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LEGAL PROBLEMS OF DEPOSITARY RECEIPT

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List of used abbreviations

AAA – American Arbitration Association

ADR – American Depositary Receipt

DOJ – Department of Justice

DR – Depositary Receipt

EDR – European Depositary Receipt

EU – European Union

FCPA – Foreign Corrupt Practices Act

FINRA – Financial Industry Regulatory Authority

FTT – First-Tier Tribunal

GAAP– Generally Accepted Accounting Principles

GDR – Global Depositary Receipt

IDR – International Depositary Receipt

IOSCO – International Organization of Securities Commissions

MOU – memorandum of understanding

OTC – Over the counter

OTCQX – Over the counter Markets Group, Inc.

SEC – Security and Exchange Commission

SOX – Sarbanes Oxley Act

U.K. – United Kingdom

U.S. – United States

Introduction

Unlike domestic security, DR's age is not even one century. Moreover, DR firstly was used as a financial-economical institution even though it did not have enough legal bases. It only relied on share collateral of foreign companies. Over and above share collateral DR did not have any other legal leverage. However it was gradually transformed in the legal field as well. Even though DR was invented and developed until the modern stage mainly in the US,just in last one-two decades this institution spread over the developed and developing countries.

Given the long distance between investor and issuing company, political instability in the developing country lured? economists to solve them. And they measured risks and tried to create suitable device to suit them. However legal differences, absence of "treaty on the reciprocal recognition and enforcement of judgments in civil and commercial matters" ref? and other such kinds of legal risks of DR did not attract much attention. All of these contributed to the fact that the DR has legal shortages today.

It is also worthwhile to mention that the main goal of DR is to raise capital for developing countries (in privatization) from developed countries and it takes place between two or more such kind of countries where economical, political cultural differences exist which make legal problems inevitable in the field of DR.

From the scientific point of view DR was not researched much. All researches concerning it were almost carried out only in the US and from the financial-economic perspective. There is only little legal experimentation related to DR which generally did not embody all of its legal problems. For mentioned reasons DR was chosen as a research object of this thesis.

Since there were not many researches conducted in this field literature and other kind of informational sources regarding securities, financial-economic information, practices and guidelines of investment banks and few legal researches about DR were used as sources. Research was carried out through the method of desk research while the main source was internet.

Hence, the thesis attempts to answer the questions about the legal problems of DR. However approach to DR in this thesis is general; we have done research in American Depositary Receipts, its forms (and Levels), Global Depositary Receipts, its types, and some other countries' DR.

The thesis is structured as follows. Chapter I of the thesis offers a brief historical overview of DR and its crux. It also explaines ADR, its types (sponsored and unsponsored ADR) and levels (four levels of ADR), GDR and its types (in the UK public offering and placing) other types of DR and their advantages and disadvantages. Chapter II directly discusses the problems of DR. First, it overviews relationships (agreements and mandatory rules) among parties of DR, then goes further touching upon legal problems of relationships among those parties. Subsequently Chapter II researches legal problems in jurisdiction and responsibility which are connected with the governments. Chapter III examines the effects of legislations of issuing company's and investor's governments, stock exchanges, companies to each other in the field of DR.

Chapter I History and main characteristics of Depositary Receipt

1. Brief insight into the history of Depositary Receipt and its crux

In order to raise capital or to improve their images – visibility, companies use securities in the US. Using securities intensively in domestic markets gradually resulted in their dissemination to international arena. So the term "internationalization of security market" was suggested. It includes cross-listing of securities, cross-national portfolio investment, open national exchanges and "passing the book"[1]. This thesis will mainly concentrate on cross-border listing[2]. For raising capital or improving their images companies "immigrate" to other companies with the way of listing in foreign countries. Primarily, these were the U.S and European countries, especially the UK and Luxemburg stock exchanges on account of their developed financial markets. Hence companies used cross-listing to achieve above mentioned goals.

There are two forms of cross-border listing, namely, direct listing and indirect listing[3]. Direct listing is the listing in which foreign corporation is listed in the stock exchange directly not via depositary or custodian bank. In other word indirect cross listing is held through DR. But in the way of indirect listing foreign company first finds depositary or custodian bank and concludes an agreement with it and on behalf of it depositary bank issues Depositary Receipts (hereinafter DR)

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[1] Z.Li, University of Glasgow, "Securities Regulation in the International Environment" <http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf> accessed 09 january 2013, at pmbl?.

[2] To use securities in their business, companies should be listed in governmental agencies such as Security and Exchange Commission in the U.S (pursuant to Section 5 of the Securities Act of 1933).

[3] Prepared by ShipraPadhi and Pallavi, Supervised by Aparajita Bhatt, Student Research Project "Depository Receipts: Comparison of Regulatory Frameworks in Taiwan, Brazil, Hong Kong, and India" 2012 <http://www.nseindia.com/research/content/RP_4_Mar2012.pdf> accessed 08 June 2013, at pmbl.

away from the company's domicile. Given direct listing needs to comply with stringent regulation and requires high fee, more companies prefer indirect listing. Having DR makes the listing easier since companies choose partner (depositary bank) in the country in which DRs are sold. And almost every act concerning DR is fulfilled by depositary bank on behalf of the issuing company.

The first DR was used in the US. Its root goes even beyond the Security Act (1933)[4]. The first American Depositary Receipt (hereinafter ADR) was created in 1927 on the shares of "Selfridge Provincial Stores Ltd."(Murray, 1995)[5]. It should also be mentioned that some scholars call it Global Depositary Receipts not American Depositary Receipts. For expanding its shareholders the UK-based company "Selfridge Provincial Stores Ltd." concuded an agreement with JPMorgan and issued ADRs. Even though, at that time, there was not proper legislation and this kind of investment was somehow complicated American investors started to buy those "shares" (may be because UK was colonial center and therefore investors were relying on company incorporated in the U.K., anyway first DRs did not fail). From that time, ADR continued its improvement, in economic term, as well as in the legislation. For instance, some regulations were changed in 1955, by the US Securities and Exchange Commission (SEC), in 1985, SEC adopted new regulation which led to emergence of range of DR instruments, in 1990, Rule 144A was adopted which plays an important role in the international finance among corporations.

Because of such improvement and need for financial resources, in last two or three decades, ADRs developed enormously. Conducted research by JPMorgan showed that Depositary Receipts account for 16% of the entire US equity market[6]. And it really demonstrates how ADRs spread across the economy of the US, as well as economy of the world.

Although Global Depositary Receipts (hereinafter GDR) has not exact definition it is worthwhile to note about its history. According to one company first GDR was used In Luxembourg in late 1980s 7. Contrarily, other company claims

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[4]Security Act (1933) regulates issuing of securities in the U.S.

[5]John Board, Charles Sutcliffe, Stephen Wells, "Distortion or Distraction: US Restrictions OnEu Exchange Trading Screens" (2004) <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/2007-2000/Distortion_or_distraction.pdf> accessed 08 June 2013, at pmbl.

6 Global Depositary Receipt Reference Guide, JPMorgan page 11 <https://www.adr.com/Home/LoadPDF?CMSID=88b09551120043cface03554006845cb>accessed 08June 2013, at pmbl.

[7]"Global Depositary Receipts: Investing in Emerging Markets" <http://www.steptoe.com/f-326.html>accessed 08 June 2013, at pmbl

that first GDR was held in December 1990 when Citibank introduced the first GDR[8]. Samsung Corporation, a South Korean trading company, wanted to raise equity capital in the United States through a private placement, but also had a strong European investor base that it wanted to include in the offering.

Moreover, emerging markets also started to establish their own DR in last two decades. These included Asian and Latin American countries such as Taiwan, China, India, Brazil Mexico, Argentina Chili, etc.

In the light of above mentioned history, we can conclude that DR, as an economic at the same time as a legal institution was launched and improved in the US legal system and spread through Europe to all over the world. However we will discuss DR's legal nature, jurisdiction, agreements and its other legal institutions further in this thesis.

Because DR is mainly researched as financial and economical institution, we will approach it as a legal institution throughout financial and economical point of view.

Crux of DR

DR is a negotiable certificate issued by a bank in a domestic country that represents ownership of shares in companies of other countries[9]. Another definition of DR was given by SEC: ADR like ADR "a negotiable instrument that represents an ownership interest in a specified number of securities, which the securities holder has deposited with a designated bank depositary."[10] It is true that this definition is more financial and not so broad to understand clearly. Therefore we will try to explain it with understandable and legal way.

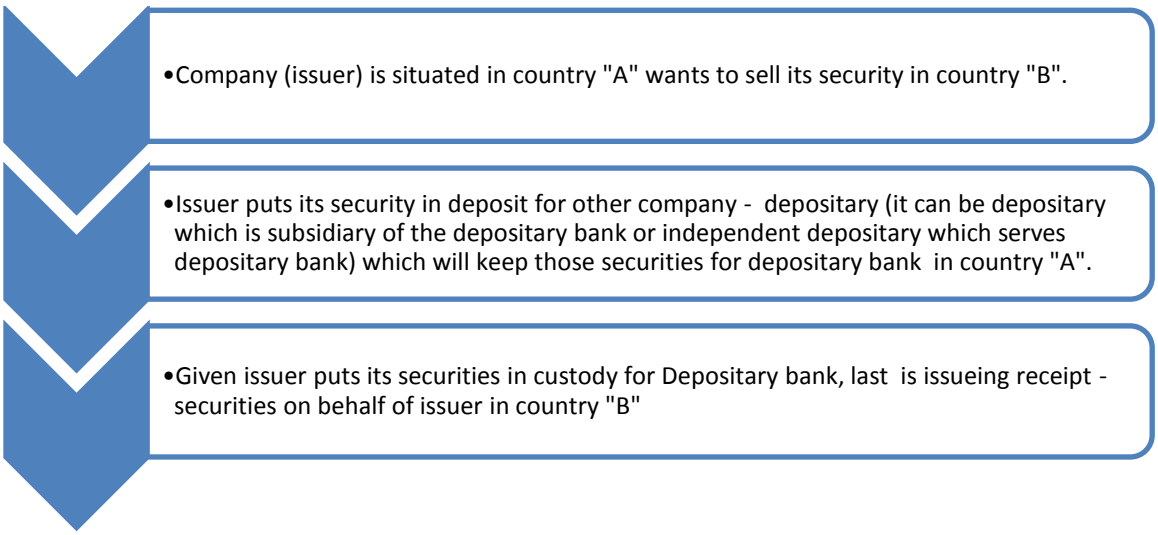
From the term itself we can see DR consists of terms - "depositary" and "receipts". From the term "depositary" it is clear that something should be put in deposit; from the term "receipts" it is understandable that someone should get receipt which proves that he or she put something or paid for something. So,

[8]"History of Depositary Receipts"<http://www.depositary-receipts.com/history.html> accessed 09 June 2013, at pmbl

[9]Prepared by ShipraPadhi and Pallavi, Supervised by Aparajita Bhatt, Student Research Project "Depository Receipts: Comparison of Regulatory Frameworks in Taiwan, Brazil, Hong Kong, and India" 2012 <http://www.nseindia.com/research/content/RP_4_Mar2012.pdf> accessed 08 June 2013, at pmbl.

[10]Exemption from Registration under Section 12(g) of the Securities Exchange Act of 1934 for Foreign Private Issuers; Final Rule, 73 Fed.Reg. 52,751, 52,752 n.14 (Sept. 10, 2008).

considering that a company (issuer) desires to sell its securities in a foreign country but not allowed to do it directly (or it would not be as serviceable as it is for domestic market) there is a way for company to put its securities in deposit as a custody for other company – bank (or its subsidiary) which issues receipts – securities on behalf of issuer in country where issuer wants (and depositary bank situated). In graph we can describe DR as the following:



As we mentioned there are many definitions of DR. One of them claims that DR is the same as underlying shares. However some scholars such as Mr. Saaybi does not agree with this idea[11]. He explains that the stocks even if they were registered in the name of Lebanese investors differ from ordinary stocks in that they are deprived from almost all their rights through a depository agreement between the company and the bank where the stocks are deposited.

Of course Mr. Saaybi's explanation is right, but for us it does not mean that we see strong border between DR and underlying shares. Because there are some DRs that give voting right to dividends, convertibility right (DR holder can change DR into underlying share of the same company) and so on. It is true that holder of DR cannot get as much dividend as holder of underlying shares. But it only happens because of service of depositary bank which brings foreign company's

[11]WaelNazir Obeid, Global depository receipts in Lebanon financial and legal aspects 2004<https://scholarworks.aub.edu.lb/handle/10938/6737>accessed 12 January, 2013, at pmbl.

share for investors, converts dividends from foreign currency into currency which investors' country uses. Hence because of such kind of features DR differs from underlying shares.

Reviewing the crux of DR and considering that these processes happen in two or three different countries, we see how complicated processes of DR are. But why do companies - issuers chose such costly security types and why do investors chose such risky securities? A lot of researches were conducted to clarify these questions in finance.

Financial scholars put into forward, for the reason why companies prefer the Depositary Receipts? There are many causes - low-cost capital, more liquidity, more visibility, wider investor bases, etc.

To understand investors' reason for choosing DR also many researches were carried out by financial scholars. Some scholars divide these reasons into three hypotheses12, however these scholars researches mentioned hypothesis concerning ADRs in comparison with underlying domestic securities (securities which issued by company in its domicile rather than in other countries). According to first hypothesis, if an issuer is based in a country that has poor investor protection laws, then investors most likely will prefer to allocate their money on the DRs of issuer rather than underlying domestic securities of that company.

Second hypothesis says that if issuer's domestic stock market was not developed enough then it is better to invest in DR than underlying domestic securities.

Last hypothesis states that if liquidity in issuer's home market is not sufficient then fund managers will choose DRs rather than underlying domestic securities.

Of course there are other advantages of DR in comparison with securities issued in investor's home country by a domestic company rather than foreign companies in third countries. In this context investors (especially institutional investors and others) opt for DRs mainly because they can get the opportunity to diversify their portfolio. "Even many multinational firms are interested in the local DR programmes to take advantage of the growth prospects of Latin American and

[12]ReenaAggarwal,* SandeepDahiya, LeoraKlapper, "ADR Holdings of U.S.-Based Emerging Market Funds" November 14, 2006 http://faculty.msb.edu/aggarwal/adrs06.pdf accessed 10 June 2013, at pmbl

Asian countries"13. Another most mentioned benefit of DR for investor is that they can get their profit in their own currency. For instance, in the US, when investors invest in ADR they can get their profit from foreign company not in foreign currency but in US dollar. So they can skip the risk of exchanging currency.

An additional pro of DR emerges when it is compared with the direct listing of foreign company. In this point corporations choose DR instead of direct listing for its less stringent rules. When company chooses direct listing then it is subjected to more regulations and rules in comparison with DRs.

Besides its pros, there are of course also cons of DR. As first disadvantages is mentioned political and economic risk. Those negative features of DR are prominent because of investors' and issuing company's home country. Given that investor's country commonly is a developed country and issuing company's home country is usually a developing country or more precisely, former country is evaluated as more powerful than latter one, there are more economic and political risks in second country.

One disadvantage of DR concerns currency risk. "Although Domestic Receipts are traded and quoted in terms of the domestic currency, dividends are declared in terms of the foreign currency which makes the return on the investment volatile and therefore risky"[14].

Another disadvantage of DR is a double taxation. Since the dividends of DR passes through two governments' agencies, there is more chance that both countries will levy tax to dividend. To get rid of such kinds of risk, investors and issuing company for their own interest (to be able to sell the DR) should be sure that there is a treaty between their countries about elimination of double taxation[15].

So from above mentioned information, it is realizable that DR has enough economically auspicious features. Now we will review some legal aspects of DR.

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[13]Prepared by ShipraPadhi and Pallavi, Supervised by Aparajita Bhatt, Student Research Project "Depository Receipts: Comparison of Regulatory Frameworks in Taiwan, Brazil, Hong Kong, and India" 2012 <http://www.nseindia.com/research/content/RP_4_Mar2012.pdf>accessed 08 June 2013, at pmbl.

[14]WaelNazir Obeid, Global depository receipts in Lebanon financial and legal aspects 2004<https://scholarworks.aub.edu.lb/handle/10938/6737>accessed 12 January, 2013, at pmbl.

[15]Jorge L. UrrutiaandJosephVu, "EmpiricalEvidenceofNonlinearityandChaosintheReturnsofAmericanDepositoryReceipts" QuarterlyJournalofBusinessandEconomicsVol. 45, No. 1/2 (Winter - Spring, 2006), <http://www.jstor.org/discover/10.2307/40473412?uid=27886&uid=3738736&uid=2&uid=3&uid=67&uid=5911848&uid=27885&uid=62&sid=21102425294827>

Primarily, we can pay attention to the history of DR from legal point of view. As we mentioned before there was not even precise security legislation in the US at the time when company "Selfridge Provincial Stores Ltd." achieved first ADR by JPMorgan, but these companies managed to do this complicated process. We think these things happened, first of all, because of common law system. As we know that system is based on not ex ante, but ex post model. So companies were free at that time to do whatever they wish, except something that contradicts the law. After first successful DR, legislation in DR developed gradually in the US legal system which we mentioned above. Besides these, there are also legal problems in the US system. We think unsatisfaction appears in the US legal system on account of DR's international character. As we mentioned before, sometimes DR takes place in three countries legislation. Hence, at least three legal systems have differences and parties encounter conflicts of law.

But how DR is used or developed in civil law system? This question is also interesting since most DR issuer companies are from civil law system and most depositary banks' countries are in common law system. So to have DR, issuer companies should meet some requirements of depositary banks' countries. For instance, some countries have different kind of corporation law; some countries even do not have corporate governance law; some countries have restriction to foreigners to own share of company which owns land. Despite of these hindrances companies and governments started to reconcile their legal systems in light of economic benefit. These kinds of acts were done by common, as well as civil law parties (governments or companies). As an example we can show that despite of the fact that some civil law countries such as Russia has not corporate governance structure it achieved corporate governance structure with the flexible model of company Joint Venture.

Competition among governments and improvement of legislation raised new approaches towards DR. For instance, "The government has allowed Indian companies to merge with firms overseas through the issue of Indian Depositary Receipts (IDRs) and the Reserve Bank of India was asked to issue detailed guidelines on the process"[16].Besides financial advantages and legislations reconciliation to establish DR, there are still legal problems with DR. For instance, until now neither scholars nor governmental agencies (courts as well) has not determined whether DR is domestic or foreign share. The only definite thing is that DR represents foreign shares. This factor and DR's internationally trading (via

[16]The Economic Times, "Companies can merge with foreign firms via IDRs; RBI to issue norms Apurv Gupta, ET Bureau" Jan 1, 2013, <http://articles.economictimes.indiatimes.com/2013-01-01/news/36094044_1_foreign-firms-indian-companies-foreign-companies> accessed 10 June 2013, at pmbl.

internet or in many countries despite of the fact that one company issues share or receipt in other countries, those shares also can be sold to other third countries) feature raises jurisdictional problems. At the beginning of this thesis we mentioned two types of DR – ADR and GDR. However, there are other types of DRs too. These types of DRs are mainly characterized by the name of countries. As an example we can show, Indian Depositary Receipts, Greek Depositary Receipts, and Russian Depositary Receipts, etc. At the same time we should mention that most of these types of DRs have their own specific features.

Because of many types and sub-types of DRs we will mention mainly widespread DRs and their main characteristics.

3. Forms and types of Depositary Receipt and their characteristics

American Depositary Receipt

We mentioned the definition of ADR at the beginning of this thesis, so now we will talk about types of ADR. First of all ADRs divided into two categories – sponsored and unsponsored ADRs.

Sponsored ADRs are the kind of ADRs which are issued by the depositary bank which has a corresponding agreement with the issuing company. However, there is not any agreement between depositary bank and issuing company for issuing unsponsored ADRs. In other words issuing company wants its shares to be sold in the US and concludes an agreement about that, nevertheless issuing company does not want (but does not reject also) its shares to be sold in the US and does not sign an agreement for that purpose. From the economical point of view we can say that in unsponsored ADRs depositary bank has a feeling that issuing company's shares can be sold and therefore without consent of issuing company issues ADR and sells it. However in sponsored ADR, issuing company has interest to sell its shares in other company and therefore concludes an agreement and does other important acts.

Besides economical point of view, wish and act of selling issuing company's securities in the US makes sense legally too. This kind of state affects jurisdictional issues, relationship between investors and issuing company, governments or its agencies and issuing company, etc.

It is also worthwhile to note that sponsored ADRs are also divided into four levels. However these levels are not completely different. For instance, Level I and

Level IV (it is also called Rule 144A) have many common points. For instance, they have almost the same disclosure level. And Level II and Level III also have the same standards. However all levels of ADR have same characteristics and common points which we discussed in previous chapters .

"In March 2006, a new trading platform for Level I ADRs, named international OTCQX, was also offered to foreign firms that are considering listing on over the counter OTC or the U.K"[17]. So this level of ADR presented to investors and issuing company last (concerning time) regardless of its name. Level I ADR does not raise capital in the US markets. It is for developing and broadening the U.S. investor base with existing shares. Apart from mentioned issues, this level of ADR is not subject to US law much. It does not need to reconcile with the US accounting standards. Among other levels, Level I ADR has the lowest disclosure. It is worthwhile to note that this Level is traded in over-the-counter market. With this way Level I adopts less regulation stage. Hence all these make Level I ADRs from the issuing company point of view less responsible legally.

Since Level I and Level IV have common features we will discuss the latter after Level I. Different from Level I, Level IV is designed to raise capital in the US markets, in this portal raising capital featured its big amount. One main character of it is that it is offered to qualified investors. "Rule 144a offerings and level I ADRs, both of which are unlisted and sold in the over-the-counter market, occupy much more ambiguous space"[18]. Additionally these levels of ADRs are not listed with the SEC of U. and this advantage give them broad freedom. For instance, they should not reconcile full GAAP. And this kind of accounting system is very expensive.

As we mentioned before Level II and Level III ADRs have common features. The most important of them is that they are listing with SEC. This is a prominent feature because it is very expensive and time consuming. Listing of ADR makes companies to disclose much material information and reconcile with GAAP, although Level II is required partially, Level III fully reconciles. Their objectives are to develop and broaden the US investor base with existing shares. These levels have high listing fee. They are almost affected by U.S. regulation. However, Level III is the only one that makes public offering and issues new shares. Besides these characteristics there were a lot of researches on ADRs. One

[17]NARJESS BOUBAKRI, JEAN-CLAUDE COSSET, ANIS SAMET "The Choice of ADRs", March 2008<http://mutan.org/actualites/ThechoiceofADRs_MUTAN.pdf>accessed 11 June 2013, at pmbl.
[18]How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

research was conducted in the US concerning control right or concentrated ownership. Scholars say "We find that the ultimate control rights of Level I firms are larger than Level II firms and lower than Rule 144A firms. Moreover, we find that level III firms no longer have higher ultimate control rights than Level I firms"[19].

It is worthwhile to mention that there are other kind of foreign receipts which are almost the same as ADR. However unlike latter, Depository Debenture is not security listed with SEC or so. This kind of foreign security certifies debt. In other words Depositary Debenture issued in the US for raising capital, but by percentage. "In 1993, Ericsson used another similar investment tool which is the American Depository Debenture. The latter is a receipt that represents debt rather than equity convertible into ordinary shares"[20].

"ADRs carry the corporate and economic rights, such as dividend and voting rights, of its underlying share"[21]. But we can call those rights economic - dividend right and legal rights-voting rights. These rights are important on ADR as they are for the domestic securities. It is true that ADR holders rights affect mostly ADR's price or other financial advantages, however they play enough roles on the legal aspect of ADR. For instance, those rights are defined in depositary agreement. Dividend rights can be shown related to taxation, how convertibility will affect dividends and so. Besides legal right-voting right also is shown broadly in the depositary agreement. It is also realized through depositary bank which could affect also issuing company. Another important characteristic of voting right is that it directly affects ADR's liquidity. For instance, Brazilian companies mostly do not give voting rights to ADR holders "In contrast, an investor in a Taiwanese firm has voting rights regardless of whether he holds the ADR or the underlying"[22]. Because of it Taiwanese firms with ADR attracts more investors rather than Brazilian firms. So, issuing companies mainly considering mentioned features choose ADR levels for their needs. Choosing ADR also depends on jurisdiction,

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[19]Nova Scotia,NarjessBoubakri, Jean-Claude Cosset, AnisSamet (Ph.D. Student), ASAC 2008, "Why Do Foreign Firms Issue A Specific ADR?" <http://ojs.acadiau.ca/index.php/ASAC/article/viewFile/687/596>accessed 11 June 2013, at pmbl.

[20]WaelNazir Obeid, Global depository receipts in Lebanon financial and legal aspects 2004<https://scholarworks.aub.edu.lb/handle/10938/6737>accessed 12 January, 2013, at pmbl.

[21]Narjess Boubakri, Jean-Claude Cosset, Anis Samet "The Choice of ADRs", March 2008 <http://mutan.org/actualites/ThechoiceofADRs_MUTAN.pdf>accessed 11 June 2013, at pmbl.

[22]ReenaAggarwal, SandeepDahiya,LeoraKlapper,The World Bank, "American Depositary Receipts (ADR) Holdings of U.S. Based Emerging Market Funds"<https://openknowledge.worldbank.org/bitstream/handle/10986/8555/wps3538.txt?sequence=2>

liability, legislation issues and other features of ADR which we will examine later in this thesis. At the end we should also mention deregistration of ADR. This process is not easy either. "Foreign private issuers that are currently reporting companies must wait eighteen months after their registration is terminated before they can use the Rule 12g3-2(b) exemption"[23]. Because of this issuing company should by ADRs back from ADR holders and cancel them via depositary bank.

Global Depositary Receipts

Given the GDR is not researched by scholars enough we will analyze it mostly with the way of guidelines and articles of depositary banks, such as JPMorgan, CitiBank, etc.

Global Depositary Receipts are used as a variation of ADR, European Depositary Receipts, International Depositary Receipts, etc. However it has its own characteristics. First of all, we should mention that GDR has not many differences from the ADR. Main difference is that GDR is designated for more than two countries.

One of the major banks in the world - City Bank defined GDR as the following in its web page: "A Global Depositary Receipt (GDR) is a negotiable instrument issued by a depositary bank in international markets — typically in Europe and generally made available to institutional investors both outside and within the U.S. — that evidences ownership of shares in a non-U.S. company, enabling the company (issuer) to access investors in capital markets outside its home country"[24]. In general we can characterize GDR as a device facilitating trade of foreign securities of two or more jurisdiction systems which help issuing company to use maximum advantages of DR.

So how does it work? To answer this question we should review GDR from the UK and the US perspective. If one issuing company from third country wants to have DR in the US and UK it has to register its shares in the US as well as UK. As to US issuing company has to choose one of 4 levels and then it should be registered in the UK. Combination of these shares is called GDR. Legal approach on the GDR will be like this: shares offered or sold in the US will be subjected to

[23]Michael A. Perino, "American Corporate Reform Abroad: Sarbanes Oxley and the Foreign Private Issuer", <http://journals.cambridge.org/action/displayFulltext?type=1&fid=191564&jid=EBR&volumeId=4&issueId=02&aid=191563>accessed 17 June 2013, at pmbl

[24]Global Depositary Receipts (GDRs): A Primer, <https://wwss.citissb.com/adr/common/file.aspx?idf=1525>accessed 11 June 2013, at pmbl.

US law, however other shares offered or sold in Europe especially in the Frankfurt Stock Exchange, Luxembourg Stock Exchange and in the London Stock Exchange, they are not subjected to US law because of Regulation S of US, they will be subject of law of that country where they are offered or sold.

It is also worthwhile to note that American legislature makes difference whether issuing company first listed in the US or not[25]. If company is listed first in the US then in other market such as Europe, then US law has not any requirement from the point of Regulation S. At this time, there is at least possibility that receipts issued in the US flow to the second market where issuing company is going to be listed in the context of GDR. Therefore it does not make any sense from the perspective of investor of a second country. Second country's investors most likely would choose receipts issued in their own country rather than in the US because of currency, jurisdiction, etc. But if that company first listed in Europe stock market, then wants to settle in the US market, Regulation S requires issuing company to wait from 40 days to one year. This is because during mentioned time issuing company should prevent receipts issued in third country flowing to the US. The reason of such kind of requirement is that the US investors choose right receipts if there are choices. In other words this is designed to protect investors of US and called "Distribution compliance period"[26]. However, generally, "GDRs are usually offered to institutional investors through a private offering, in reliance on exemptions from registration under the Securities Act of 1933"[27]. It is true that DR, as well as GDR was invented and improved by the US market. However, internationalization of capital market paved the way to other countries to originate its DR. Given there are a lot of DR (for instance, Brazilian DR, Indian DR, Singapore DR, etc.) across the world, it is possible third country's company to have Brazilian DR as well as Indian DR. So GDR is not limited by the US and UK or other European market even though it is widespread over the US and Europe because of their developed capital market.

So GDR was also established for raising capital or being present in developing, at the same instance in the developed capital market.

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[25]Seth Chertok, Ze'-ev D Eiger, Nilene R Evans, David I Fasman, Lloyd S Harmetz, Charles M Horn, David M Lynn, Jerry R Marlatt, Barbara R Mendelson, Adam L Ostrowsky, Anna T Pinedo, Gerd D Thomsen, Edward M Welch, International Financial Law Review "Considerations for ForeignBanks Financing in the US" http://www.mofo.com/files/Uploads/Images/Considerations-for-Foreign-Banks-Financing-in-the-US-2012.pdfaccessed 11 June 2013, at pmbl.

[26]Regulation S of the U.S. Rule 902(f).

[27]Global Depositary Receipts (GDRs): A Primer, <https://wwss.citissb.com/adr/common/file.aspx?idf=1525>accessed 11 June 2013, at pmbl.

Besides above mentioned characteristics, GDR can be used for raising capital, or making issuing company visible in international market. Under the condition that company wants to raise capital in the US, it settles on Rule 144A in the US, but if company seeks to be visible in the US it can chose Level I or Level II. But if company prefers to be visible as well as to raise capital it can opt for Level III which is very expensive. With the registration in the U.S., company also chooses simultaneously other country's stock exchange for GDR. In this case company issuing GDR can decide on public offering or placing[28] in UK. According to the UK DR public offering is that the company decides to get substantial amount of capital from broad institutional investors; however placing is offered to limited number of investors in comparison with public offering.

"Moreover, while the shares made available in Europe and the US via a GDR are most often denominated in US dollars, other currencies could be utilized"29. GDR is also denominated in euro, if this happens then GDR is also called European Depositary Receipt. We should also mention that GDR is called International Depositary Receipt in Europe. Contrarily ADRs called International Depositary Receipt in the U.S.

In addition, GDRs can be converted to underlying share when investors wish it, but if it is shown in the agreement then limitation can be imposed on conversion by depositary bank or issuing company. Conversion is useful for investor, as well as issuing company because of liquidity of the company.

We should also mention that GDR's price is not mostly adequate of issuing company's underlying share price. Former mostly represent two, three or even 10 underlying share of issuing company.

As we see from structure of GDR, it is more flexible and gives more advantages than DR or ADR. "In recent years, capital raising using GDRs has increased steadily. Accounting for less than one percent of the market in 2000, in 2005 GDRs accounted for nearly 45% of all capital raised using depositary receipts worldwide Capital raising"[30].

One important thing related to international organization about GDR or DR: there are some international organizations which have some connection with DR but not

[28]Global Depositary Receipt Reference Guide, JPMorgan page 11 accessed 08June 2013, at pmbl. (https://www.adr.com/Home/LoadPDF?CMSID=9ed05064409d4172be019227c14dd882)
[29]See Global Depositary Receipt Reference Guide, supra note 18
[30]Global Depositary Receipts (GDRs): A Primer, <https://wwss.citissb.com/adr/common/file.aspx?idf=1525>accessed 11 June 2013, at pmbl

completely works on DR. For instance, the "The Basel Committee established by the central-bank Governors of the Group of Ten countries at the end of 1974, consists of representatives of twelve central banks that regulate the world's largest banking markets"[31]. Other international organization is the International Accounting Standards Boards founded on April 1, 2001. Although these organizations have not direct connection with DR, they regulate some aspects of securities. The International Organization of Securities Commissions (IOSCO) is organized in 1974 in Quebec Canada. Although this organization deals with security issues its regulations are not mandatory. It summarizes information all over the world and issues regulation mainly concerning international securities. "In 2005 the Presidents Committee set a new strategic direction. That decision had two aims: to raise the standard and consistency of securities market regulation world-wide, and to increase the number of jurisdictions signed on to the IOSCO multilateral MOU"[32]. It is worthwhile to mention that this organization's influence area is not so broad in comparison with the US SEC. Therefore the US regulation is more prominent than regulation of IOSCO.

[31] Zhao Li PhD, University of Glasgow, "Securities Regulation in the International Environment" <http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf> accessed 09 June 2013, at pmbl.
[32] Zhao Li PhD, University of Glasgow, "Securities Regulation in the International Environment" <http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf> accessed 09 June 2013, at pmbl.

Chapter II Legal nature of Depositary Receipt

1. Legal relationships between issuer and depositary bank

Because of depositary agreement we will first of all analyze relationships between issuing company and depositary bank. Depositary agreement is one of the main documenst through DR. Sometimes besides depositary agreement, there is an agreement between depositary bank and custodian which keeps underlying security in the custody. And therefore we will also focus on their relationships also in this Chapter.

Inclination to establish DR comes from issuing company. It seeks depositary bank in foreign country. If it finds one they are discussing to issue DR, doing due diligence and concluding an agreement. So relationships between issuing company and depositary bank are regulated by that agreement which is called Depositary agreement. However those relationships also were affected by the legislation of domiciled legislation of issuing company and depositary bank. But we will first pay attention to Depositary agreement.

One of the main requirements about depositary agreement concerning issuing company was mentioned by JPMorgan as following: "The adoption of a resolution by the Company's board of directors approving the appointment of the depositary; and, The approval and execution of the Deposit Agreement and any related agreements and any market required filings"[33].

It is worthwhile to note that not every DR requires Depositary agreement, especially in the US. For example, there is not depositary agreement between issuing company and depositary bank on unsponsored DR. So these kinds of DRs are regulated by legislation of countries of issuer and depositary bank. And this issue affects a jurisdiction of court which will be discussed below.

But every sponsored ADR, as well as other kind of DR (for instance GDR, Hon-Kong DR, etc) mainly has depositary agreement. This type of agreement, firstly, regulates underlying DRs' kept in custody. Keeping in the custody of DR can be fulfilled by the depositary bank's affiliate or other bank or custodian in the issuing company's country. So there is other possibility that custodian (which is not an affiliate of depositary bank) and depositary bank have an agreement

[33] Global Depositary Receipt Reference Guide, JPMorgan page 11 <https://www.adr.com/Home/LoadPDF?CMSID=88b09551120043cface03554006845cb> accessed 08 June 2013, at pmbl.

between themselves. "The role and duties of the custodian appointed by the depositary to hold the deposited shares for the account of the depositary on behalf of the holders of the depositary receipts, segregated from all other property of the custodian"34. Mentioned agreements regulate how underlying or newly issued (by the issuing company) shares will be kept or transferred to third party (it can be issued company itself). This sort of transferring generally happens when DRs are terminated.

Besides these agreements keeping underlying or newly issued shares is the main legal problem on the DR. There were some disputes for the nature of keeping underlying shares in USs, UK's and other country's courts. As an example we can show the decision of the First-Tier Tribunal (FTT) in HSBC v Commissioners. The decision of the First-Tier Tribunal on HSBC v Commissioners for HMRC (2012) UKFTT 163 "raised an awkward question about the legal status of American depository receipts (ADRs)"[35].

HSBC's US based affiliate merged with US Company "Houshold". Because of termination of latter's shares, its shareholders were offered shares of HSBC or newly established sponsored ADRs which were issued by Bank of New-York Mellon Corporation. To deal with this issues HSBC concluded an "Exchange Agency Agreement" with Computershare Trust Company of New York. According to that agreement Computershare Trust Company of New York became nominee for former household shareholders. In other words former "Houshold"'s shares allotted account of Computershare Trust Company of New York. So, depending upon "Houshold" shareholders' opt for HSBC shares or ADRs, Computershare Trust Company of New York should be transferred to former "Houshold" shares accordingly to the Bank of New-York Mellon Corporation or HSBC.

In spite of the fact that the dispute was raised because of tax issues, this case came to be prominent for ownership issues on ADR. HSBC argued his position with the fact that "when Computershare Trust Company of New York transferred HSBC shares to BNY Nominees Computershare Trust Company of New York was merely transferring bare legal title, because the former Houshold shareholders were the beneficial owner of those shares immediately before and immediately after the transfer"36. But FTT did not consider HSBC's point as an argument on its decision despite of the fact that decision was made in favor of HSBC.

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[34] Chapter 19, A equity securities issuers incorporated in the People's Republic of China, <http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_19a.pdf> accessed 13 June 2013, at pmbl.

[35] The International Investor, Legal status of ADRs, 16 November 2012 < http://the-international-investor.com/2012/legal-status-adrs> accessed 13 June 2013, at pmbl.

[36] Graham Iversen "American Depositary Receipts, beneficial ownership and the HSBC case " Slaughter and May, Article June 2012 <http://www.slaughterandmay.com/media/1826046/american-depositary-receipts-beneficial-ownership-and-the-hsbc-case.pdf> accessed 13 June 2013, at pmbl.

Considering the US security law, tax law, insolvency law, New-York law (it was applicable), Uniform Commercial Code, as well as expert witnesses FTT decided that there is not beneficial interest on ADR. Judges argued that if BNY releases ADR while breaching its contractual obligation, for instance, selling ADR without backed underlying (given there was not such an agreement between BNY and HSBC) shares, what will be future of ADR, will it has beneficial ownership of underlying shares or not. Other approach of judges to ADR in this case was that in the event of insolvency of BNY, whether ADR will be object of satisfying the creditors of BNY or they will just be in trust which is belonging to ADR holders? Because of these points FTT even did not consider ADR as a beneficial ownership.

Some scholars or practitioners do not consider this approach as a generally accepted approach. For them "it's barely necessary to say that the considerations of a UK tribunal would have absolutely no impact on the question of whether ADR holders have a beneficial interest or not in the eyes of a US court – which would be all that matters as to their true status"37, however other part of practitioners38 think that this assessment is general and "flawback" arrangement or others are factors which FTT took into account just as an additional support. Other supporter – "Mr. Saaybi explains that the stocks even if they were registered in the name of Lebanese investors, these registered stocks differ from ordinary stocks in that they are deprived from almost all their rights through a depository agreement between the company and the bank where the stocks are deposited".[39] Court also did take into account depositary agreement for making decision. "In order to consider whether holders of HSBC ADRs have rights in rem in the underlying shares, we first consider the contract under which the ADR holders hold their ADRs and then the law which applies to that contract, and then reach our conclusion"[40]. These facts really mean that underlying shares differ from ADR regardless they represented one company. So, beneficial ownership issue, as mentioned before, cannot be decided only depending upon one factor, all factors should be taken altogether.

Besides these, some legislation deliberates on underlying shares as a trust of holder of DR. Even though rule, in People's Republic of China, requires that underlying shares should be accepted as a trust in peremptory rule. It defines that "The deposit agreement must be in a form acceptable to the Exchange. It must be executed by the depositary and the issuer and must provide that the depositary

[37] Ibid., 33
[38] Ibid., 34

[39] Wael Nazir Obeid, Global depository receipts in Lebanon financial and legal aspects 2004 <https://scholarworks.aub.edu.lb/handle/10938/6737> accessed 12 January, 2013, at pmbl.

[40] First-Tier Tirbunal in HSBC v Commissioners for HMRC (2012) UKFTT 163, <http://www.bailii.org/cgi-bin/markup.cgi?doc=uk/cases/UKFTT/TC/2012/TC01858.html&query=%22depositary%20receipt%22> accessed 14 June, 2013, at pmbl

holds on trust (or equivalent arrangements) for the sole benefit of the holders of depositary receipts the securities to which the depositary receipt certificates relate, all rights relating to the securities and all money and benefits that it may receive in respect of them, subject only to payment of the remuneration and proper expenses of the depositary"[41].

That norm also mentions that "it also must provide, without limitation for: the status of depositary receipts as instruments representing ownership interests in shares of an issuer that have been deposited with the depositary". There is possibility that after mentioned case, Stock Exchange of Hong Kong decided to adopt such kind of rules which protect its investors.

Agreeing with the latter approach we want to note that former modus operandis would undermine ADR if mentioned case overwhelmed. With this thought or risks – ADR holders have not beneficial ownership; investors could hesitate to buy ADR.

Depositary agreement also regulates issuing additional DRs. Being contingent on defined situation it is possible that depositary bank can issue additional DRs, if it is shown in the agreement. Additional issuing can be backed either by underlying securities or new securities which are issued by issuing company. Underlying securities can be given into custody whether previous shareholder or company's itself. In latter case issuing company can use whether old shares which were not sold or new shares which company will issue in addition to its previous shares.

The agreement also regulates DR holders' voting right or this right's realization mechanism. Such kind of norms are defined in this agreement, because, mainly these rights are given to the DR holders by issuing company and it defines these rights' main points and they are realized by Depositary banks. About these processes JPMorgan informs on its guideline that "The Company should consider providing JPMorgan as depositary with all the information at least six to eight weeks before the shareholders meeting. This timeframe should enable the depositary to prepare the voting instruction card, distribute it through the clearing systems to your DR holders, receive their voting instructions and provide our custodian with the votes and any necessary paperwork for the votes to be included in the shareholders' meeting"[42].

In the depositary agreement also is shown how DR's cancelation is processed. Generally, it happens either according to the wish of DR holder or decision of

[41] Rules governing the listing of securities on the Stock Exchange of Hong Kong limited Equity Securities, Chapter 19B.16, <http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_19b.pdf > accessed 14 June, 2013, at pmbl

[42] Global Depositary Receipt Reference Guide, JPMorgan page 11 <https://www.adr.com/Home/LoadPDF?CMSID=88b09551120043cface03554006845cb> accessed 08 June 2013, at pmbl.

issuing company. At the time of cancelation depositary bank returns proportion of underlying shares to the company but process of cancelation is changing depending upon levels or types of DR. For instance, if it is Level II or III ADR, the cancelation process will take long; however in the event of Level I ADR, deregistration will be short and easy.

As we mentioned legal relationships between issuer and depositary bank sometimes are regulated by the requirements of governments. For instance, concerning ADRs (except Level IV ADR), SEC demands from foreign issuing companies Form-6 which requires that the registrant provide in its prospectus a description of the depositary agreements, including information about fees and charges imposed on the ADR holder[43]. So mentioned information cannot be confidential because of investor protection measure.

Besides government or its agencies, Stock exchanges also regulate legal relationships between issuer and depositary bank. For instance, according to Hon Kong Stock exchange "the issuer must ensure that the depositary performs the depositary's obligations under the deposit agreement and the Exchange Listing Rules, and that the rights of depositary receipt holders are fully recognized and are generally equivalent to the rights of shareholders of the issuer"[44].

2. Legal relationships among issuer, bank and investor

Main reason of dividing DR relationship into two parts is that first part is regulated by the agreement, second part is regulated as well as with law and relationships are gathering here as complete which assessment of them is becoming easier in that point. These types of relationships are not regulated only by depositary agreement. They are generally adjusted by the rules and regulations of country in which depositary receipts are issued. For instance, in the US they are controlled by the Security Act of 1933, Securities and Exchange Act of 1934, rules of SEC and other legislations of the US. Being conditional on ADRs or GDRs, legislation or regulations of government agencies adjust these relationships. Governments are paying attention to them because of their investor protection measures. Besides legislation, almost all stock exchanges have their regulations. It

[43] Rule 13a-16 or 15d-16 under the Securities Exchange Act of 1934 < http://www.sec.gov/about/forms/form6-k.pdf > accessed 08 June 2013, at pmbl.

[44] Rules governing the listing of securities on the Stock Exchange of Hong Kong limited Equity Securities, Chapter 19B.16, <http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_19b.pdf > accessed 14 June, 2013, at pmbl

is worthwhile to mention that these regulations also are inclining to investors' security.

For example, in general Hon Kong Security regulation says that "the primary principle underlying the Exchange Listing Rules dealing with depositary receipts is that the holders of depositary receipts are to be treated as generally having equivalent rights and obligations as those afforded to shareholders in an issuer under:

(a) the issuer's constitution;

(b) the law governing the rights and liabilities as between shareholders and the issuer;

(c) the Exchange Listing Rules; and

(d) the Securities and Futures Ordinance and subsidiary legislation (including but not limited to the provisions relating to market misconduct and disclosure of inside information and of interests)"[45].

Because of so many laws and regulations sometimes issue arises about which law, regulation or agreement will have priority. Most commonly law or regulation which will be applied is defined in the depositary agreement or in law itself. Apart from agreement, application of "peremptory rule" is set out in law itself. As an example we can show disclosure rules. Other than an agreement, these kinds of duties are mandatory by law, notwithstanding there are also legal problems concerning which law will put in for (for instance, which law has priority). Given problems related to conflicting laws is general in the legal area we will discuss mainly which agreement – depositary agreement or transaction between depositary bank and investor is prioritized or contemplated "relevant transaction".

Since many disputes come to light with reference to investor protection issues, courts in the US more likely considered "the relevant transaction" that transaction which is concluded between depositary and ADR holders. Maybe therefore, some scholars defined ADR certificate as follow: "The ADR certificate acts as a contract between the ADR holder and the depositary"[46]. We also agree with this statement, since it can ease relationships between parties. However at that point the responsibility of issuing company will disappear before investors. Unlike above mentioned approach, lately depositary agreement was taken as a relevant transaction. Some scholars claim that "Contractual relationship is established between the shareholder, the depositary, and the foreign private issuer by virtue of

[45] Rules governing the listing of securities on the Stock Exchange of Hong Kong limited Equity Securities, Chapter 19B.16, <http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_19b.pdf > accessed 14 June, 2013, at pmbl

[46] Mark Saunders, Fordham International Law Journal Volume 17, Issue 1 1993 Article 2, "American Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies" p.55

the depositary agreement"[47]**.** Given that DR mainly is used and developed in the U.S. it would be reliable to review its practice. In the case of *Morrison v. National Australia Bank Ltd*, the U.S. Supreme Court stated that "The majority of decisions so far seem to view the investor's purchase of the ADR issued by the depositary bank as the relevant transaction"[48]. In the mentioned article author states that despite of the fact that the Supreme Court deliberates on transaction between Depositary and ADR holders as a relevant transaction, there are a lot of reasons why we should take depositary agreement as a relevant transaction. To argue his point author gives as an example the fact that there are many cases "the investor may even exchange the ADRs for the underlying foreign securities. ADRs muddy the Morrison holding because they occupy a borderland between foreign and domestic transactions"[49]. While agreeing this author's idea we want to mention also that there are some ADRs which were not backed by depositary agreement. Even there were some court hearings about depositary certificate regulating relationships between depositary and investors which is not accepted as a relevant transaction by the court.

Which transaction will be referred to as a core of relationships is really important issue. Party's principal agreement bases on that document and therefore it is called "relevant transaction". Considering its importance SEC gives special characteristics of ""the relevant transaction": the method of purchase and sale, the parties to the transactions, the nature of the security, the effect on international relations, and the need to protect investors"[50]. These again confirm that because of DR has multi-character (for instance there many types of DR) "the relevant transaction" featured also as a flexible.

Other relationship issue between DR holders and issuing company comes from "President and Fellows of Harvard College (Harvard) against JSC Surgutneftegaz" case. In this case first parties alleged that JSC Surgutneftegaz did not pay dividends to them which were declared in its prospectus. An important aspect in this case is that one clause of the depositary agreement referring for arbitration jurisdiction in accordance with the rules of the American Arbitration

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[47] Mark Saunders, Fordham International Law Journal Volume 17, Issue 1 1993 Article 2, "American Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies" p.56

[48] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

[49] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

[50] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

Association of "any controversy, claim or cause of action brought by any party arising out of or relating to"[51] the ADRs. Then, that agreement defines that disputes with reference to US security law "may, but need not, be submitted to arbitration as provided" in the agreement. From the mentioned provisions it is clear that most disputes relating to security issues, commonly will be heard by American Arbitration Association (AAA). And therefore plaintiffs claimed that despite of the fact that their demand is class action it should be heard by AAA. Because of the importance of agreement this case was ended by the decision of the Supreme Court of U.S. Even though "the class actions in Colombia are subject to the exclusive jurisdiction of the court, but the Supreme Court of Justice rejected that argument on the grounds that the arbitration agreement did not limit the types of claims that could be submitted to arbitration and thus did not exclude class arbitrations as a matter of law". So this case put into force that no matter what exclusive jurisdiction requires, on the class action concerning ADR, parties can define that disputes will be heard in Arbitration.

Another argument in this case was that since only parties (depositary and issuing company) signed depositary agreement they could change that agreement without consent of ADR holders, so how ADR holder could refer to that agreement regarding choice of jurisdiction. As we saw from the decision of the Supreme Court of Justice that argument did not play an important role. The court took all these relationship as a complete. It did not divide relationships on the ADR that those relationships only belonged to depositary and company.

For us this kind of approach to ADR is important because, as we mentioned above there are many types of DR and many legislations and rules.

Another conclusion from that case is that the court cited depositary agreement and considered its clause as important. This fact implies that the document should have priority which relates to issuing company's will. Same modus operandis was in the case where judges and scholars were trying to find the answer to the jurisdictional issues.

Other auspicious aspect of relationships between issuing company and depositary holder is the prospectus, in other words disclosure of issuing company. Last mentioned case also underlay this moment. Besides main attention in that case

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[51] Dana H. Freyer, John L. Gardiner, Barry H. Garfinkel, Lea Haber Kuck, Marco E. Schnabl, November 1, 2007, "Arbitration of Securities Claims Directed to Proceed as a Class Action Based on Deposit Agreement Governing American Depositary Receipts" <http://www.martindale.com/securities-law/article_Skadden-Arps-Slate-Meagher-Flom-LLP_332642.htm> accessed 14 June, 2013, at pmbl

was jurisdictional problem, however plaintiffs claimed their dividends according to prospectus of JSC Surgutneftegaz.

Prospectus is also signified on account of Depositary holders' three main rights (getting dividends, voting, redemption). To realize these rights depositary holders mainly base to prospectus, they read information on it, analyze, check and if information is not coincide with reality they are filing case.

4. Jurisdiction

As we mentioned one problem with the DR is jurisdiction. This problem comes from the nature of this interstate institution. "The mixed and ambiguous nature of securities like ADRs, however, may make it difficult to obtain clear, simple, certain and consistent results"[52]Another hindrance in this institution (jurisdiction) is that it connects more than one country. As we mentioned above DR occurs at least under two countries laws. First, issuer is subject to its own country's law where it was incorporated, then to the country's law where issuers are going to sell their securities in. But sometimes this relationship is going beyond two countries boundary to third and even forth countries' jurisdiction. So, jurisdictional problems, in these circumstances, are inevitable.

Since DR appeared and was developed in the US, as might be expected, we first have to take a look at the American practice. In this context if we are talking about jurisdiction, of course, we will first pay attention to parties (defendants and claimants), as well as subject-matter jurisdiction. In US legal system, there are two kinds of claimants – private person (or class action) and agency (in this case SEC). Regarding to subject-matter jurisdiction they can apply same norms – Section 10(b) Exchange Act and Rule 10b-5. Nevertheless, SEC additionally can apply Sections 11 and 12 of the Exchange Act.

Concerning parties we will first discuss the claimants although separately. Now we will clarify which person is implied under claimant? Who are they? Are they defined? Regarding SEC there is not any problem about who can be understood under it, it is SEC or its affiliate. However, there is problem in reference to SEC's jurisdiction which will be discussed below.

From the beginning it is seen that as if there could not be misunderstanding of private claimants (or as mentioned "any person" in the language of the Rule

[52] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

10b-5). It can enclose the US citizens as well as foreigners[53]. But if we consider that the US law is not tailored for extraterritoriality in its true sense, then we can realize the fact that foreigners can be plaintiff under the U.S law when they are closely connected to the US. In other words, not all foreigners can be plaintiff in the US for ADRs. In this context another question occurs: is there any possibility that other plaintiffs - the US citizens can be plaintiffs in any circumstances? Of course, no. For instance, if the US citizens conduct any selling or buying act in other country in connection with GDR then we cannot say directly that there should be the jurisdiction of the US. Hence, one conception becomes clear which the effect test is. The "effects test" examined "whether the wrongful conduct had a substantial effect in the United States or upon United States citizens,"[54]. This test comes from the US Court of Appeal for the Second Circuit's case Schoenbaum v. Firstbrook.[55] It means that jurisdictional problem is not only connected with plaintiffs, it also depends on fraudulent acts effect on the US or on its citizens.

Beside jurisdiction concerning people, two kinds of their acts - buying and selling DRS can make us face some jurisdictional problems. For instance, which country's jurisdiction will apply to the relationship between foreigner and ADR issuer?

There is also another issue emerging from "place of conduct". But this time place of conduct is reviewed not as a place where buying and selling happens on, it is reviewed as a place where fraudulent act occurs on. To determine jurisdiction in the Depositary Receipt or in transactions with foreign elements, the US court introduced in 1970s the conduct test in its famous decision in Leasco Data Processing Equipment Corp. v. Maxwell[56]. The "conduct test" asked "whether the wrongful conduct occurred in the United States"[57] or not.

Besides not both tests are applied, we should mention that these tests' roots originate from criminal law. In criminal codes it is generally written that if criminal act happens in country's territory or if it happens against its citizens then

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[53] There is also another practice in reference to "any person" (private claimants). According to Rule 10b-5 it (it is defined in the language of the rule) shall be unlawfull to any person in connection with the purchase or sale of any security. For the reason of the "in connection with the purchase or sale" there is definition in some cases.

[54] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

[55] Marco Ventoruzzo, Virginia Journal of International Law, 2012, Volume 52, Number 2 Page 405 "Like Moths to a Flame? International Securities Litigation after Morrison: Correcting the Supreme Court's "Transactional Test"" <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027530>

[56] Marco Ventoruzzo, Virginia Journal of International Law, 2012, Volume 52, Number 2 Page 405 "Like Moths to a Flame? International Securities Litigation after Morrison: Correcting the Supreme Court's "Transactional Test"" <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027530>

[57] Marco Ventoruzzo, Virginia Journal of International Law, 2012, Volume 52, Number 2 Page 405 "Like Moths to a Flame? International Securities Litigation after Morrison: Correcting the Supreme Court's "Transactional Test"" <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027530>.

culprit shall be examined in that country's court. As we see from above the criminal procedure embraces conduct and effect tests. Most of the countries criminal law follows the way of extraterritoriality. May be therefore the UScourts did not take extraterritoriality into consideration much in civil cases.

Nevertheless, since these tests paved the way for extraterritoriality, some scholars criticized these tests and at the end in the *Morrison* case Supreme Court decided to implement new test for defining jurisdiction. Terming it transactional test, the Supreme Court introduced two independent prongs to determine all over the cases. The first prong states that section 10(b) applies to "transactions in securities listed on domestic exchanges."[58] The second prong states that section 10(b) also applies to "domestic transactions in other securities."[59] With this way the Supreme Court removed some uncertainties and extraterritoriality approach. However from the critic's point of view this test also did not establish certainty in this field.

Beside this, in the Dodd-Frank Act Congress partially rejected *Morrison's* transaction test. The first provision is Section 929P (b), which explicitly gives federal courts jurisdiction over actions brought by the SEC or the Department of Justice (DOJ) if conduct within the United States "constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors," or if conduct occurring outside the United States "has a foreseeable substantial effect within the United States"[60].

As we can see even the cases with foreign elements have jurisdiction problems and they were not solved by the congress (may be intentionally explain more). As for the ADRs, there is not any concrete norm for them how to treat even sponsored or unsponsored Depositary Receipts. Although not many scholars were interested in ADR's jurisdiction, there are some ideas in scholars' article about these issues[61]. Some of them think that all ADRs – sponsored and unsponsored should be treated as an American transaction. However, some of them suggest that ADRs should be accepted as an American transaction depending on their relations to the U.S. According to them if issuers are subjecting themselves to the U.S. law

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[58] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl.

[59] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl.

[60] Marco Ventoruzzo, Virginia Journal of International Law, 2012, Volume 52, Number 2 Page 405 "Like Moths to a Flame? International Securities Litigation after Morrison: Correcting the Supreme Court's "Transactional Test"" <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027530>

[61] How American are American Depositary Receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank < http://www.bc.edu/content/dam/files/schools/law/bclawreview/pdf/52_5/05_chiappini.pdf> accessed 14 June, 2013, at pmbl

with their intention (reaching an agreement with the depositary bank) – sponsored Depositary Receipt, then transaction on ADRs should be accepted as the U.S. transaction. In the other hand if issuers have not such kind of intention to be subjected to an American law – agreement with the American depositary banks, then the transaction should not be accepted as a U.S. transaction[62].

As we mentioned before there is subject matter claiming problem also regarding DR. In this paragraph we will show why court cases occur in connection with DR or ADR. Here we see that almost all litigations appear because of fraudulent conduct. And these relationships are regulated by Section 10(b) of the Exchange Act of 1934 and some other rules in the U.S. and therefore courts have difficulties to apply that norm to the ADR. "Under this approach, U.S. courts have adjudicative jurisdiction when either substantial conduct relevant to the violation has been carried in the United States, when the alleged fraud has caused some damage in the United States to American plaintiffs, or both"[63].

There is also one theory that plaintiffs want to apply to U.S. courts, on the reason that US courts have advantages in favor of investor-plaintiffs. Scholars to prove that theory mention there are "contingency fee", "fishing expeditions", and absence of a "loser pays" institutions[64].

According to "contingency fee" in the US lawyers get their payment after the case (if they win case). Because of investors do not spend money beforehand for their case most probably they will apply to the court more than where there is not such kind of institution.

According to "fishing expeditions" institution, parties have chance to get information from other side. This institution also encourages plaintiffs to choose US jurisdiction.

Absence of a "loser pays" is also an important institution for court cases. With this way investors are not afraid of losing case. In other words they have not material risk applying to the court.

Giving the fact that owning security is a risky business, then investors have to have guaranty that they can apply to the court and this court will not be bias.

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[62] Sarah M. Crandall, Supervised by Professor Howell E. Jackson, Harvard Law School, May 2, 2012 "Beyond Morrison v. National Australia Bank: Approaches for the Securities and exchange commission in light of the transactional Test" <http://www.law.harvard.edu/programs/about/pifs/symposia/brazil/sarah-crandall.pdf>

[63] Rule 10b-5 prohibts the use of any act or omission to defraud or decisive in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (2011). And this Rule is applying to the class action

[64] Marc Galanter, "Anyone Can Fall Down a Manhole: The Contingency Fee and its Discontents" (1998) <http://www.academia.edu/884249/Anyone_Can_Fall_Down_a_Manhole_The_Contingency_Fee_and_Its_Discontents>

5. **Responsibilities (liability) in depositary receipt**

Responsibility on DR is as much problematic as legal nature of it. We think they have much correlation between themselves and they are affecting to each other. These problems occur on account of number of parties, number of regulations; especially because, parties are residents of different countries as well as they are subject to different law system. Problems are not confined with mentioned issues; there are also dual liability almost in all legal systems. These issues show themselves especially in the US system. They are synthesized mostly with the Public and private cause of action. Public cause of action is taken to the court by SEC and Financial Industry Regulatory Authority (FINRA) and Department of Justice (DOJ), Private cause of action is taken by investors or other parties (it can be legal entity or physical person).

SEC enforcement action covers almost every aspect of securities; however FINRA embodies financial aspect of Securities. In other words these agencies as well as DOJ protect public interest on Security issues. Therefore they, especially the SEC have more power to bring an enforcement action against any person. For instance, it can sue any broker, insider, investor etc. In short, we can say that power of the SEC is more than FINRA, DOJ or investors. "For example, only the SEC may enforce Regulation FD and the filing requirements under the periodic disclosure system[65].

Apart from mentioned power, the SEC can bring criminal action against companies for fraudulent acts or so. Unlike civil legal system, this feature of the US system is common in the common legal systems. So, the SEC has power to enforce criminal liability. These liabilities can be fine, imprisonment or demise of company. After Enron case fine and imprisonment against company became much stricter. "Maximum criminal penalties under the Exchange Act are increased for individuals from fines of $1 million and imprisonment of ten years to fines of $5 million and imprisonment of twenty years. Fines for organizations are increased from $2.5 million to $25 million"[66]. "It may also be reasonable to expect judges to be less willing to dismiss class action lawsuits in the wake of recent corporate scandals, despite legislative changes, such as the Private Securities Litigation

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[65] Stephen J.Choi, A.C.Pritchard, "Securities Regulation: cases and analysis", 2012, Third edition p.744

[66] Michael A. Perino, St. John's Law Review, Volume 76, Issue 4 Volume 76, Fall 2002, Number 4 Article 1, 2012, "Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002" <http://scholarship.law.stjohns.edu/cgi/viewcontent.cgi?article=1362&context=lawreview&sei-redir=1&referer=http%3A%2F%2Fscholar.google.nl%2Fscholar%3Fq%3D%2522wire%252C%2Bsecurities%252C%2Bor%2Bany%2Bother%2Bfraud%2Bshall%2Bbe%2Bsubject%2Bto%2Bthe%2Bsame%2Bpenalties%2Bas%2Bfor%2Ba%2522%26btnG%3D%26hl%3Dnl%26as_sdt%3D0%252C5#search=%22wire%2C%20securities%2C%20or%20any%20other%20fraud%20shall%20subject%20same%20penalties%20as%22> accessed 17 June 2013, at pmbl.

Reform Act, that were designed to make it harder for non-meritorious cases to proceed"[67]. As an example we can show "Siemens AG" which listed with the way of Level II and Level III of ADR, was fined $450 million by SEC for criminal FCPA violations. And without admitting criminal allegation, Siemens disgorged $ 320 million[68].

Besides mentioned strict measures SEC can use lenient measures such as "deferred prosecution agreements", "Consent judgments". Besides these measures also are applied in such a punishable ways, they are not as strict as mainly courts' decisions are. Hence SEC somehow can exempt company from criminal responsibility. It applies domestic companies mainly. "The SEC also had no authority to exempt foreign private issuers from federal criminal laws"[69]. With this approach we can say that foreign public issuers mainly are Level II and Level III ADR issuers, cannot exempt federal criminal law.

Other one of important liability comes from Foreign Corrupt Practices Act (FCPA). **"**Exposure to the U.S. FCPA exposes foreign issuers to the risk of criminal and civil penalties that U.S. enforcement authorities can obtain for violations"70.

FCPA is applied generally from the context of "anti-bribery provisions" and the "accounting provisions." These provisions can be applied also to the ADR issuer whose ADR is sponsored and registered. Those types ADR are Level II and Level III ADR. Level I is excepted since it is not listed, Level IV is not considered as foreign security. Therefore latter will be treated neither as a domestic security nor as a listed foreign security. It will be treated with a special status. According to Zingales' (2006) research "the large increase in the number of 144A registrations by foreign firms after SOX which, by allowing them to avoid U.S. legal liability,

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[67] Michael A. Perino, "American Corporate Reform Abroad: SarbanesOxley and the Foreign Private Issuer", <http://journals.cambridge.org/action/displayFulltext?type=1&fid=191564&jid=EBR&volumeId=4&issueId=02&aid=191563 > accessed 17 June 2013, at pmbl

[68] Darryl S. Lew, Committee Co-Chair and Partner, White & Case LLP, American Bar Association Section Of International Law And Practice,Volume IV, issue 2, may 2010 "International Criminal Law Committee Newsletter" <http://www.scribd.com/doc/98792308/AMERICAN-BAR-ASSOCIATION-SECTION-OF-INTERNATIONAL-LAW-AND-PRACTICE-May2010>accessed 17 June 2013, at pmbl.

[69] Michael A. Perino, "American Corporate Reform Abroad: SarbanesOxley and the Foreign Private Issuer", <http://journals.cambridge.org/action/displayFulltext?type=1&fid=191564&jid=EBR&volumeId=4&issueId=02&aid=191563 > accessed 17 June 2013, at pmbl

[70] Darryl S. Lew, Committee Co-Chair and Partner, White & Case LLP, American Bar Association Section Of International Law And Practice,Volume IV, issue 2, may 2010 "International Criminal Law Committee Newsletter" <http://www.scribd.com/doc/98792308/AMERICAN-BAR-ASSOCIATION-SECTION-OF-INTERNATIONAL-LAW-AND-PRACTICE-May2010>accessed 17 June 2013, at pmbl.

helps them tap the U.S. markets via the "back door.""71 So, ADR issuing company can be liable on the base of FCPA depending upon its listing type. As an example we can show DOJ and SEC's FCPA enforcement action against Total S.A., a French oil and gas company case. Given Total S.A. had ADR, registered with the SEC and traded on the New York Stock Exchange DOJ and SEC commenced criminal enforcement action against it for the corruption act between that company and National Iranian Oil Company. Although case resulted in "deferred prosecution agreement" "Total agreed to pay approximately $398 million to resolve its alleged FCPA scrutiny ($245.2 million to resolve the DOJ enforcement action and $153 million to resolve the SEC enforcement action)"[72].

But we should mention that as civil liability, criminal liability also has legal problem with regard to ADR. Unlike fine of criminal liability, demise of the company and imprisonment of company's personnel is not easily executed punishment. First of all, there are many countries which do not recognize demise of company as a punishment. Therefore it would be impossible to execute punishment for the country which does not have such kind of punishment. Another inhibition could be that country would not like to have ramifications for their economy. Therefore these types of countries would not recognize those kinds of decisions.

Another difficulty is connected with personal of company's imprisonment. Many countries of the world have such kinds of regulations that not any government can give its citizens to third country, even he or she committed crime.

Other liability, such as fine or civil law monetary liability has problem on the sphere of DR concerning treaty on the reciprocal recognition and enforcement of judgments in civil and commercial matters. Since there are not above mentioned types of agreements among many countries, enforceability of liability faces many difficulties which negatively affect images of DR. Nevertheless even with warning investors, in the prospect, with such kinds of risks do not stop future of DR. For instance, in the prospectus of "Yandex" it is mentioned that "there is no treaty on the reciprocal recognition and enforcement of judgments in civil and commercial matters between the United States and the Netherlands and between the United States and Russia, courts in the Netherlands and Russia will not

[71] Prof. François Leroux, Prof. Jean-Claude Cosset, Prof. Narjess Boubakri, Prof. Sergei Sarkissian, Prof. Usha Mittoo, Prof. Martin Coiteux "ADR Listings and the Financing Decisions of Foreign Firm", Mai 2009, <http://mutan.org/actualites/Thesis_Anis_Samet_May2009_VF.pdf> accessed 17 June 2013, at pmbl.

[72] FCPA Professor, A forum Devoted to the Foreign Corrupt Act, "Total agrees to pay $398 million to Resolve its FCPA Scrutiny" < http://www.fcpaprofessor.com/category/oil-and-gas-industry> accessed 18 June 2013, at pmbl

automatically recognize and enforce a final judgment rendered by a U.S. court"[73]. For us these kinds of information does not affect much to that kind of companies' ADR due to their overspread affiliation. Investors of ADR know that they can make US court judgments in other countries where issuing company has affiliation or asset and the US has treaty on the reciprocal recognition and enforcement of judgments with those countries. And since Yandex is international company and it has many affiliates in many countries that risk of enforceability of judgments is decreasing.

Besides mentioned difficulties in enforceability of court decision we should also note advantages of the US court systems concerning to investor protective measures. In previous paragraph it was shown how the UScourt effective with the aspect of investor protective. Three advantages - "contingency fee", "fishing expedition" and absence of "looser pays" clause declared that until the enforcement of court decision the US court system is investor-oriented. We should also mention that liability of issuer before investor is also stronger than in another country. This was also shown by research. "From the point of view of defrauded investors in the EU, these remedies generally have less bite than rule 10B-5"[74].

[73] Prospectus of "Yandex", < http://google.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHtmlSection1?SectionID=9152543-112110-116994&SessionID=-HGKFSsb1gIncD7#A2213570Z424B7_HTM_BG42105A_MAIN_TOC > accessed 17 June 2013, at pmbl

[74] Marco Ventoruzzo, Virginia Journal of International Law, 2012, Volume 52, Number 2 Page 405 "Like Moths to a Flame? International Securities Litigation after Morrison: Correcting the Supreme Court's "Transactional Test"" <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027530>

Chapter III Depositary Receipt's effects on legislations

1. Depositary Receipt's effects on issuing company and its country's legislations

Two or more countries' legislations meet in DR, and at that point one question arise: which country's legislation will be dominant. In this context, law of nature is not excepted as well. More powerful countries win in this battle field and they dictate their laws and interests and achieve their main goal and change less powerful countries legislation. Economic reason of it is that issuing company needs to raise capital or to get visibility from host country (investor's country) and therefore they are ready to concede their rights to more powerful countries in return of mentioned goals. And these kinds of practices embody mainly all developing countries. For instance, People's Republic of China after having opportunity to issue DR adopted the rule which affects the rule of issuing companies' country. It declares that "The law of the issuer's place of incorporation, as supplemented by the issuer's Constitution, must not be inconsistent with the rights of shareholders or of the holders of Depositary receipts under Hong Kong law and the Exchange Listing Rules"[75]

However this rule does not always work in favor of investors' country, given that investors' country has its own interest it is logical that legislation of issuing companies' country effects host country's legislation. It is also worthwhile to note that first affects are stronger than second one.

But we also should mention that not all scholars think that main feature of being subject to foreign law is economically benefitial. For instance, Jack Coffee explains in its "binding theory" that there are some situations when company knows that its home country's legislation, regulation agencies and courts will not be efficient enough for its improving and therefore chose other jurisdiction such as U.S.'s U.K.'s jurisdiction. "In this view, cross-listing on a foreign stock market can serve as a bonding mechanism for corporate insiders to credibly commit to a better governance regime"[76]. Companies with the ADR through cross-listing can achieve corporate governance which is in international standard and it paves the way for

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[75] Rules governing the listing of securities on the Stock Exchange of Hong Kong limited Equity Securities, Chapter 19B.16, <http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_19b.pdf > accessed 14 June, 2013, at pmbl

[76] Amir N. Licht, Berkeley Journal of International Law Volume 22, Issue 2, Article 2, 2004 "Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform" <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1269&context=bjil > accessed 14 June, 2013, at pmbl

them to develop their business. However these affects do not always result in development or so. Sometimes issuing companies even encounter adverse effects. These adverse effects are mostly mentioned as the result of "cultural differences".

However good result with the adoption of other country's legislation most commonly is connected with transactional company which has a lot of affiliation around the world. As an example we can note South Korea and its big corporation "Samsung". "In the wake of the 1997 Asian financial crisis, Korea adopted North American corporate governance features to embark on a path of legal and institutional reform. In addition, the Korean government in 2002 took steps to encourage cross-listing of Korean corporations on several foreign markets". From mentioned point it is clear that after first adoption of North American corporate governance regulation, South Korea adopted additional regulation from America. This fact was also proved by the fact of Samsung's successes. It is worthwhile to mention that Samsung also has ADR which we think also played an important role for adoption of legislation.

Another important example could be Brazil. This is a country that used ADR much and was subject to the legislation of the US much. Like other scholars we think that this connection, between the US legislation and Brazil companies, considerably affected Brazil's legislation. For example, most important requirement for foreign company on ADR in the legislation of the US is that company should adopt or be subjected to the rule which protects minority shareholder's rights. And a company issuing Level II and Level III ADRs definitely comply with those kinds of requirements. Now from the improvement of Brazilian legislation we see that "the Corporation Law (6,404/1976) and the Securities Commission Law (6,385/1976) have been amended in order to strengthen minority shareholders' rights, corporate transparency and the rule-making and enforcement powers of the Brazilian Securities Commission (CVM)"[77]. Besides governmental reform, improvement showed itself also in São Paulo Stock Exchange. It also started to require from companies to reconcile its corporate governance structure and bylaws with its standard.

Other important aspect of improving developing countries legislation concerning DR comes from international organizations' requirements. In this context we can mention that "the World Bank, the International Monetary Fund and the Organization for Economic Cooperation and Development – have contributed to the evolution of a corporate governance culture in Brazil"[78]. For us

[77] Henrique Silva Gordo Lang, Pinheiro Neto Advogados, "Overview of recent corporate governance reforms", <http://www.globalcorporategovernance.com/n_latinamerica/142_148.htm> accessed 14 June, 2013, at pmbl

[78] Henrique Silva Gordo Lang, Pinheiro Neto Advogados, "Overview of recent corporate governance reforms", <http://www.globalcorporategovernance.com/n_latinamerica/142_148.htm> accessed 14 June, 2013, at pmbl

besides mentioned requirements suggested by international organizations, they are also in interest of developed countries issuing securities and so on.

As to the US, symbolically we can divide effects of the US legislation to foreign countries two separate era – era until the Sarbanes-Oxley Act and era after Sarbanes-Oxley Act.

Until the Sarbanes-Oxley Act foreign issuers mostly were enjoying many exemptions. But threat of downturn in security market (after Enron scandal) made government to think about stricter rules concerning foreign issuers. For example, "many foreign issuers, particularly those with two-tier boards, did not have audit committees prior to the Act, because US exchanges frequently exempted foreign issuers from these listing requirements"[79]. However after mentioned Act foreign issuers with two-tier boards were required to have audit committee.

Sometimes, companies want to comply with the requirements of the legislation of investor's home country, but legislation of issuing country does not allow to make such kind of decision directly as it is accepted in investor's country. For instance, Georgian Railway Company decided to issue GDR in the UK. One of U.K's requirements is that issuing company should have corporate governance structure, however, since there is not corporate governance regulation they used more flexible company form "Joint Venture" instead of corporation governance itself. Of course if there are many companies using ADR they will demand or lobby in Parliament or in other government agencies about legislation changes. And with this way ADR effects the legislation of issuing company's country.

Another important effect of legislation of investor's country on legislation of issuing company's country happened between Lebanon and Swiss country. A project called Sannine Zenith Lebanon decided to raise $ 1.2 billion capital through GDR in Swiss country. According to deposit agreement Swiss Bank EFG in Switzerland should have issued GDR and in case of any disagreement Swiss law would apply in Swiss court's jurisdiction. However there was a problem when litigation rose after the issuing GDR and parties argued about jurisdiction. On the result of issuing company Sannine Zenith Lebanon had a lot of real estate and therefor Lebanese part was arguing that it is exclusive jurisdiction and case should be heard in Lebanon court. But other part was basing on the depositary agreement which defined that law and court should be Swiss law and court. Considering that legislation and court of investor's country contain important point in DR's crux,

79 Michael A. Perino, "American Corporate Reform Abroad: Sarbanes-Oxley and the Foreign Private Issuer" <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=439501 > accessed 14 June, 2013, at pmbl

this legal dispute should be resolved in favor of Swiss part on the reason of investor protection measure. Swiss part won the case. But there was much effort for this result even parties lobbied their position in the parliament and in other governmental agencies. And this case really shows how DR effects the legislation of issuing company's country. Although there was exclusive jurisdiction, power of GDR changed such kinds of law or made government or court to bypass that rule with adding many interpretation such as freedom of the contract, priority of international law and so on[80].

2. Depositary Receipt's effects on the legislations of investor's countries

DR's financial-economic characters make us, before reviewing legal aspect of DR's affect, to look at its financial-economic aspects. Research has shown that not only investor's security market affects issuing company's security market, it also occurs vise-versa. "Specifically, foreign firms' home markets tend to dominate the price formation processes of their securities. This dominance by the foreign firms' home market is also related to cultural distance through its effect on informational asymmetries"[81]. So, first affect is financial-economic affect. Of course, if there is economical reason we will see also legal effects of issuing companies' countries.

We should mention that effect of legislation of issuing company's country could affect the investors' interest with two ways one of them is that mentioned legislation could be reflected by the legislation of investors' home country or by the stock exchange which issuing company will be listed.

DR's effects on the legislation of investor's country, of course, happen on the result of majority's requirement. In other words investors' countries change their legislation or adopt new rule if there are many requirement. For instance, the US legal system made changes in its legislation with making safe harbor for ADR issuing companies which are incorporated civil law countries such as Germany which had two-tier system in corporate governance. Because of its wide power "The SEC has used this authority to create "tailored exemptions" for foreign private issuers, which it viewed more appropriate than accommodations relating to disclosure, because the audit committee requirements "could result in direct

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[80] **Wael Nazir Obeid, Global depository receipts in Lebanon financial and legal aspects 2004 <https://scholarworks.aub.edu.lb/handle/10938/6737> accessed 12 January, 2013, at pmbl.**

[81] Amir N. Licht, Berkeley Journal of International Law Volume 22, Issue 2, Article 2, 2004 "Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform" <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1269&context=bjil > accessed 14 June, 2013, at pmbl

conflicts with home country requirements"[82] So, it is clear from the latter thought that legislation of issuing company's country directly affected the legislation of the investor's country. It is worthwhile to note that there were many exceptions before Sarbanes-Oxley Act. So, after Sarbanes-Oxley Act mentioned exemption for two-tier system nullified by the the US legislation body[83].

Other kind of effect could be with the way of double taxing. In the absence of a "treaty eliminating double taxing" we can notice that affect. For instance, if there is not "treaty abolishing double taxing between countries" on one country resides investors, and on the country issuing company incorporated, then DR can make investors, depositary and issuing company for their own interests to lobby among government agencies for signing "treaty abolishing double taxing between countries".

Legislation of investors' country could also be affected by the way of attracting new issuing company, for instance the Athens Stock Exchange Market. "The distinctive feature of said market consists in the fact that the securities listed on it are related to emerging capital markets. Such markets basically constitute the countries of Middle East, Caucasus, Mediterranean Central and East Europe". From the last idea it is clear that priority of Athens Stock Exchange Market is lure firms from said region to list in and therefore Athens Stock Exchange Market should consider those countries legislation even should reconcile its rules to mentioned legislation.

We should also mention that there are effects to the legislation of investors' country from the issuing company's perspective concerning ADR in the court's jurisdiction. In the US courts are mainly inclined to take many cases in their jurisdiction although those cases mainly belonged to the other country's jurisdiction. To eliminate this practice a lot of theories (effect test, conduct test, Morrison's transactional test etc) were invented and applied. Besides last test – Morrison's transactional test was considered bright line test afterwards its defects too occured. As if it was not enough recently adopted Dodd-Frank Act forwarded judges again to trouble in the context of ADR court's jurisdiction.

[82] Michael A. Perino, "American Corporate Reform Abroad: SarbanesOxley and the Foreign Private Issuer", <http://journals.cambridge.org/action/displayFulltext?type=1&fid=191564&jid=EBR&volumeId=4&issueId=02&aid=191563 > accessed 17 June 2013, at pmbl

[83] 15 USC § 78j-1(m)(3)(C) (2003).

Conclusion

Besides financial advantages and legislations' reconciliation to establish DR, there are still legal problems with it. Until now neither scholars nor governmental agencies (courts as well) have not determined whether DR is domestic or foreign shares. The only definite thing is that DR represents foreign shares. This factor and DR's internationally trading (via internet or in many countries despite of the fact that one company issues share or receipt in other countries, those shares also can be sold to third countries) feature raises legal problems.

These problems roots firstly originate from countries, companies and individual investors interests. However main reason for them is that DRs relationships take place between at least two countries. Companies and countries are interested in DR because of its financial advantages, although there are enough legal risks.

It was clear from few court cases that legal nature of DR was not defined properly yet. Some judges declare that DR bears "trust" feature, while some do not agree with that idea. So this blurred approach to DR undermines its reliability from the legal aspect. Because with this way investors can put their investment under risk that in the case of insolvency or such kind of other situation they cannot get guarantee that their receipts will be in the enforcement. A newly developing legislations of some countries estimated DR as a "trust". However because of some precedence, it is not obvious whether every court or arbitration will estimate it as a "trust".

In light of legal procedure that court decision can be issued in one country and be enforced in other country divided one problem into two: first, jurisdictional problem, second, enforceability problem.

DR's main characteristics – being international, makes interest areas challenging between countries. U.S. courts, for instance, tried to resolve court's jurisdictional problems in last few decades and succeeded at some point, but Congress by making amendment to the legislation left court's jurisdictional problems unsolved again.

Although responsibility problem is connected with DR's multi-country character it is one of the main hindrances in DR from legal perspective. This problem occurs not only because of distance; its other reason is that countries have different legal systems. For instance, most common law countries have company's demise, but not civil law countries.

So some punishments are impossible to be enforced in comparison with other countries. Here we also should mention that, sometimes, there is not "treaty on the reciprocal recognition and enforcement of judgments" between issuing company's country and investors' country. In this case there is possibility that investor's interest on DR becomes under huge risk. Because no country could agree for some asset to flow from its territory to another country's territory, if it has not such kinds of obligation under international law.

Other legal problems descend from the forms (and levels) of DR. Given that firms and depositaries try to create DR for various reasons, in that case their legal problems also differ. For instance problems on sponsored DR are connected with the issuing company directly from investor holders' country, however, on unsponsored DR, its holders generally try to communicate to the issuing company not directly from his or her country, but in the country where issuing company is situated.

For us these mentioned problems are not completely resolved or attempted to be resolved because this institution is expensive device to be created and therefore not widespread. We think there are big corporations and institutional investors in this field and problems between them almost do not happen (because of their images and so) and therefore they do not lobby hardly to adopt new rules or legislations to resolve mentioned problems

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