

Client Alert

SEC Adopts Long-Awaited Final Rules to Ease the Deregistration Process for Foreign Private Issuers

On March 27, 2007, the SEC published its long-awaited final rules that govern when a foreign private issuer may terminate the registration of a class of equity securities under Section 12(g) of the Securities Exchange Act of 1934 and the corresponding duty to file reports required under Section 13(a) of the Exchange Act, and when it may terminate its reporting obligations regarding a class of equity or debt securities under Section 15(d) of the Exchange Act.¹ The new rules considerably ease the deregistration process compared to both the existing rules and the proposed rules announced by the SEC in December 2005, but are substantially similar to the repropose rules announced by the SEC in December 2006, save for some technical adjustments and transitional relief.² The new rules, adopted on March 21, 2007 and effective June 4, 2007, are designed to promote capital formation in the U.S. and make the U.S. markets a more hospitable and attractive environment for foreign issuers by eliminating conditions that were considered a barrier to entry without sacrificing investor protections.

Existing Registration and Deregistration Rules

A foreign issuer can become subject to the reporting requirements of the Exchange Act in three ways. First, if the foreign issuer lists a class of equity securities on a U.S. securities exchange, it must register the class of equity securities with the SEC under Section 12(b) of the Exchange Act. Second, if a class of the foreign issuer's equity securities is held (i) by more than 500 record holders worldwide and by more than 300 record holders in the U.S., or (ii) by more than 300 record holders in the U.S. and its assets exceed \$10 million, it must register the class of equity securities with the SEC under Section 12(g) of the Exchange Act. Registration under either Section 12(b) or 12(g) requires the foreign issuer to prepare and file the reports required by the Exchange Act. Finally, if a foreign issuer offers and sells equity or debt securities in the U.S. pursuant to an offering registered under the Securities Act of 1933, the foreign issuer must file the reports required under the Exchange Act pursuant to Section 15(d) of the Exchange Act. These requirements sometimes overlap, but, at any time, an issuer is only required to file Exchange Act reports under one of the

¹ See SEC Release No. 34-55540; International Series Release No. 1301; File No. S7-12-05. A copy of this Release is available on the SEC's website at www.sec.gov/rules/final/2007/34-55540.pdf. See also Press Release No. 2007-55. A copy of the Press Release is available on the SEC's website at www.sec.gov/news/press/2007/2007-55.htm.

² For a discussion of the December 2006 proposal, see our Client Alert, "SEC Reproposes Rules to Ease the Deregistration Process for Foreign Private Issuers," and for a discussion of the December 2005 proposal, see our Client Alert, "SEC Proposes Rules to Ease the Deregistration Process for Foreign Private Issuers," both available on our website at www.chadbourne.com/publications/.

requirements. However, upon termination of one requirement, an issuer's obligation to file reports under another applicable requirement may be reactivated.

Under the existing Exchange Act registration and reporting rules, a foreign private issuer may only deregister a class of its securities if the class is held by fewer than 300 U.S. residents, or fewer than 500 U.S. residents for issuers with less than \$10 million in assets, as of the end of its last completed fiscal year. The issuer must "look through" the record ownership of brokers, dealers, banks or nominees on a worldwide basis and count the number of separate accounts of customers residing in the U.S. for which the securities are held. If an issuer can satisfy all of the criteria, the issuer may cease reporting; however, in most cases, the issuer may only suspend (not terminate) its reporting obligations and, as a result, is still required to determine on a year-to-year basis whether it meets the reporting exemption threshold.

New Deregistration Rules

New Rule 12h-6 permits the termination, not just suspension, of Exchange Act reporting regarding a class of securities under either Section 12(g) or Section 15(d) of the Exchange Act by a foreign private issuer that meets certain conditions described below for its debt and equity securities.

Conditions for Equity Securities Issuers

New Rule 12h-6 enables a foreign private issuer to terminate its Exchange Act registration and reporting obligations regarding a class of equity securities if it can meet the four conditions set forth below.

1. Quantitative Benchmarks

a. Non-Record Holder Benchmark: Average Daily Trading Volume ("ADTV") Standard

The new rule enables a foreign private issuer, regardless of size or number of holders that are U.S. residents, to terminate its registration and reporting obligations, assuming it meets the other conditions of Rule 12h-6, if the U.S. ADTV (including off-exchange trading) of the subject class of equity securities has been 5% or less of the ADTV of that class of securities on a worldwide basis (and not against its primary trading market as repropounded by the SEC in December 2006) during a 12-calendar-month period that ended no more than 60 days before the filing date of its certification regarding termination of registration (Form 15F).³ When calculating the ADTV standard, equity-linked securities (such as warrants, puts, options or

³ When calculating the U.S. ADTV as a percentage of worldwide ADTV, an issuer would have to account for all U.S. trading of its subject securities, whether occurring on a registered national securities exchange or elsewhere, as reported through the U.S. transaction reporting plan, and then divide its U.S. ADTV by its worldwide ADTV for the subject class of securities (including its U.S. ADTV and off-market transactions, such as transactions conducted through alternative trading systems and transactions occurring on an exchange, so long as an issuer has obtained the information concerning off-market transactions from publicly available and reliable sources that do not merely duplicate exchange-reported trading).

other convertible securities) are not included. However, before an issuer may deregister in reliance on this ADTV standard, the new rule requires that:

- an issuer that delists from a U.S. exchange prior to deregistering under Rule 12h-6 must either meet the ADTV standard at the date of delisting or else wait 12 months before proceeding with deregistration under Rule 12h-6 in reliance on the ADTV standard; and
- an issuer that terminates a sponsored American Depositary Receipt (ADR) facility prior to deregistering under Rule 12h-6 must either meet the ADTV standard at the time of termination or else wait 12 months before proceeding with deregistration under Rule 12h-6 in reliance on the ADTV standard;

provided that any foreign private issuer that delisted or terminated a sponsored ADR facility before the adoption of the new rule may file a Form 15F to deregister despite exceeding the ADTV standard for the 12 months preceding delisting or termination.

b. Alternative Benchmark: 300 Record Holders

New Rule 12h-6 includes an alternative to the above ADTV standard: a foreign private issuer may terminate its Exchange Act reporting obligations regarding a class of equity securities if it has fewer than 300 record holders on a worldwide basis or who are U.S. residents as long as the issuer meets the new rule's other conditions. The new rule simplifies the counting method from the existing rules (as discussed further below under "Revised Counting Methods"). This alternative allows a foreign private issuer that cannot meet the ADTV standard to nevertheless terminate its Exchange Act reporting obligations, and prevents that issuer from being worse off under Rule 12h-6 than under the existing exit rules.

2. Prior Exchange Act Reporting Conditions

In order for investors in U.S. securities markets to have enough time to make investment decisions regarding a foreign private issuer's securities based on the information provided in an Exchange Act annual report and the interim home country materials, new Rule 12h-6 requires a foreign private issuer of equity securities to:

- have been an Exchange Act reporting company for at least one year;
- have filed or submitted all Exchange Act reports required for this period; and
- have filed at least one annual report pursuant to Section 13(a) of the Exchange Act.

3. One Year Dormancy Condition

New Rule 12h-6 requires that a foreign private issuer must not have sold securities in the U.S. in a registered offering under the Securities Act during the 12 months preceding its exit from the Exchange Act reporting system, except for those securities issued:

- to the issuer's employees;
- by selling security holders in non-underwritten offerings;
- upon the exercise of outstanding rights granted by the issuer if the rights are granted pro rata to all existing security holders of the class of the issuer's securities to which the rights attach;

- pursuant to a dividend or interest reinvestment plan; or
- upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer.

The new rule provides that an issuer will not be prevented from making use of the rule as a result of the unregistered sale of securities that are exempted from registration under the Securities Act, including sales pursuant to Section 4(2), Regulation D, Rule 144A, Rules 801 and 802, and exempt securities under Section 3 of the Securities Act, including Section 3(a)(10).

4. Foreign Listing Condition

To insure that there is a non-U.S. jurisdiction that principally regulates and oversees the issuance and trading of the issuer's securities and the issuer's disclosure obligation to investors, the new rule requires that, for at least 12 months preceding the filing of its Form 15F, a foreign private issuer must have maintained a listing of the subject class of securities on an exchange in a foreign jurisdiction, which, either singly or together with one other foreign jurisdiction, constitutes the "primary trading market" for that class of securities. Additionally, if an issuer aggregates the trading of its securities in two foreign jurisdictions for the purpose of Rule 12h-6, the trading market for the issuer's securities in at least one of the two foreign jurisdictions must be larger than the U.S. trading market for the issuer's securities. However, an issuer may aggregate trading in the same class of its equity securities on all of its exchanges within a single foreign jurisdiction or in no more than two foreign jurisdictions for the purpose of the foreign listing condition, as long as the trading in one of the foreign jurisdictions is greater than the trading in the U.S. "Primary trading market" means that at least 55% of the trading in the foreign private issuer's subject class of securities took place in, on or through the facilities of a securities market or markets in no more than two foreign jurisdictions during a recent 12-month period.

Conditions for Debt Securities Issuers

Under new Rule 12h-6, a foreign private issuer may terminate its Exchange Act reporting obligations regarding a class of debt securities as long as:

- the issuer has filed or furnished all reports required under Section 13(a) or Section 15(d) of the Exchange Act, including at least one Exchange Act annual report; and
- that class of debt securities is held of record by fewer than 300 holders either on a worldwide basis or who are U.S. residents as calculated under the revised counting method as discussed further below.

Revised Counting Method

A foreign private issuer will no longer have to "look through" the accounts of brokers, banks and other nominees on a worldwide basis to determine the number of its U.S. resident holders, as currently required. Instead, under the new rules, an issuer can limit its inquiry to brokers, banks and

other nominees located in the U.S., the issuer's jurisdiction of incorporation, legal organization or establishment and, if different, the jurisdiction of its primary trading market.⁴

This new counting method would only apply to:

- an issuer of equity securities proceeding under the alternative 300 holder provision; or
- to a debt securities issuer that must meet the 300 holder standard for U.S. residents.

Expanded Scope of Rule 12h-6

New Rule 12h-6 also provides relief for successor issuers and foreign private issuers that had suspended their Exchange Act reporting obligation under the existing rules.

1. Application to Successor Issuers

The new rule specifically provides that a foreign private issuer that has succeeded to the Exchange Act reporting obligations of another company following a merger, consolidation, exchange of securities, acquisition of assets or otherwise could take into account the Exchange Act reporting history of its predecessor when determining whether it meets the conditions to deregister under Rule 12h-6. This successor issuer provision would also enable a non-Exchange Act reporting foreign private issuer that acquires a reporting foreign private issuer in a transaction exempt under the Securities Act to qualify immediately for termination of its reporting obligations under the Exchange Act without having to file an Exchange Act annual report (as long as the successor issuer meets all of the conditions pertaining to equity securities registrants, including the dormancy condition, the rule's listing and quantitative benchmark conditions, and the acquired company's reporting history fulfills Rule 12h-6's prior reporting condition). But, if the same non-Exchange Act reporting foreign private issuer acquires an Exchange Act reporting company by consummating an exchange offer, merger or other business combination registered under the Securities Act, the immediate qualifications provision would not apply.

2. Application to Foreign Private Issuers that Had Suspended Reporting Obligations

Under the new rule, a foreign private issuer that suspended its Exchange Act reporting obligations under the existing exit rules before the effective date of Rule 12h-6 would be able to avail itself of the benefits of termination under Rule 12h-6, as long as it meets the following conditions:

- with respect to a class of equity securities: (i) the issuer must satisfy Rule 12h-6's foreign listing condition regarding the class of equity securities for which it had suspended its Exchange Act reporting obligations; (ii) the issuer must satisfy either Rule 12h-6's trading volume or alternative holder provision; and (iii) the issuer must file a Form 15F; and

⁴ A foreign private issuer that aggregates the trading volume of its securities in two foreign jurisdictions for the purpose of meeting the rule's listing condition will have to look through nominee accounts in both foreign jurisdictions which comprise its primary trading market, as well as the other jurisdictions described above.

- with respect to a class of debt securities: (i) the issuer must meet Rule 12h-6's record holder provision for debt securities; and (ii) the issuer must file a Form 15F.

Rule 12g3-2(b) Amendment

In addition to the changes in new Rule 12h-6, the SEC's adopted new amendments that would permit a foreign private issuer to claim the exemption from registration of equity securities under the Exchange Act provided by Rule 12g3-2(b) immediately upon its termination of Exchange Act reporting under Rule 12h-6, instead of having to wait 18 months as is currently required.⁵ To do this, the foreign private issuer must publish in English the home country materials required by Rule 12g3-2(b) on its Internet website or through an electronic information delivery system that is generally available to the public in its primary trading market.

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⁵ Exchange Act Rule 12g3-2(b) provides an exemption from registration under the Exchange Act of a class of equity securities of a foreign private issuer that would otherwise meet the requirements for registration under Section 12(g) of the Exchange Act if the issuer submits a claim of exemption to the SEC containing prescribed information and furnishes to the SEC (i) the information it makes public pursuant to the law of the country of its domicile or in which it is incorporated or organized, (ii) publicly available information that it files with a non-U.S. stock exchange and (iii) other information that it distributes to its security holders. Rule 12g3-2(b) is not available if the issuer's equity securities or ADRs representing such securities are listed on a U.S. stock exchange or quoted in a U.S. automated interdealer quotation system, subject to grandfathering provisions for securities quoted prior to the mid-1980s.

For Additional Information

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