

## Client Alert

# SEC Reproposes Rules to Ease the Deregistration Process for Foreign Private Issuers

On December 22, 2006, the SEC repropose amendments to the 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.<sup>1</sup> The SEC's reproposal is in response to criticisms regarding the original version of the proposed rules first published in December 2005 and indicates a desire by the SEC to make the United States a more hospitable environment for foreign issuers in order to encourage them to create markets for their securities in the United States.<sup>2</sup>

### Current 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 United States, or (ii) by more than 300 record holders in the United States 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 United States 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 requirements. However, upon termination of one requirement, an issuer's obligation to file reports under another applicable requirement will be reactivated.

Under the current Exchange Act registration and reporting rules, a foreign private issuer may only deregister a class of its securities if the class is held by less than 300 U.S. residents, or 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

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<sup>1</sup> See SEC Release No. 34-55005; International Series Release No. 1300; File No. S7-12-05. A copy of this Release is available on the SEC's website at [www.sec.gov/rules/proposed/2006/34-55005.pdf](http://www.sec.gov/rules/proposed/2006/34-55005.pdf). See also Press Release No. 2006-207. A copy of the Press Release is available on the SEC's website at [www.sec.gov/news/press/2006/2006-207.htm](http://www.sec.gov/news/press/2006/2006-207.htm).

<sup>2</sup> For a discussion of the December 2005 proposal, see our Client Alert, "SEC Proposes Rules to Ease the Deregistration Process for Foreign Private Issuers," available on our website at [www.chadbourne.com/memo/SECsProposedRulestoEaseDeregistrationProcessforForeignPrivateIssuers.pdf](http://www.chadbourne.com/memo/SECsProposedRulestoEaseDeregistrationProcessforForeignPrivateIssuers.pdf).

on a worldwide basis and count the number of separate accounts of customers residing in the United States 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.

### **Proposed Deregistration Rules**

In December 2005, the SEC proposed Exchange Act Rule 12h-6 which would allow a foreign private issuer to permanently terminate, not just suspend, its reporting obligations under the Exchange Act as long as the issuer meets specified criteria. One such criteria was the “public float” test that allowed for termination if U.S. residents held no more than 5% of the worldwide public float of the issuer’s equity securities at a date within 120 days before the filing date of the Form 15F, regardless of U.S. trading volume. In response to comments that the December 2005 proposal would not achieve its goal of easing the termination of registration and reporting obligations under the Exchange Act, the SEC has now proposed a simpler approach.

### **Reproposed Deregistration Rules**

Reproposed Rule 12h-6 would permit 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**

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

#### **1. *Quantitative Benchmarks***

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

The reproposed rule enables a foreign private issuer, regardless of size, to terminate its registration and reporting obligations, assuming it meets the other conditions of Rule 12h-6, if the U.S. ADTV of the subject class of equity securities has been 5% or less of the ADTV of that class of securities in the issuer’s primary trading market during a 12-calendar month period that ended no more than 60 days before the filing date of the Form 15F.<sup>3</sup> This proposal reflects the SEC’s view that trading volume may be a superior benchmark because it is a direct measure of the issuer’s nexus with the United States and is easier to obtain than public float or record holder data.

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<sup>3</sup> When calculating the U.S. 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 the ADTV in the jurisdictions that comprise its primary trading market. “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.

The repropose rule was structured so as not to create an incentive for a foreign private issuer to delist its securities from a U.S. exchange for the purpose of decreasing its U.S. trading volume, and also structured to encourage foreign private issuers to maintain their American Depositary Receipts (ADR) facilities even when they delist from a U.S. market and terminate their Exchange Act reporting obligations. The repropose rule requires that:

- an issuer that delists from a U.S. exchange prior to deregistering under Rule 12h-6 must either meet the trading volume standard at the date of delisting or else wait 12 months before it can proceed with deregistration under Rule 12h-6 in reliance on the trading volume standard; and
- an issuer that terminates an ADR facility must wait 12 months before seeking deregistration under Rule 12h-6 in reliance on the trading volume standard.

b. **Alternative Benchmark: 300 Record Holders**

Repropose Rule 12h-6 would include an alternative to the above ADTV standard: a foreign private issuer would be able to terminate its Exchange Act reporting obligations regarding a class of equity securities if it has less than 300 record holders on a worldwide basis or who are U.S. residents as long as the issuer meets the proposed rule's other conditions. The repropose rule would also simplify the counting method from the original proposal (as discussed further below under "Revised Counting Methods"). This alternative would allow 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 current 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, repropose 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*

Repropose Rule 12h-6 requires that a foreign private issuer must not have sold securities in the United States 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.

In a change from the 2005 proposal, the repropose rule would permit the unregistered sale of securities that are exempted under the Securities Act. This would include 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). This change was in response to concerns that the originally proposed dormancy condition could well drive many private placement financings and other unregistered offerings by foreign companies offshore, to the detriment of U.S. investors and U.S. broker-dealers, since many companies might prefer to finance outside the United States under Regulation S rather than inside to avoid triggering the dormancy condition.

#### 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 repropose rule requires that 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. "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 repropose 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 less than 300 holders either on a worldwide basis or who are U.S. residents.

### **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, an issuer can limit its inquiry to brokers, banks and other nominees located in the United States, the issuer's jurisdiction of incorporation, legal organization or establishment and, if different, the jurisdiction of its primary trading market.<sup>4</sup>

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<sup>4</sup> 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.

This repropoed counting method would only apply to:

- an issuer of equity securities proceeding under the alterative 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**

In response to commenters' concerns on the originally proposed rule, the scope of Rule 12h-6 was expanded in two respects.

#### *1. Application to Successor Issuers*

The repropoed 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 immediately qualify 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 the rule's listing and quantitative benchmark conditions, and the acquired company's reporting history fulfills Rule 12h-6's prior reporting condition). However, 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 Prior Form 15 Filers*

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

- the issuer must currently not be required to register a class of securities or file reports under Section 12(g) or Section 15(d) of the Exchange Act;
- the issuer must file a Form 15F; and
- if its Form 15 applied to a class of equity securities for at least 12 months before the filing of its Form 15F, the issuer must have maintained a listing for that class of equity securities on an exchange in a foreign jurisdiction which constitutes the primary trading market for that class of equity securities (either singly or together with another foreign jurisdiction).

### **Rule 12g3-2(b) Amendment**

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

## Comments Sought

As this is a reproposal of a previously proposed rule, the SEC is providing a limited comment period which expires on February 12, 2007. The SEC expects to take final action as expeditiously as possible after the end of the comment period. Information on submitting comments to the SEC can be found on the SEC's website at [www.sec.gov/rules/submitcomments.htm](http://www.sec.gov/rules/submitcomments.htm).

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