not more than one person for purposes of Sections 7(d) and 3(c)(1) of the 1940 Act.

4. We understand that the directors of the Company (the "Directors") are entitled to require the transfer of the Shares the holding or beneficial ownership of which would (whether on its own or when taken together with any other relevant circumstances, such as, but not limited to, a proposed transfer of the Shares by another holder), in the opinion of the Directors, cause or be likely to cause: (i) the assets of the Company to be considered "plan assets" within the meaning of regulations adopted by the United States Department of Labor under ERISA, (ii) some legal, regulatory pecuniary, tax or material administrative disadvantage to the Company or holders of the Shares, or (iii) the Company to have an aggregate of more than [80] U.S. persons who are beneficial owners of Shares (including beneficial ownership by attribution pursuant to Section 3(c)(1)(A) of the 1940 Act). Until such transfer is effected, the holder of such Shares shall not be entitled to any rights or privileges attaching to such Shares. If the required transfer is not effected within [21] calendar days after service of a notice to do so, the Shares concerned may be compulsorily redeemed by the Company on the terms set out in the Articles of Association of the Company.

5. We have received copies of, and are familiar with, the Memorandum and have had access to such other information concerning the Company as we have deemed necessary for us to make an informed decision to purchase the Shares. We have reviewed the disclosures relating to and consulted our own independent advisers or otherwise have satisfied ourselves concerning (i) U.S. taxation of the Company and our investment in the Company, including the expected status of the Company as a passive foreign investment company, (ii) the fact that the Company has not been and will not be registered as an investment company under the 1940 Act, and (iii) the status of the offering of Shares as a private placement under the 1933 Act. We acknowledge the risk factors involved in an investment in the Company as set forth in the Memorandum.

6. We acknowledge that (i) we are purchasing the Shares as part of an initial offering of the Shares, (ii) we have received a copy of the Memorandum, and (c) we have had access to such financial and other information and have been afforded the opportunity to ask questions and receive satisfactory answers from

representatives of the Company regarding the Company, and the terms and conditions relating to investment in the Company, and all such questions have been answered to our full satisfaction. We are relying solely on the information contained in the Memorandum and investigations made by us and acknowledge that we have not relied on the U.S. Placement Agent or any of its affiliates or any person acting on its or their behalf in connection with our investigation of the accuracy of such information or our decision to invest in the Shares.

7. We agree to keep the Memorandum confidential, it being understood that the Memorandum is strictly for our use and is not to be redistributed or duplicated by us.

8. We have such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Shares. We are able to bear the economic risk of the investment with particular reference to the fact that the Shares will be "restricted securities" within the meaning of Rule 144(a)(3) under the 1933 Act and may not be transferred except as set forth in paragraph 3(a) herein. We are acquiring the Shares for investment (i) for our own account or (ii) for not more than one account as to which we exercise sole investment discretion (a "Managed Account") and not with a view to, or for resale in connection with, any distribution or other disposition of the Shares within the meaning of the 1933 Act. We have no contract, undertaking, arrangement, or agreement with any person to sell or transfer or to have any person sell for us all or any portion of the Shares. We have no present obligation, indebtedness, or commitment, nor is any circumstance in existence, which will compel us to secure funds by the sale of any of the Shares, nor are we a party to any plan or undertaking which would require or contemplate that proceeds from the sale of all or a part of the Shares be utilized in connection therewith, and we do not now have any reason to anticipate any change in circumstances or other particular occasion or event which would cause us to transfer the Shares. In the event that we are acquiring the Shares for a Managed Account, we are familiar with the Managed Account and each of the confirmations, representations and acknowledgments made hereunder are true for the Managed Account and we are duly authorized to make them on behalf of the Managed Account.

9. We have not been formed for the purpose of purchasing the Shares and have substantial assets in addition to the funds to be used to purchase the Shares.

10. We are not purchasing the Shares (i) as a result of or subsequent to becoming aware of any advertisement, article, notice or other communication published in any newspaper, magazine or similar medium or broadcast over television or radio; or (ii) as a result of or subsequent to attendance at a seminar or meeting called by any of the means contained in (i); or (iii) as a result of or subsequent to any solicitation by a person not previously known to us in connection with investments in securities generally.

11. Our principal office is as indicated below.

12. We understand that our acceptance of the offer to subscribe for the Shares is irrevocable unless and until rejected by the Company.[8]

13. The information provided herein is true and correct in all respects as of the date hereof. We agree to notify the Company and the U.S. Placement Agent immediately if any of the statements made herein shall become untrue.

As used herein, the terms "United States" and "U.S. person" shall have the meanings ascribed thereto in Rule 902 of Regulation S promulgated under the 1933 Act.
Our obligations under this letter shall be governed by and construed in accordance with the laws of the State of New York without regard to its rules as to conflicts of laws.

Yours truly,

Date:____

By: ____

Name: ____

Title: ____

U.S. Tax ID No.: ________________ ________________________

Number of Shares: __________________________________

Aggregate Purchase Price
(minimum investment U.S. $[50,000]):________________________

Address of Principal Office of Purchaser: ________________________

____

Telex No.:____

Fax No.:____

Address for delivery of notices, if different from above: ________________

____

Confirmation of the number of Shares allocated to us should be sent to:
Name of Investor [Institution]: ____________________________

[8] If acceptance of an offer to subscribe for the Shares is conditional on the Shares of the Company being admitted to an offshore securities exchange and on such admission becoming effective on or before a certain date, language to this effect should be added to the representation in this paragraph.

Form 12 (contd.)

Attention: ____

Date: ____

Address: ____

____

Telex No.: ____

Telephone No.: ____

ATTACHMENT A

ACCREDITED INVESTOR QUALIFICATION[9]

Name of Purchaser:____________________

Please check the appropriate entries below that accurately describe the Purchaser on whose behalf the Investment Letter is executed:

- ☐ Any bank as defined in Section 3(a)(2) of the Securities Act of 1933, as amended (the "1933 Act"), or any savings and loan association or other institution as defined in Section 3(a)(5)(A) of the 1933 Act whether acting in its individual or fiduciary capacity.
- ☐ Any broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934, as amended.
- ☐ Any insurance company as defined in Section 2(13) of the 1933 Act.
- ☐ Any investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act") or a business development company (as defined in Section 2(a)(48) of the 1940 Act).
- ☐ Any Small Business Investment Company licensed by the United States Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958.
- ☐ Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000.
- ☐ Any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), if the

---

[9] This investment letter contemplates the possibility of investment by ERISA plans. However, as discussed in Chapter 10 of the CL&M Memorandum, there are a number of risks associated with permitting investment by ERISA plans and it is recommended that such investors be excluded. Should an issuer choose to exclude ERISA plans, this Attachment A should be modified and the investment letter should contain a representation by the investor that it is not an ERISA plan, such as the following:

We are not (i) an "employee benefit plan" (as defined in Section 3(3) of ERISA) which is subject to ERISA, (ii) a "plan" as defined in Section 4975(e)(1) of the U.S. Internal Revenue Code of 1986, as amended, or (iii) an entity whose underlying assets include "plan assets," within the meaning of Department of Labor Regulation Section 2510.3-101, or any of the foregoing by reason of investment in such entity.

Although it is recommended that the Company allow only institutional investors to participate, this form may be modified to allow investment by individual accredited investors.

investment decision is made by a plan fiduciary, as defined in Section 3(21) of the ERISA, which is either a bank, savings and loan association, insurance company or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors.

☐ A private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940, as amended.

☐ Any organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000.

☐ Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) of Regulation D under the 1933 Act.

☐ Any entity in which all of the equity owners are accredited investors.

Model Form 13: Form of Investment Letter for a Section 3(c)(7) Fund

FORM OF INVESTMENT LETTER

THE SHARES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "1933 ACT"), OR THE LAWS OF ANY STATE, AND MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT IN CERTAIN TRANSACTIONS EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE 1933 ACT.

[Name and address of [Name and Address of
the Company] U.S. Placement Agent]

Re: Private Placement of Shares
of [•] (the "Company")

Ladies and Gentlemen:

This letter relates to the private placement in the United States of Shares of [•] (the "Company"). We hereby confirm our acceptance of your offer of the Shares of the Company on the terms and conditions set out in the Company's Confidential United States Private Placement Memorandum dated [•].

In connection therewith, we also confirm that:

1. We understand and acknowledge that neither the Shares nor any interest therein has been or will be registered under the 1933 Act, or the securities laws of any state or other political subdivision of the U.S. and that the Company has not been registered, nor will it be registered, under the U.S. Investment Company Act of 1940, as amended (the "1940 Act").

2. We confirm also that we are a "qualified purchaser" within the meaning of Section 2(a)(51)(A) of the 1940 Act (a "Qualified Purchaser") and have accurately indicated the bases for such determination on Attachment A hereto (the "Qualified Purchaser Qualification"), and that we are an "accredited investor" within the meaning of Rule 501(a) of Regulation D under the 1933 Act (an "Accredited Investor"), and have accurately indicated the basis for such accreditation on Attachment B hereto, (the "Accredited Investor Qualification"), are either purchasing Shares for our own account or for the account of an Accredited Investor who is also a Qualified Purchaser for which we are acting as agent with complete investment discretionary authority and power to bind, and we (and, if applicable, such investor) (A) have sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the purchase of the Shares, (B) are prepared to bear the economic risk of investing in and holding such Shares, and (C) are not acquiring the Shares with a view to any public resale or distribution thereof.

3. We further confirm, on behalf of ourselves, and, if applicable, the other Accredited Investor for which we are acquiring the Shares, that:

(i) We will not re-offer, resell, pledge, hypothecate or otherwise transfer or dispose of any Shares (or certificates that may be received in replacement thereof or in exchange therefor) except in accordance with the Articles of Association of the Company and either: (A) pursuant to an offer and sale meeting the requirement of Regulation S under the 1933 Act or (B) to an Accredited Investor who is also a Qualified Purchaser, provided that the purchaser shall execute and deliver to the [Manager] of the Company an Investment Letter substantially in the form of this letter, and, if requested by the [Manager], shall furnish an opinion of counsel acceptable to the [Manager] to the effect that such offer, sale, pledge, hypothecation, transfer or disposition (x) is in compliance with the registration requirements of the 1933 Act, [if employee benefit plans are excluded as investors] (y) is not being made to an employee benefit plan or other plan which is subject to, or to any entity the assets of which are considered to be "plan assets" of any employee benefit plan or other plan under, the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or Section 4975 of the U.S. Internal Revenue Code of 1986, as amended, and (z) will not result in the Company being required to register as an investment company under the 1940 Act. We acknowledge that the [Manager] may restrict transfers or require redemptions of Shares in order to comply with the 1933 Act, the 1940 Act or other applicable laws. We acknowledge that each Share purchased hereunder (and any certificates issued in replacement thereof or in exchange therefor) shall bear restrictive legends in substantially the following form, and that an appropriate stop transfer order implementing the same shall be lodged with the Registrar for the Shares:

THE SHARES REPRESENTED HEREBY AND ANY INTEREST HEREIN OR THEREIN HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "1933 ACT"), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE COMPANY HAS NOT BEEN REGISTERED AND WILL NOT BE REGISTERED, UNDER THE U.S. INVESTMENT COMPANY ACT OF 1940, AS AMENDED (THE "1940 ACT"). AT NO TIME MAY ANY U.S. PERSON WHO IS NOT A "QUALIFIED PURCHASER" WITHIN THE MEANING OF SECTION 2(A)(51)(A) OF THE 1940 ACT OWN BENEFICIALLY AN INTEREST IN THE SHARES, AND NO INTEREST HEREIN OR THEREIN MAY BE RE-OFFERED, RE-SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED OR DISPOSED OF EXCEPT IN ACCORDANCE WITH THE ARTICLES OF ASSOCIATION OF THE COMPANY AND EITHER: (i) PURSUANT TO AN OFFER AND SALE MEETING THE REQUIREMENTS OF REGULATION S UNDER THE 1933 ACT OR (ii) TO AN

"ACCREDITED INVESTOR" WITHIN THE MEANING OF RULE 501(a) OF REGULATION D UNDER THE 1933 ACT WHO IS ALSO A "QUALIFIED PURCHASER", PROVIDED THAT IN CONNECTION WITH ANY SALE REFERRED TO IN CLAUSE (ii) THE PURCHASER SHALL EXECUTE AND DELIVER TO THE [MANAGER] OF THE COMPANY AN INVESTMENT LETTER AND, IF REQUESTED BY THE [MANAGER], SHALL FURNISH AN OPINION OF COUNSEL ACCEPTABLE TO THE [MANAGER] TO THE EFFECT THAT SUCH OFFER, SALE, PLEDGE, HYPOTHECATION, TRANSFER OR DISPOSITION (X) IS IN COMPLIANCE WITH THE REGISTRATION REQUIREMENTS OF THE 1933 ACT, [IF EMPLOYEE BENEFIT PLANS ARE EXCLUDED AS INVESTORS] (Y) IS NOT BEING MADE TO AN EMPLOYEE BENEFIT PLAN OR OTHER PLAN WHICH IS SUBJECT TO, OR TO ANY ENTITY THE ASSETS OF WHICH ARE CONSIDERED TO BE "PLAN ASSETS" OF ANY EMPLOYEE BENEFIT PLAN OR OTHER PLAN UNDER, THE UNITED STATES EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED, OR SECTION 4975 OF THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED, AND (Z) WILL NOT RESULT IN THE COMPANY REFERRED TO ABOVE BEING REQUIRED TO REGISTER AS AN INVESTMENT COMPANY UNDER THE 1940 ACT.

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO COMPULSORY TRANSFER OR REDEMPTION IN CERTAIN CIRCUMSTANCES PURSUANT TO THE PROVISIONS OF THE ARTICLES OF ASSOCIATION OF THE COMPANY, A COPY OF WHICH MAY BE OBTAINED FROM THE COMPANY UPON REQUEST MADE TO IT AT ITS REGISTERED OFFICE OR TO [ITS MANAGER] [insert name and address of manager]. IN ADDITION, SUCH SHARES MAY NOT BE SOLD OR OTHERWISE TRANSFERRED UNLESS THE PURCHASER OR OTHER TRANSFEREE SHALL FURNISH TO THE REGISTRAR OF SUCH SHARES A CERTIFICATE IN FORM SATISFACTORY TO SUCH MANAGER TO ENABLE THE COMPANY TO DETERMINE THAT IMMEDIATELY FOLLOWING SUCH SALE OR TRANSFER CIRCUMSTANCES WOULD NOT EXIST WHICH WOULD ENABLE THE COMPANY TO REQUIRE THE COMPULSORY TRANSFER OR REDEMPTION OF SUCH SHARES.

4. We understand that the directors of the Company (the "Directors") are entitled to require the transfer of Shares the holding or beneficial ownership of which would (whether on its own or when taken together with any other relevant circumstances, such as, but not limited to, a proposed transfer of Shares by another holder), in the opinion of the Directors cause or be likely to cause; (i) the assets of the Company to be considered "plan assets" within the meaning of regulations adopted by the United States Department of Labor under ERISA, (ii)

some legal, regulatory pecuniary, tax or material administrative disadvantage to the Company or its shareholders, or (iii) any shares of the Company to be owned by a U.S. person who is not a Qualified Purchaser. Until such transfer is effected, the holder of such Shares shall not be entitled to any rights or privileges attaching to such Shares. If the required transfer is not effected within [21] calendar days after service of a notice to do so, the Shares concerned may be compulsorily redeemed by the Company on the terms set out in the Articles of Association of the Company.

5. We have received copies of, and are familiar with, the Memorandum and have had access to such other information concerning the Company as we have deemed necessary for us to make an informed decision to purchase the Shares. We have reviewed the disclosures relating to and consulted our own independent advisers or otherwise have satisfied ourselves concerning (i) U.S. taxation of the Company and our investment in the Company, including the expected status of the Company as a passive foreign investment company, (ii) the fact that the Company has not been and will not be registered as an investment company under the 1940 Act, and (iii) the status of the offering of Shares as a private placement under the 1933 Act. We acknowledge the risk factors involved in an investment in the Company as set forth in the Memorandum.

6. We acknowledge that (i) we are purchasing the Shares as part of an initial distribution of the Shares, (ii) we have received a copy of the Memorandum relating to the Shares, and (iii) we have had access to such financial and other information and have been afforded the opportunity to ask questions and receive satisfactory answers from representatives of the Company regarding the Company, and the terms and conditions relating to investment in the Company, and all such questions have been answered to our full satisfaction. We are relying solely on the information contained in the Memorandum and investigations made by us and acknowledge that we have not relied on the U.S. Placement Agent or any of its affiliates or any person acting on its or their behalf in connection with our investigation of the accuracy of such information or our decision to invest in the Shares.

7. We agree to keep the Memorandum confidential, it being understood that the Memorandum is strictly for our use and is not to be redistributed or duplicated by us.

8. We have such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Shares. We are able to bear the economic risk of the investment with particular reference to the fact that the Shares will be "restricted securities" within the meaning of Rule 144(a) under the 1933 Act and may not be transferred except as contained in paragraph 3(a) herein. We are acquiring the Shares for investment (i) for our own account or (ii) for not more than one account as to which we exercise sole investment discretion (a "Managed Account") and not with a view to, or for resale in connection with, any distribution or other disposition of the

Shares within the meaning of the 1933 Act. We have no contract, undertaking, arrangement, or agreement with any person to sell or transfer or to have any person sell for us all or any portion of the Shares. We have no present obligation, indebtedness, or commitment, nor is any circumstance in existence, which will compel us to secure funds by the sale of any of the Shares, nor are we a party to any plan or undertaking which would require or contemplate that proceeds from the sale of all or a part of the Shares be utilized in connection therewith, and we do not now have any reason to anticipate any change in circumstances or other particular occasion or event which would cause us to transfer the Shares. In the event that we are acquiring the Shares for a Managed Account, we are familiar with the Managed Account and each of the confirmations, representations and acknowledgments made hereunder are true for the Managed Account and we are duly authorized to make them on behalf of the Managed Account.

9. We have not been formed for the purpose of purchasing the Shares and have substantial assets in addition to the funds to be used to purchase the Shares.

10. We are not purchasing the Shares (i) as a result of or subsequent to becoming aware of any advertisement, article, notice or other communication published in any newspaper, magazine or similar medium or broadcast over television or radio; or (ii) as a result of or subsequent to attendance at a seminar or meeting called by any of the means contained in (i); or (iii) as a result of or subsequent to any solicitation by a person not previously known to us in connection with investments in securities generally.

11. Our principal office is as indicated below.

12. We understand that our acceptance of the offer to subscribe for Shares is irrevocable unless and until rejected by the Company.[10]

13. The information provided herein is true and correct in all respects as of the date hereof. We agree to notify the Company and the U.S. Placement Agent immediately if any of the statements made herein shall become untrue.

As used herein, the terms “United States” and “U.S. person” shall have the meanings ascribed thereto in Rule 902 of Regulation S promulgated under the 1933 Act.

Our obligations under this letter shall be governed by and construed in accordance with the laws of the State of New York without regard to its rules as to conflicts of laws.

Yours truly,

Date: ____

[10] If acceptance of an offer to subscribe for Shares is conditional on the Shares of the Company or Fund being admitted to a offshore securities exchange and on such admission becoming effective on or before a certain date, language to this effect should be added to the representation in this paragraph.

Form 13 (contd.)

By: ____

Name: ____

Title: ____

U.S. Tax ID No.: ____
Number of Shares: ____
Aggregate Purchase Price
(minimum investment U.S. $[50,000]): ____________________________
Address of Principal Office of Purchaser: ____________________________
____
____
Telex No: ____
Fax No.: ____
Address for delivery of notices, if different from above: ________________
____
____
Confirmation of the number of Shares allocated to us should be sent to:
Name of Investor [Institution]: ____________________________________
Attention: ____
Date: ____
Address: ____
____
Telex No.: ____
Telephone No.: ____

ATTACHMENT A

QUALIFIED PURCHASER QUALIFICATION

Name of Purchaser:____________________

Please check the appropriate entries below that accurately describe the Purchaser on whose behalf the Investment Letter is executed:

☐ A natural person who, along or with his or her spouse, owns not less than U.S. $5 million in investments.

☐ A company that owns not less than U.S. $5 million in investments and that is owned, directly or indirectly by or for two or more natural persons who are related as siblings or spouses (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons.

☐ Any trust not covered by the immediately preceding category and that was not formed for the specific purpose of acquiring the Shares, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settler or other person who has contributed assets to the trust, is a qualified purchaser within one of the categories set forth in this Qualified Purchaser Qualification.

☐ A person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than U.S. $25 million in investments.

ATTACHMENT B

ACCREDITED INVESTOR QUALIFICATION[11]

Name of Purchaser:____________________

Please check the appropriate entries below that accurately describe the Purchaser on whose behalf the Investment Letter is executed. The Purchaser is a Qualified Purchaser as set forth in Attachment A hereto and:

- ☐ Any bank as defined in Section 3(a)(2) of the Securities Act of 1933, as amended (the "1933 Act"), or any savings and loan association or other institution as defined in Section 3(a)(5)(A) of the 1933 Act whether acting in its individual or fiduciary capacity.

- ☐ Any broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934, as amended.

- ☐ Any insurance company as defined in Section 2(13) of the 1933 Act.

- ☐ Any investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act") or a business development company (as defined in Section 2(a)(48) of the 1940 Act).

- ☐ Any Small Business Investment Company licensed by the United States Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958.

- ☐ Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions for the benefit of its employees, if such plan has total assets in excess of $5,000,000.

- ☐ Any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of the ERISA, which is either a bank, savings and loan association, insurance company or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed

---

[11] This investment letter contemplates the possibility of investment by ERISA plans. However, as discussed in Chapter 10 of the CL&M Memorandum, there are a number of risks associated with permitting investment by ERISA plans and we generally recommend that such investors be excluded. Should a fund choose to exclude ERISA plans, the investment letter should contain a representation by the investor that it is not an ERISA plan and this Attachment B should be modified. Although it is recommended that the Company allow only institutional investors, this form may be modified to allow investment by individual accredited investors.

plan, with investment decisions made solely by persons that are accredited investors.

☐ A private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940, as amended.

☐ Any organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000.

☐ Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) of Regulation D under the 1933 Act.

☐ Any entity in which all of the equity owners are accredited investors.

Model Form 14: Suggested Provisions for Certificate of Incorporation or other Organizational Documents of the Company

TRANSFER OF SHARES

[For a closed-end fund]: The Shares in the Company are in registered form. The transfer of the Shares shall be effected by transfer in writing in any usual or common form in use in the [Cayman Islands] or in any other form approved by the directors of the Company (the "Directors") but need not be under seal. The instrument of transfer of the Shares shall state the full name and address (and, if required by the Directors, the nationality) of the transferor and shall be signed by or on behalf of the transferor and (for partly paid shares) by the transferee also. The transferor shall be deemed to remain the owner in respect of such Shares until the name of the transferee is entered in the Register in respect thereof. The Directors may in their absolute discretion decline to register any transfer of the Shares in respect of which the nominal value or premium payable in respect of such Shares has not been received by the Company or on which the Company has a lien. The Directors may also decline to register a transfer: (i) unless the instrument of transfer has been deposited at the registered office of the Company or the office of the Registrar or such other place as the Directors may reasonably require, accompanied by the certificate for the Shares to which it relates, and such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer; and (ii) if the instrument of transfer is in favor of more than [four] transferees.

COMPULSORY TRANSFER AND REDEMPTION OF SHARES

(i) If it shall come to the attention of the Directors that (A) any Share or Shares are or may be owned or held directly or beneficially by any person or persons whose holding or continued holding of those Shares (whether on its own or in conjunction with any other circumstance appearing to the Directors to be relevant) might in the sole and conclusive determination of the Directors cause or be likely to cause some legal, regulatory, pecuniary, tax or material administrative disadvantage to the Company or Shareholders or cause or be likely to cause the assets of the Company to be considered "plan assets" within the meaning of regulations adopted under the United States Employee Retirement Income Security Act of 1974, as amended, or Section 4975 of the United States Internal Revenue Code of 1986, as amended; or (B) [if a 3(c)(1) fund, insert the following: the aggregate number of U.S. persons who are beneficial owners of Shares (which for the purposes of the Articles shall include beneficial ownership by attribution under Section 3(c)(1)(A) of the U.S. Investment Company Act of 1940, as amended (the "1940 Act")) is or may be more than [80]] [or, if a 3(c)(7) fund, insert the following: any U.S. person who is not a "qualified purchaser" as defined in Section 2(a)(51)(A) of the 1940 Act beneficially owns any Shares of the Company], the Directors may serve a notice (hereinafter called a "Transfer Notice") upon the person (or any one of such persons where Shares are

registered in joint names) appearing in the Register of members as the holder (the "Vendor") of the Share, the Shares or any of the Shares concerned (the "Relevant Shares") requiring the Vendor within 21 calendar days (or such extended time as in all the circumstances the Directors shall consider reasonable) to transfer (and/or procure the disposal of interests in) the Relevant Shares to another person whose holding of such Relevant Shares, in the sole and conclusive determination of the Directors, would not fall within (a) above and would not result in [if a 3(c)(1) fund, insert the following: the aggregate number of U.S. persons who are beneficial owners of Shares being [80] or more] [or, if a 3(c)(7) fund, insert the following: the beneficial ownership of Shares of the Company being held by any U.S. person who is not a qualified purchaser] (such person being hereinafter called an "Eligible Transferee"). On and after the date of such Transfer Notice, and until registration of a transfer of the Relevant Shares to which it relates pursuant to the provisions of this sub-paragraph (i) or sub-paragraph (ii) below, the rights and privileges attaching to the Relevant Shares shall be suspended and not capable of exercise.

(ii) If within [21] calendar days after the giving of a Transfer Notice (or such extended time as in all the circumstances the Directors shall consider reasonable) the Transfer Notice has not been complied with to the satisfaction of the Directors, the Directors may arrange for the Company to sell the Relevant Shares at the best price reasonably obtainable to any Eligible Transferee or Transferees or the Directors may arrange for the Company to redeem the Shares in accordance with the provisions of the Articles. For this purpose the Directors may authorize in writing any officer or employee of the Company to execute on behalf of the holder or holders of the Relevant Shares a transfer of the Relevant Shares to the purchaser or purchasers, or, as the case may be, a redemption notice in respect of the Shares. The net proceeds of the sale or redemption (as the case may be) of the Relevant Shares shall be received by the Company whose receipt shall be a good discharge for the purchase money or the redemption money and shall be paid over by the Company to the former holder or holders (together with interest at such rate as the Directors consider appropriate) upon surrender by him or them of the certificate for the Relevant Shares, which the Vendor shall forthwith be obliged to deliver to the Company. In the case of a transfer, the Company may register the transferee or transferees as holder or holders of the Relevant Shares and issue to him or them a certificate for the same and thereupon the transferee or transferees shall become absolutely entitled thereto.

(iii) A person who becomes aware that his holding, directly or beneficially, of the Shares will, or is likely to, fall within sub-paragraph (i)(A) above or, being a U.S. person and a beneficial owner of Shares, becomes aware that [if a 3(c)(1) fund, insert the following: the aggregate

number of U.S. persons who are beneficial owners of the Shares is more than [80]] [or, if a 3(c)(7) fund, insert the following: Shares of the Company are beneficially owned by a U.S. person who is not a qualified purchaser], shall forthwith, unless he has already received a Transfer Notice pursuant to sub-paragraph (i) above, either transfer the Shares to an Eligible Transferee or Transferees or give a request in writing to the Directors for the issue or a Transfer Notice in accordance with sub-paragraph (i) above. Every such request shall be accompanied by the certificate or certificates for the Shares to which it relates.

(iv) Subject to the provisions of the Articles, the Directors shall, unless any Director has reason to believe otherwise, be entitled to assume without inquiry that none of the Shares are held in such a way as to entitle the Directors to serve a Transfer Notice in respect thereof. The Directors may, however, at any time and from time to time call upon any holder (or any one of joint holders) of the Shares by notice in writing to provide such information and evidence as they shall require upon any matter connected with or in relation to such holder or joint holders of the Shares. In the event of such information and evidence not being so provided within such reasonable period (being not less than 21 calendar days after service of the notice requiring the same) as may be specified by the Directors in the said notice, the Directors may, in their absolute discretion, treat any Share held by such a holder or joint holders as being held in such a way as to entitle them to serve a Transfer Notice in respect thereof.

(v) The Directors shall not be required to give any reasons for any decision, determination or declaration taken or made in accordance with this Article. The exercise of the powers conferred by sub-paragraph (i) and/or (ii) and/or (iv) above shall not be questioned or invalidated in any case on the ground that there was insufficient evidence of direct or beneficial ownership of the Shares by any person or that the true direct or beneficial owner of any Shares was otherwise than appeared to the Directors at the relevant date provided that the said powers shall have been exercised in good faith.

Model Form 15

Form of Provisions for Placement Agent's Agreement

1. **Definitions**. For the purpose hereof, the following terms shall have the meanings indicated:

(a) "Directed Selling Efforts" means "directed selling efforts" as defined in Rule 902(b) under Regulation S;

(b) "Institutional Accredited Investor" means an accredited investor under Rule 501(a)(1), (2) or (3) of Regulation D;

(c) "Qualified Institutional Buyer" means a "qualified institutional buyer" as defined in Rule 144A;

(d) "Regulation D" means Regulation D adopted by the Commission under the 1933 Act;

(e) "Regulation S" means Regulation S adopted by the Commission under the 1933 Act;

(f) "Rule 144A" means Rule 144A adopted by the Commission under the 1933 Act;

(g) "Commission" means the United States Securities and Exchange Commission;

(h) "United States" means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia;

(i) "1933 Act" means the U.S. Securities Act of 1933, as amended; and

(j) "1934 Act" means the U.S. Securities Exchange Act of 1934, as amended.

2. **Representations and Commitments of the Company**. The Company hereby represents and agrees to the following:

(a) The Company is a "foreign issuer" as defined in Rule 902 of Regulation S under the 1933 Act and reasonably believes that as of the date hereof there is and as of the date of issuance of the Shares there will be no "substantial U.S. market interest" (as defined in Rule 902 under Regulation S) in the Shares of the Company.

(b) The Company (i) is not an open-end investment company, closed-end investment company, unit investment trust or face-amount certificate company that is registered or required to be registered under the United States Investment Company Act of 1940, as amended; and (ii) has not during the past six months offered or sold any securities issued by it in the U.S.

(c) As of the date hereof and as of the date of issuance of the Shares: (i) the Shares are not and will not be, (ii) no securities of the same class as the Shares are or will be, and (iii) no American Depositary Share representing any securities of the same class as the Shares are or will be,

(A) listed on a national securities exchange that is registered under Section 6 of the 1934 Act, (B) quoted in any "U.S. automated inter-dealer quotation system" (as such term is used in the 1934 Act), or (C) convertible or exchangeable at an effective exercise premium (calculated as specified in paragraph (a)(6) or (a)(7) of Rule 144A, as appropriate) of less than ten percent (10%) for securities so listed or quoted.

(d) Neither the Company nor any of its affiliates has taken or will take any action which would cause the safe harbor provision afforded by Regulation S and the exemptions afforded by Section 4(2) and Rule 144A under the 1933 Act to be unavailable for the offer and sale of the Shares under the Placement Agent's Agreement or which would constitute a violation of Regulation M under the 1934 Act.

(e) For so long as any of the Shares are outstanding and may not be resold to the public in the U.S. without restrictions unless registered under the 1933 Act, if the Company is not exempt under Rule 12g3-2(b) under the 1934 Act from the reporting requirements of Sections 13 or Section 15(d) of the 1934 Act, and is not otherwise subject to such requirements, it will provide to any holder of Shares and any prospective purchaser of Shares designated by such holder, upon the request of such holder or prospective purchaser, the information required to be provided to such holder or prospective purchaser by paragraph (d)(4) of Rule 144A.

(f) None of the Company, its affiliates or any person acting on its or their behalf (other than the U.S. Placement Agent and its affiliates as to which the Company makes no representation) has offered or will offer to sell the Shares by means of any form of general solicitation or general advertising (as those terms are used in Regulation D) or in any manner involving a public offering within the meaning of Section 4(2) of the 1933 Act.

(g) Neither the Company, its affiliates nor any person acting on its or their behalf (other than the U.S. Placement Agent and its affiliates as to which the Company makes no representation) has offered or will offer any of the Shares or has made or will make any Directed Selling Efforts with respect to the Shares, to the extent that any such action would cause the safe harbor afforded by Regulation S to be unavailable for offers and sales of the Shares.

(h) The Shares may be offered and sold in the U.S. only in accordance with applicable state securities laws and in accordance with the provisions of Section 3(c).

3. Representations and Commitments of the Placement Agent. The Placement Agent hereby represents and agrees to the following:

(a) The Placement Agent acknowledges that the Shares have not been and will not be registered with the Commission under the 1933 Act and that the Shares are being offered and sold in reliance upon an exemption from registration and under Regulation S (and, for offers and sales to persons in the U.S. in exempt transactions in the manner contemplated in Section 3(c) of this Schedule).

(b) The Placement Agent agrees that neither it nor any of its respective affiliates nor any person acting on its behalf or their respective affiliates (i) has engaged or will engage in any Directed Selling Efforts with respect to the Shares, (ii) except to the extent permitted by Section 3(c), has made or will make (A) any offer to sell or solicitation of any offer to buy any of the Shares to any person or (B) any sale of the Shares to any person unless (x) the seller of such Shares and any person acting on its behalf reasonably believe that at the time such person placed the order to purchase Shares such person was outside the U.S. and (y) such sale is otherwise in compliance with the applicable requirements of Regulation S, (iii) has taken or will take any action which would constitute a violation of Regulation M under the 1934 Act; or (iv) has solicited or will solicit offers for, or offers to sell, the Shares by means of any form of general solicitation or general advertising (as those terms are used in Regulation D) or in any manner involving a public offering within the meaning of Section 4(2) of the 1933 Act or which would otherwise cause the safe harbor afforded by Regulation S to be unavailable for offers and sales of the Shares.

(c) Offers and sales of the Shares in the U.S. may be made only (i) by the Company in accordance with the requirements of Rule 506 of Regulation D or (ii) by the U.S. Placement Agent or its affiliates either (A) to Qualified Institutional Buyers (or persons reasonably believed to be Qualified [Institutional] Buyers) in resale transactions in reliance on and accordance with the requirements of Rule 144A or (B) to Institutional Accredited Investors in reliance on and in accordance with another exemption from the registration requirements of the 1933 Act, provided that all offers and sales under this Section 3(c) shall be made in accordance with applicable state securities laws and provided, further, that each purchaser shall, prior to the sale of Shares to it under this Section 3(c), have received a copy of the Memorandum in form acceptable to the Company and the U.S. Placement Agent and have executed and delivered to the Company an Investment Letter in the form attached hereto as Exhibit __.

(d) The Placement Agent agrees that offers to sell, solicitations of offers to buy and sales contemplated by this Agreement shall be made only in

compliance with any applicable U.S. federal or state laws relating to broker-dealer registration.

(e) The Placement Agent has not entered into, and will not, without the prior written consent of the Company, enter into, any contractual arrangement with respect to the distribution of the Shares in the U.S., except with its affiliates.

Model Form 16

Provisions Regarding Company's Obligations to Provide Information for QEF Election

It is recommended that the Company formalize its commitment to provide U.S. shareholders with any information and representations necessary for them to make a qualified electing fund election. This formal commitment may be inserted in the Private Placement Memorandum or delivered by the Company as a closing document. *See also* the statement in the tax section of the Private Placement Memorandum (*see* Form 10) that the fund will provide such information upon request. The formal commitment by the Company may include the following language:

> The Company shall provide upon request such information and representations as are required under the United States Internal Revenue Code of 1986, as amended (the "Code"), the Treasury Regulations thereunder and administrative guidance with respect thereto, as shall enable a shareholder to make a "qualified electing fund" election with respect to the Company, or any similar provision of subsequent law. Under current law, such information and representations include:
>
> (i) The year to which the information applies.
>
> (ii) The shareholder's pro rata share of the ordinary earnings and net capital gains of the Company (computed in accordance with U.S. income tax principles), or sufficient information to enable the shareholder to calculate the same.
>
> (iii) The amount of cash and fair market value of property distributed or deemed distributed to the shareholder during the year.
>
> (iv) A statement that the passive foreign investment company will permit the shareholder to inspect and copy the Company's books of account, records, and such other documents as may be maintained by the Company that are necessary to establish that the Company's ordinary earnings and net capital gain, as provided in section 1293(e) of the Code, are computed in accordance with U.S. income tax principles.