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The Structuring of (Unregistered) Security Offerings of Swiss Listed Companies

Revisiting General Principles and U.S. Liability Considerations coupled with a Comparison to the Swiss Liability Regime

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I. Introduction

The United States («U.S.») has the world's deepest pool of investors and is one of the biggest potential source of funding for issuers, including issuers with a primary listing in Switzerland. Any offers and sales of securities into the U.S., regardless of whether such an offering is registered under U.S. securities laws, subjects transaction participants to obligations under U.S. securities laws and potential liability relating to such offering. The issuer, its directors and officers and certain related parties, as well as the banks and other advisors involved in the offering may be subject to liability under U.S. securities laws.

This article examines the U.S. federal securities laws for unregistered securities offerings by Swiss listed companies and will serve as a useful reminder that certain aspects of the U.S. anti-fraud provisions apply to any offering of securities inside the U.S. The discussion begins by examining the basic framework of the U.S. federal securities laws, focusing on the typical exemptions used in connection with unregistered Swiss securities offerings with a U.S. element. Thereafter, the discussion shifts to providing a high-level overview of the liability considerations under the U.S. federal securities laws, with a detailed section dedicated to Rule 10b-5, which is the most common liability consideration in these types of transactions. Finally, the article concludes with a brief outline of the Swiss liability regime together with a comparison of the different liability concepts.

II. Basic Framework of the United States Federal Securities Laws for Securities Offerings

Under the U.S. Securities Act of 1933, as amended (the «Securities Act»), all offers and sales of securities in the United States must be registered under the Securities Act or otherwise exempt from, or not subject to, this registration requirement. This basic principle is set out in Section 5 of the Securities Act, which prohibits any sales or offers for sale of securities unless a registration statement

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has been filed with the U.S. Securities and Exchange Commission (the «SEC») or unless an exemption from such registration is available. Most securities offerings by European issuers are conducted in reliance on one or more exemptions from, or in a transaction not subject to, the registration requirement under Section 5 of the Securities Act. In particular, transactions in Europe are generally conducted as private placements to institutional investors in certain jurisdictions, including (i) in the U.S. exclusively to so-called «qualified institutional buyers» or «QIBs» in reliance on Rule 144A under the Securities Act («Rule 144A») and/or (ii) outside of the U.S. in reliance on Regulation S under the Securities Act («Regulation S» or «Reg S») (the «Private Placement»).

1. Rule 144A

Rule 144A exempts from the registration requirements the offer or sale of a security by a person other than the issuer to any QIBs, or to any person that the seller reasonably believes to be a QIB, if:

(a) the securities were not at the time of issuance of the same class as securities of the issuer listed on a U.S. securities exchange;

(b) the seller advises the buyer that it may be relying on Rule 144A; and

(c) unless the issuer is a reporting company or exempt from the U.S. Securities Exchange Act of 1934, as amended (the «Exchange Act») registration under Rule 12g3-2(b),[1] the issuer has agreed to furnish the buyer, upon request with certain specified information.

1.1. Rule 144A is not available to an issuer of securities

Rule 144A is a resale exemption and is therefore not available to the issuer of the securities. When we informally refer to a Rule 144A transaction involving the sale of newly issued securities by an issuer, from a U.S. securities law perspective, the transaction is formally two separate transactions – (i) a private placement of securities by the issuer to the «initial purchasers» (the underwriters, i.e., typically investment banks), which is exempt from the registration requirements under Section 4(a)(2) of the Securities Act (see section II.2 below, «Section 4(1½) – Investor private resale procedure»), and (ii) a Rule 144A resale by such initial purchasers to QIBs.

1.2. Resales may be made only to QIBs

Rule 144A limits resales of securities to persons who are QIBs or to persons who the seller reasonably believes are QIBs. In adopting Rule 144A, the SEC implicitly took the position that certain large institutional investors, which they have defined as QIBs, do not need the protections that registration would afford under the Securities Act. QIBs are defined as institutional investors with a portfolio of securities valued at more than USD 100 million, either owned or under management, registered broker-dealers with at least USD 10 million in securities owned or managed, and any bank or savings and loan association that both (i) owns, or invests on a discretionary basis in, at least USD 100 million in third-party securities and (ii) has an audited net worth of at least USD 25 million.

1.3. Other criteria for the availability of Rule 144A

a. Securities not of the same class as securities of the same issuer listed on a U.S. national securities exchange

Rule 144A requires that securities sold in reliance on this rule must not be of the same class as any securities of the same issuer listed on a U.S. national securities exchange or quoted on a U.S. automated inter-dealer quotation system. The concern was to prevent parallel trading markets for a single class of securities in the U.S.

b. Seller must advise buyer that it may be relying on Rule 144A

Any seller relying on the exemption provided by Rule 144A is required to take reasonable steps to ensure that the purchaser is aware that the seller is relying on the exemption. An underwriter typically discharges this by delivering to the investor a prospectus or offering circular that includes the relevant selling restrictions, by including a statement to this effect in a one-way investor representation letter, or by including a statement of possible reliance on Rule 144A in the confirmation sent to the investor.

c. Provision of information by issuers not subject to the U.S. reporting requirements

In order for the Rule 144A exemption to be available, the issuer must agree to provide designated information to a purchaser of securities upon request unless it is already a public reporting company in the United States or exempt from such reporting under the Exchange Act. It is therefore customary, that applicable transaction documentation contains a covenant from the issuer to supply the necessary information to a purchaser upon request, unless the issuer is otherwise exempt.

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[1] To qualify for the exemption, foreign private issuer must: (i) be listed on a non-U.S. securities exchange which qualifies as the foreign private issuer's primary trading market; (ii) not be subject to a current Exchange Act reporting requirement; and (iii) promptly publish, in English, certain home country disclosure documents on its website. Most of Swiss companies listed on the SIX Swiss Exchange will qualify under the exemption requirement.

2. Section 4(1½) – investor private resale procedure

It has become relatively common in Europe that when Rule 144A is not available for technical reasons but the transaction participants nonetheless desire to access the US QIB market, the transaction is structured to rely on the so-called Section 4(1½) exemption. The so-called Section 4(1½) exemption is not derived from an actual section of the Securities Act nor is it formally established by any other U.S. law or written SEC rule or regulation. Instead, it has been developed over time by practitioners to facilitate private placement style transactions conducted through underwriters or placement agents, but where for formal or technical reasons Rule 144A is not available. The exemption's provenance, including its unusual designation, is derived from combining two other exemptions:

- Section 4(a)(2) of the Securities Act permits an issuer (but not an underwriter) to sell securities in a «private placement» without registration. A transaction structured to comply with the requirements that have developed to support a Section 4(a)(2) private placement typically includes, among other things, a subscription agreement executed between the issuer and the subscribers and representations and warranties provided by the subscribers in the subscription agreement (or other relevant transaction documents) to evidence the subscribers' intention not to acquire the securities from the issuer with a view to a distribution or the intention to publicly resell, as well as their level of sophistication and the work they have done to satisfy themselves as to the nature of the investment. These provide confidence that the protections that would otherwise be available through the SEC registration process are not required in the circumstances.
- Section 4(a)(1) of the Securities Act exempts from registration transactions by any person other than an issuer (including an affiliate of the issuer), underwriter, or dealer. A holder of securities who is not an issuer (or an affiliate of the issuer), underwriter or a dealer can, therefore, sell non-restricted securities freely without the need for registration. Section 4(a)(1) is the exemption relied upon for ordinary course (non-affiliate) secondary market trading.

Over time, practitioners combined aspects of the practice under Sections 4(a)(1) and 4(a)(2) to develop the Section 4(1½) procedures. A Section 4(1½) transaction generally includes:

- a limited number of U.S. offerees / purchasers, all of which are QIBs;
- strict limitation on the publicity and marketing of the transaction to ensure that there is no general solicitation or general advertising;
- the availability of sufficient information about the issuer (note that in the context of an undocumented offering for a SIX-listed company, this is usually achieved through the regular reporting and *ad hoc* announcements); and
- two-way investor representation letters through which the issuer and underwriters or placement agents obtain the same type of reciprocal representations that purchasers in a private placement would provide.

3. Regulation S

Regulation S is a safe harbor that provides a list of criteria for certain offers and sales of securities to investors outside the United States, which if adhered to, allows the transaction participants to be comfortable that their transaction is not subject to the registration requirements of the Securities Act.

Regulation S can be used in conjunction with Rule 144A (or other exemptions, such as Section 4(a)(2)) to offer or sell securities outside the U.S. at the same time that securities are being sold in the U.S.

The Regulation S criteria vary depending upon the nature of the seller, the type of offering, the characteristics of the issuer, the characteristics of the securities and the degree of pre-existing U.S. market interest in securities of the issuer.

There are two principal restrictions in Regulation S that apply to all Regulation S-compliant offerings of securities:

- each offer or sale must be made as an «offshore transaction» (as defined in Regulation S); and
- there must be no «directed selling efforts» (as defined in Regulation S) in the U.S.

An «offshore transaction» is an offer made to a person outside the U.S., and the buyer must be outside the U.S. at the time that the buy order is originated (or the seller must reasonably believe this to be the case).

The prohibition on «directed selling efforts» in the U.S is meant to limit any action which is intended, or that could reasonably be expected, to result in conditioning the U.S. market for the sale of the securities being offered. Examples of «directed selling efforts» include advertisements in or press releases targeted at the U.S.

Regulation S categorizes all transactions into three categories – Categories 1, 2 and 3, with Categories 2 and 3 imposing offering restrictions in addition to the basic requirements set out above. Generally, the higher the risk of flowback into the U.S. of the securities that are the subject of the transaction, the greater the restrictions and conditions.

The restrictions mainly relate to the imposition of a «distribution compliance period» during which «distributors» (i.e., transaction participants) are prohibited from selling the subject securities to U.S. persons. In certain circumstances, legends and other procedures are also required. For transaction involving newly issued debt securities, compliance with the distribution compliance period can be relatively easy, however, for equity transactions involving listed shares where the newly issued shares are fungible with those that already exist, compliance with this requirement can be very difficult to monitor.

In addition to the prohibition on sales to U.S. persons, during a distribution compliance period, distributors and dealers have certain notification requirements in respect of the restrictions imposed by Regulation S. The following table sets out the requirements for Categories 1, 2 and 3 of Regulation S, with Category 1 being the least stringent and Category 3 the most stringent.

Category	Debt Securities	Equity Securities	Requirements
Category 1 Lowest Flowback Risk	• Foreign issuers with no substantial U.S. market interest («SUSMI»[2]) • Overseas directed offerings (foreign issuers or non-convertible debt of U.S. issuers) • Securities backed by foreign government • Securities sold pursuant to foreign law governed employee benefit plan	• Foreign issuers with no SUSMI • Overseas directed offerings (foreign issuers only) • Securities backed by foreign government • Securities sold pursuant to foreign law governed employee benefit plan	• Offshore transaction • No directed selling efforts
Category 2 Moderate Flowback Risk	• Reporting and non-reporting foreign issuers with SUSMI • Reporting U.S. issuers	• Reporting[3] foreign issuers with SUSMI	• Offshore transaction • No directed selling efforts • Offering restrictions[4]
Category 3 Highest Flowback Risk	• Non-reporting U.S. issuers	• Reporting and non-reporting U.S. issuers • Non-reporting foreign issuers with SUSMI	• Offshore transaction • No directed selling efforts • Offering restrictions • Additional transactional restrictions[5]

III. Basic Framework of Liability under the United States Federal Securities Laws for Securities Offerings

1. Overview

There is a long list of statutory provisions in the Securities Act and the Exchange Act that establish and regulate liability in connection with offers and/or sales of securities. This liability is based on the fundamental duty to disclose all material information in connection with

2 Equity securities: (i) U.S. market (in the aggregate) constituted the single largest market for the class of securities being offered in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation (Rule 902(j)(1)(i)); or (ii) 20% or more of all trading in the class of securities being offered took place through U.S. markets and less than 55% of all trading in the same class of securities occurred through the 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 (Rule 902(j)(1)(ii)).
Debt securities: (i) 300 or more U.S. holders of record; (ii) USD 1 billion or more of the outstanding principal (prior to the relevant offering), the greater of liquidation preference or par value of non-participatory preferred stock or the principal amount of balance of asset-backed securities, is held of record by U.S. persons; and (iii) 20% or more of the outstanding principal, the greater of liquidation preference or par value of non-participatory preferred stock or the principal amount or balance of asset-backed securities is held of record by a U.S. person.

3 A reporting issuer is an issuer that is subject to the ongoing reporting obligations of the U.S. securities laws.

4 Applies to Category 2 and 3. Distribution compliance period: (i) 40 days from the later of: the date the securities were first offered to persons other than distributors in reliance on Regulation S; and the date of the closing of the offering; (ii) during the distribution compliance period, no offers or sales can be made to U.S. persons (even if they are not in the U.S.) after the offshore offering commences unless pursuant to registration or another exemption; and (iii) distributors must notify all participants (e.g., retail broker-dealers) that the participants become subject to the same restrictions on offers and sales that apply to the distributor.

5 Equity securities: (i) No offers or sales to U.S. persons during one-year distribution compliance period (6 months if distributor is a reporting issuer); (ii) Certification by non-distributor purchasers that they are either (A) a non-U.S. person or (B) U.S. persons purchasing in an exempt transaction; Purchaser must agree that any resale will be (A) registered, (B) exempt from registration or (C) pursuant to the resale safe harbor; and (iv) Distributors must notify members of the selling group that during the one-year distribution compliance period they are subject to the same restrictions (6 months if distributor is a reporting issuer).
Debt securities: Securities must be issued under a temporary global security that is not exchangeable for definitive securities until either: (i) expiration of 40-day distribution compliance period; or (ii) certification by a non-distributor purchaser that they are either (A) a non-U.S. person or (B) U.S. persons purchasing in an exempt transaction.

an offer or purchase of a security and the prohibition of fraud and deceit and applies to the issuers of the relevant securities, their «control persons», and offering participants such as brokers, dealers and underwriters, participating counsel, auditors and other participating experts.

The statutory bases of liability in connection with offers and/or sales of securities are many and the case law, as applied by the federal and state courts and enforced by the SEC, is voluminous, complex and, in certain areas, inconsistent. Broadly, the Securities Act is designed to protect purchasers of securities in connection with primary distributions, whereas the Exchange Act protects both sellers and purchasers of securities from fraud, deceit and manipulative practices in all securities transactions, including primary distributions and secondary purchases and sales. As a general matter, liability under one provision of the Securities Act or Exchange Act does not preclude liability under another[6] and, in advancing a securities action, plaintiffs will typically claim a number of securities law violations cumulatively or in the alternative. Plaintiffs may also (and often do) pursue state common law claims, such as actions for common law fraud, because the federal securities laws do not always pre-empt state law claims.

Issuers of securities, underwriters, placement agents and other offering participants in a primary distribution of securities can encounter civil liability for two types of unlawful activity: (i) violation of the registration and prospectus delivery requirements under Section 5 of the Securities Act («Section 5 Violations») and (ii) violations of the anti-fraud provisions of the Securities Act and the Exchange Act («Disclosure Violations»).

1.1. Section 5 violations

In connection with Section 5 Violations, a person who makes an unregistered sale of a security violates Section 5 of the Securities Act where the seller is unable to prove that the security or the transaction, of which the unregistered offer or sale was a part, was exempt from registration under the Securities Act. The SEC may seek administrative or judicial relief, including, where appropriate, civil penalties, against any person who violates Section 5. In addition, Section 12(a)(1) of the Securities Act provides the express right of action for certain purchasers of unregistered securities to rescind the unregistered sale or, if the securities have been resold by any purchaser, to recover damages from the seller who violated Section 5. A claim under Section 12(a)(1) of the Securities Act must be brought within one year after the violation upon which it is based. Private Placements are not registered under Section 5 of the Securities Act and must rely on one of the applicable exemptions from registration, or the transaction will be entirely unlawful.

1.2. Disclosure violations

In connection with Disclosure Violations, there are many different bases of liability. Sections 11 and 12(a)(2) of the Securities Act and Rule 10b-5 under the Exchange Act («Rule 10b-5») are the provisions that are most likely to be implicated in any distribution of securities in the context of a Private Placement.

Section 11 of the Securities Act imposes liability on the issuer and other designated persons for any material misrepresentation or omission in a registration statement. While the issuer has few defenses to an action by a purchaser based on a misleading representation or omission (aside from actual knowledge of the misrepresentation by the purchaser), other parties have an affirmative defense if they can prove that they made a reasonable investigation and had a reasonable basis to believe, and did believe at the time the registration statement became effective, that there were no material misstatements or omissions. This is the essence of due diligence in securities transactions and one of the fundamental mitigating factors for underwriters and other offering participants: a reasonable investigation resulting in reasonable grounds to believe and an actual state of mind in which the underwriter or other participant does believe that the registration statement was correct.

Section 12(a)(2) of the Securities Act provides the buyers of securities an express remedy for material misstatements or omissions made by «any seller» in connection with the offer or sale of the issuer's securities involving a prospectus or oral communications. Liability under this provision extends beyond the specific categories of persons enumerated in Section 11, attaching instead to any seller of the securities.

Potential liability under Sections 11 and 12(a)(2) of the Securities Act is designed to provide relief to anyone who buys a security directly from an issuer or underwriter that is unregistered in violation of Section 5 of the Securities Act, or on the basis of false or misleading oral representations or a false or misleading prospectus. In connection with a Rule 144A and/or Reg S offering, provided that the requirements of being exempt from the registration requirements of Section 5 of the Securities Act are met, liability under Sections 11 and 12(a)(2) will not be applicable to these types of offerings. Furthermore, a litigant may pursue both Section 11 and 12(a)(2) actions to judgment and then electing his / her remedy, i.e., if the action is successful, you cannot have relief under both of these sections but must choose one.

[6] See, e.g., Herman & MacLean v. Huddleston, 459 U.S. 375, 383–87 (1983).

1.3. Other violations

Section 15 of the Securities Act provides that any person who «controls» a person liable under Section 11 or Section 12 of the Securities Act is liable jointly and severally with and to the same extent as the controlled person. The term «controls» is broadly defined for purposes of this section and the concept of control can include directors, officers and principal shareholders, depending on the specific facts and circumstances.

Section 10(b) of the Exchange Act and Rule 10b-5 issued thereunder prohibit fraudulent devices and schemes, material misstatements and omissions of any material facts, and acts and practices that operate as a fraud or deceit on any person in connection with the purchase or sale of a security. Each offering participant, including the issuer, its officers and directors, the underwriters, accountants and other experts, is potentially liable under this provision.

Section 20(a) of the Exchange Act imposes liability on any person who directly or indirectly controls any person liable under Section 10(b) or Rule 10b-5, to the same extent as the controlled person. Section 15 of the Securities Act and Section 20 of the Exchange Act have been interpreted as parallel provisions.

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

Section 10(b) of the Exchange Act is designed to eliminate fraud and manipulation in securities transactions and promote accurate disclosure in offering documents. Section 10(b) was designed to enable prospective investors to make informed investment decisions. The SEC promulgated certain rules to implement the protections of Section 10(b), including Rule 10b-5, which is patterned closely after Section 17(a) of the Securities Act.

Rule 10b-5 is generally considered to be the most important basis for civil liability under the U.S. federal securities laws. It can be enforced by the SEC in both injunctive and civil penalty actions and by the United States Department of Justice in actions which impose criminal liability for willful violations of the Exchange Act. Over the years, courts in every circuit have also implied a private right of action under Rule 10b-5, thereby allowing private citizens to pursue Rule 10b-5 claims for both registered and unregistered offerings.[7]

Rule 10b-5 prohibits, directly or indirectly, the use of any means or instrumentality of interstate commerce to (a) employ any device, scheme or artifice to defraud, (b) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) engage in any act, practice or course of business that operates as a fraud against any person, in connection with the purchase or sale of any security. The offering document, or any other disclosure document or communication made or used in the offering, including a press release, a term sheet or oral statements made in an investor roadshow, will be subject to the anti-fraud provisions of Rule 10b-5.[8]

To prevail on a Rule 10b-5 claim, a plaintiff must prove that:

(1) the defendant made a false statement or an omission of material fact,
(2) with «scienter»,
(3) in connection with the purchase or sale of a security,
(4) upon which the plaintiff justifiably relied, and
(5) which proximately caused,
(6) the plaintiff's economic loss.[9]

2.1. Persons liable

Rule 10b-5 imposes liability on:

(1) the «maker» of materially false or misleading statements,
(2) «in connection with» the purchase or sale of a security.

a. Makers of false or misleading statements

The «maker» of a statement is generally defined as «the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.»[10] The U.S. Supreme Court has noted that «[w]ithout control, a person or entity can merely suggest what to say, not ‹make› a statement in its own right»,[11] and has also held that Section 10(b) does not support liability on the basis of aiding and abetting.[12]

An investment bank's involvement in preparing and disseminating an offering document may be sufficient to render it a «maker», particularly where the bank solicits investors, distributes a prospectus, «signs off» on the

7 Janus Capital Grp., Inc. v. First Derivatives Traders, 131 S. Ct. 2296, 2302 (2011) (noting the U.S. Supreme Court has held that private rights of action under Section 10(b) are implied and this continues to be the law); Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 165 (2008) (holding the implied private right of action in Rule 10b-5 «remains the law»).

8 17 C.F.R. §240.10b-5.

9 Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 133 S. Ct. 1184 (2013); Matrixx Initiatives Inc. v. Siracusano, 131 S. Ct. 1309 (2011).

10 Janus Capital Grp., Inc. v. First Derivatives Traders, 131 S. Ct. 2296, 2302 (2011).

11 Id.

12 Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994).

statements and is authorized to make representations on behalf of the issuer to investors.[13] This is a fact-driven analysis that depends, in part, on the agreement between the issuer and the investment bank, as well as the investment bank's discussions with investors.

It is important to note that the U.S. Supreme Court in Lorenzo v. SEC ruled that anyone responsible for communicating to investors, even if not individually responsible for the content of those communications, may incur primary liability for disseminating information they know to be false or misleading.[14]

b. In connection with

Courts have repeatedly interpreted the language «in connection with the purchase or sale of a security» broadly. The leading case, SEC v. Tex. Gulf Sulphur Co.,[15] held that even where a defendant does not purchase or sell securities, the requirement is satisfied where his conduct occurred in a manner reasonably calculated to influence the investing public.

2.2. Scienter

A violation of Rule 10b-5 requires evidence of scienter, which is intentional or willful fraud rather than mere negligence.[16] However, the U.S. circuit courts have also identified certain forms of recklessness as satisfying the scienter requirement.[17] While some courts require severe recklessness, others only require ordinary recklessness.[18]

Courts have found that engaging internal and external counsel, auditors and other parties to be sufficient to negate scienter[19] but this cannot be presumed to always be the case. Each transaction should be assessed to determine what type of transaction execution and due diligence process is reasonable in the context in order to mitigate this risk and establish a due diligence defense which is not a bright line test and depends on the circumstances.

2.3. Reliance

Reliance is a necessary element for a Rule 10b-5 private suit.[20]

a. Establishing reliance

A Rule 10b-5 private plaintiff must show that the prohibited conduct of defendants was a substantial factor in causing the plaintiff to enter into the transaction. This is a highly fact-specific analysis that typically would depend on each case.

But where fraud is alleged to be committed by way of omission, and such omission is material, the courts have applied a presumption of reliance.[21] This presumption of reliance may be rebutted «by showing that the market did not respond to the alleged misrepresentations, or that the plaintiff did not actually rely on the market price when making his or her investment decision.» In Basic Inc. v. Levinson,[22] the U.S. Supreme Court indicated that a presumption of reliance would apply where the price of the security decreased in response to market information, and the plaintiff could prove that the market in which the securities traded was efficient at pricing market information.

2.4. Loss causation

In order to establish loss causation, «a plaintiff must prove ‹that the economic harm that it suffered occurred as a result of the alleged misrepresentations› and that ‹the damage suffered was a foreseeable consequence of the misrepresentation.›»[23] Plaintiffs typically prove loss causation through evidence of (i) a corrective disclosure that corrects a previous fraud to the market, (ii) a subsequent decrease in the price of the security after such disclosure, and (iii) the existence of no alternative explanations for such decrease in price.[24]

While most cases have applied loss causation in the context of public offerings of securities, the courts have shown a willingness to require loss causation in the context of private placements and inefficient markets, as

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13 See In re Puda Coal Sec. Inc., Litig., 2014 WL 3427284, at 3 (S.D.N.Y. July 14, 2014).

14 Lorenzo v. Securities and Exchange Commission, 139 S. Ct. 1094, 1101.

15 401 F.2d 833 (2d Cir. 1968). See also S.E.C. v. Greenstone Holdings, Inc., No. 10 CIV. 1302 MGC, 2012 WL 1038570, at 11 (S.D.N.Y. Mar. 28, 2012) («[T]he Second Circuit has interpreted the ‹in connection with› requirement broadly for cases involving false or misleading press.»).

16 Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193–199 (1976).

17 See, e.g., Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 99–100 (2d Cir. 2001); In re Genzyme Corp. Sec. Litig., 754 F.3d 31, 40 (1st Cir. 2014); Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 639 (D.C. Cir. 2008); Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353, 366 (5th Cir. 2004); PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 681 (6th Cir. 2004); Ottmann v. Hanger Orthopedic Grp., Inc., 353 F.3d 338, 344 (4th Cir. 2003).

18 Compare, e.g., Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 639 (D.C. Cir. 2008) (holding that extreme recklessness can satisfy the scienter requirement) with United States v. Gansman, 657 F.3d 85, 91 n.7 (2d Cir. 2011) (requiring «[mere] recklessness» for civil liability).

19 See for example SEC v. Shanahan, 646 F.3d 536 (8th Cir. 2011) (holding that the defendant's scienter had not been established even where he «never questioned the accuracy…or discuss[ed] the meaning or import» of certain facts provided to him).

20 Berckeley Inv. Grp., Ltd. v. Colkitt, 455 F.3d 195, 222 (3d Cir. 2006); Currie v. Cayman Res. Corp., 835 F.2d 780, 785 (11th Cir. 1988).

21 See, e.g., Castellano v. Young & Rubicam, Inc., 257 F.3d 171, 186 (2d Cir. 2001).

22 485 U.S. 224, 241–50 (1988).

23 Rothman v. Gregor, 220 F.3d 81, 95 (2d Cir. 2000) (quoting Citibank, N.A. v. K-H Corp., 968 F.2d 1489, 1495 [2d Cir. 1992]).

24 Meyer v. Greene, 710 F.3d 1189, 1196–97 (11th Cir. 2013).

well.[25] In both actions involving securities that trade in a liquid and efficient market and those that do not, the plaintiff must establish both (i) transaction causation (i.e., that the plaintiff entered into the transaction in reliance on the alleged misrepresentation or omission) and (ii) loss causation (i.e., that the facts misrepresented or omitted were a substantial factor in causing the plaintiff's economic loss), and the courts have expressly rejected the notion that the two can be conflated.[26] In an action involving private placed securities that do not trade in a liquid and effective market, establishing loss causation may be more complicated than in a typical action where the causal link between the misrepresentation or omission and a decline in market price is often more evident.[27]

3. Practical considerations

As a result of the foregoing, it is imperative that an offering document, such as a prospectus or offering circular, as well as other materials related to the offering (e.g., roadshow materials and other investor presentations, press releases, etc.), be carefully prepared with input from management, legal counsel, financial advisors and auditors. This process includes vetting the prospectus through a due diligence and drafting process, which is designed to ensure that the information upon which investors base their investment decision is materially accurate and complete.

The typical elements of a customary due diligence process include: (i) business due diligence, (ii) financial due diligence, (iii) accounting and auditor due diligence, and (iv) legal and documentary due diligence.

With respect to business due diligence, the typical areas of investigation include, *inter alia*, investigating and understanding the issuer's business operations, identifying the material business risks, confirming the integrity of management, verifying the viability of the business plan, and establishing the management's commitment to disclosed strategy. This due diligence can be achieved through, among other things, presentations by, and discussions with, management, attending site visits, engaging in customer, supplier and lender due diligence, and customary background checks through standard directors and officers' questionnaires.

Financial, accounting and auditor due diligence involves the review of financial statements, other financial operating data along with financial analysis and modelling. This review is customarily supported by the company's auditors who will be asked to deliver comfort letters that provide assurances as to the integrity of certain financial data included in the offering document and that the company has not experienced any materially negative effects to its financial condition. In parallel, the auditors will be required to attend and present at auditor due diligence sessions, which stress test the integrity of the auditing process. A key element of accounting due diligence is to establish whether the company has and/or is experiencing any significant deficiencies and/or material weaknesses in its internal control environment and its ability to prepare accurate and compliant financial statements. Separately, as part of financial due diligence, it is also important to ensure that a contemplated offering does not violate any existing agreements (e.g., covenants included in existing financing documents).

Legal and documentary due diligence is a comprehensive review of all legal and risk issues, as well as all material documents. This process is aimed at establishing a clear picture of the company's business, its relevant legal considerations and to help understand and dimension risk. Typically, a virtual data room will be set up with documents that cover, among other things, the company's corporate matters, material contracts (including financing arrangements), auditor correspondence and material legal and regulatory matters (including litigation and environmental). This document review process is supplemented by meetings and discussions with management and internal legal and compliance officers, and assists all stakeholders to put together informed disclosure and is key to any offering process.

The due diligence process is designed to facilitate the preparation of an offering document that discloses all of the relevant information that may be material to a potential investment decision.

The drafting of the offering document or prospectus is an iterative process led by the issuer and its advisors, and which involves all stakeholders, advisors and transaction participants. This cooperative and interactive approach adds important aspects to the overall due diligence efforts. Through the enquiries that result from the drafting process, further due diligence questions and discussions will take place, thereby helping to ensure the accuracy and completeness of the offering document's disclosure. In addition, a counsel-led verification process assists in ensuring the correctness of all material data included in the document.

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25 McCabe v. Ernst & Young, LLP, 494 F.3d 418, 433 (3d Cir. 2007); Nuveen Mun. High Income Opportunity Fund v. City of Alameda, 730 F.3d 1111, 1123 (9th Cir. 2013). See also 15 U.S.C. § 78u-4(b)(4) (2006) (requiring loss causation within the context of private class action suits as part of the Private Securities Litigation Reform Act). Nuveen Mun. High Income Opportunity Fund v. City of Alameda, 730 F.3d 1111, 1119 (9th Cir. 2013).

26 Nuveen Mun. High Income Opportunity Fund v. City of Alameda, 730 F.3d 1111, 1119 (9th Cir. 2013).

27 McCabe v. Ernst & Young, LLP, 494 F.3d 418, 426 (3d Cir. 2007) («… in a non-typical § 10(b) action, where the plaintiff does not simply allege that the price of a publicly-traded security has been affected, the factual predicates of loss causation fall into less of a rigid pattern.»).

Due diligence is the key component of the overall transaction process that ensures that the disclosure satisfies the necessary legal and regulatory requirements and helps to mitigate any potential liability under applicable securities laws by ensuring that participating investors are making informed investment decisions based on accurate and complete information. Every transaction participant should be aware of these requirements when participating in a potential offering.

IV. Swiss Considerations and Comparison

1. Overview

In contrast to the U.S. federal securities laws, the Swiss prospectus and securities offering liability regime is not widely dispersed but laid down in the Swiss Federal Act on Financial Services[28] (the «FinSA»). It has two prongs: a civil law and a criminal law provision.

The civil law provision provides that any person who fails to exercise due care and thereby furnishes information that is inaccurate, misleading or in violation of statutory requirements in prospectuses, key information documents or similar communications is liable to the acquirer of a financial instrument for the resultant losses.[29]

According to the criminal provision, a fine of up to CHF 500,000 may be imposed on any person who willfully provides false information or omits material facts in the prospectus; or who fails to publish the prospectus by the beginning of the public offer at the latest.[30]

2. Communications covered by liability

While Swiss prospectus liability targets primarily the statements (and omissions) made in a prospectus, it also applies to any other communications made in connection with an offering or listing (so-called «similar communications»). Similar to the anti-fraud provisions of Rule 10b-5 in the U.S., such «similar communication» may include a broad variety of information furnished to investors or the public in general in connection with an offering or listing including a press release, a term sheet or oral statements made in an investor roadshow.

As a result of this broad understanding of communications being subject to liability under both the Swiss and the U.S. provisions, it is common practice that counsels draft publicity guidelines, which provide that all information released in connection with the offering must be circulated for review to a working group in order to make sure that all published information is consistent with the prospectus and every statement made in a presentation or other communication is included in the prospectus which serves as a basis for an investment decision.

3. Liable persons

Anyone who «makes statements» in prospectuses, key information documents or similar notices may potentially be liable. As regards the «makers» of a statement, similar considerations apply as under the U.S. provisions (cf. section III.2 above): «Makers» are primarily persons who are actively involved in the drafting of the prospectus and include not only persons within the company but also advisors involved in the prospectus drafting, including e.g., investment banks or auditors. In the Swiss doctrine, it is debated to which extent persons, such as board members, who are entrusted with the preparation of the prospectus, as well as persons who know or have reason to know that information they supply will be incorporated in the prospectus are liable: Some argue that the responsibility is limited to those who are actively engaged in the preparation of the prospectus, which is not necessarily the case for board members if they did not materially contribute to the prospectus. This view is, however, contested by some authors.[31] As the liability provisions were entered into force only recently, it remains to be seen how Swiss court will address this question.

4. Requirements for liability

To establish a prospectus liability, the following elements are required: (i) breach of duty, (ii) damage, (iii) causal connection, and (iv) fault. These elements and requirements are thus is in line with the general conditions of Swiss liability in tort.

4.1. Breach of duty

A person commits a breach of duty of due care if it fails to meet the objective standard of due care that applies in respect of the preparation of a prospectus and makes or disseminates statements that were inaccurate or misleading or did not meet the legal requirements. While there is no legal provision regarding the scope of a due diligence in connection with the preparation of a prospectus under Swiss law, a Swiss market practice has been established over the years, which serves as a guidance for the stan-

28 Swiss Federal Act on Financial Service of 15 June 2018, as amended (SR 950.1).
29 Art. 69 para. 1 FinSA.
30 Art. 90 FinSA.

31 Von der Crone, Aktienrecht, 2nd ed., Zürich 2020, Rz. 1961; see also FIDLEG/FINIG Handkommentar-Vogel/Heiz/Luthiger, Art. 69 N 8; SK FIDLEG-Weber/Fahrländer, Art. 69 N 42.

dard of diligence in connection with the preparation of a prospectus.

It is worth noting that the approval of the prospectus by the prospectus review body does not constitute a valid defense against a claim, since the prospectus review body's examination is limited to formal aspects and does not substitute a proper due diligence process.

Note that Swiss law provides a different liability standard for forecasts in prospectuses by acknowledging the particularities of statements in forecast sections: Taking into account that forecasts are uncertain, the Swiss prospectus liability regime limits the liability for forecasts made in prospectuses and other communication which are false or misleading to cases where such false or misleading forecast was provided against «better knowledge» or without reference to the uncertainty regarding future developments.[32]

4.2. Damage and damage causation

The damage determined for purposes of prospectus liability generally equals the difference between the purchase price paid for a security by a plaintiff based on the information contained in the prospectus, and the price that would have been paid if the plaintiff (and the market) had had access to correct information. A plaintiff claiming damages must prove that the damage has occurred.[33]

A causal link must exist between the inaccurate or misleading statement or omitted information and the damage sustained by the plaintiff. A causal link exists if the claimant would not have suffered the damage if the prospectus had not contained the inaccurate or misleading information or omitted material information. Hence, for such causal link, the plaintiff must prove that it purchased the securities on the basis of the information in the incorrect prospectus. This standard contrasts the U.S. Rule 10b-5 which applies the so-called «fraud to the market theory.» According to this theory, the causality of incorrect prospectus content for the purchase decision is presumed, as it is assumed, in the case of an efficient market, that all available information, including incorrect information, is directly incorporated into the share price and is therefore directly causal for any overpayment. Consequently, under such theory, it may be irrelevant whether the plaintiff has read the prospectus at all. Since art. 69 FinSA does not provide for such a presumption, pure listing prospectuses without any public offer of shares should only rarely give rise to liability, as they are unlikely to come to the attention of market participants.[34]

Since it is often not possible to prove causation with absolute certainty, the Swiss standard of evidence is lower and a plaintiff is not required to provide strict proof; rather, it is sufficient that a plaintiff establishes preponderance of probability of a causal link between the inaccuracy or omission and the damage.

A court will take into account contributory negligence by the injured party. While an investor has no obligation to conduct its own investigations with regard to the content of a prospectus, a court will not affirm causality if the defendant can prove the investor's knowledge of the inaccuracy of the prospectus.[35]

4.3. Fault

Swiss law further requires that the defendant «fails to exercise due care», which covers not only intent and gross negligence, but also slight negligence.[36] The standard of fault is objective, i.e., the standard of care someone could and should have exercised under the relevant circumstances are decisive. Hence, the level of care required depends on the area of responsibility of the individual parties involved. For example, specialists (e.g., lawyers or other advisors) are required to exercise due care in their specific area of responsibility and expertise. In addition, members of the board of directors and management may generally rely on expert advice, provided that the specialists in question have been carefully selected and instructed.[37]

Overall, the required standard of fault under the Swiss prospectus regime is lower than its U.S. counterpart which requires scienter, i.e., intentional or willful fraud or – as discussed above – certain forms of recklessness. However, both jurisdictions seem to agree that for members of the board of directors and management, reasonably relying on internal and external counsel, auditors and other parties should be sufficient to negate fault. As a result, it is crucial that for each transaction, the reasonability of the due diligence process is carefully considered in light of the particular context in order to mitigate potential prospectus liability risks.

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32 Art. 69 para. 3 FinSA.
33 Art. 42 para. 1 Swiss Code of Obligations (the «CO»).

34 Gericke/Schifferle, Die Prospekthaftung nach FIDLEG, GesKR 2/2020, 189 ff.
35 SK FIDLEG-Weber/Fahrländer, Art. 69 N 56 with further references.
36 SK FIDLEG-Weber/Fahrländer, Art. 69 N 95.
37 Gericke/Schifferle (FN 34), 189 ff.

V. Conclusion

Rule 144A offerings have traditionally been a more intensive and rigorous process compared to a Regulation S offering without any concurrent Rule 144A offering to U.S. investors. Rule 144A offerings, however, provide for substantial advantages, such as the ability to access the deep pool of capital in the United States and increased issuer visibility in the U.S. market.

Although enforcement actions by the SEC pursuing disclosure claims against a foreign issuer (that is not registered with the SEC) remain rare, this article serves as a useful reminder that the U.S. anti-fraud provisions apply to any offering of securities in the United States. These risks, however, can generally be effectively mitigated through proper management of the offering process, including through a U.S.-market style due diligence and disclosure process tailored specifically to the issuer and transaction, as well as early and frequent discussions and planning with legal counsel and financial advisors.