SEC PROPOSES RULES LIBERALIZING FOREIGN PRIVATE ISSUERS' ABILITY TO DEREGISTER UNDER THE EXCHANGE ACT

On December 27, 2005, the Securities and Exchange Commission (the "SEC") published proposals[1] to amend its rules regarding termination of reporting requirements for foreign private issuers under the U.S. Securities Exchange Act of 1934 (the "Exchange Act"). Comments on the proposed rules are due on February 28, 2006.

I. Background

Under current Exchange Act rules, it is extremely difficult for most foreign private issuers to exit from the Exchange Act reporting system for two principal reasons. First, the current Exchange Act exit rules are available only to issuers with a limited number of U.S. resident security holders (less than 300 in the case of issuers with total assets in excess of $10,000,000).[2] In assessing the availability of the Exchange Act deregistration, foreign private issuers are required to "look through" the record ownership of brokers, dealers, banks and nominees on a *worldwide* basis for purposes of counting the number of U.S. resident security holders. Given the internationalization of the securities markets, the resident security holder limits are easily exceeded by foreign companies that may have engaged in little or no recent capital-raising activity in the United States and it can be difficult and costly to accurately determine the number of U.S. resident security holders. Second, issuers that have registered debt or equity securities under a Securities Act[3] registration statement (i.e., engaged in a public offering in the United States) can only suspend, not terminate, the requirement to file reports under the Exchange Act.[4]

II. The SEC's Proposed Rules

In response to concerns expressed by foreign issuers and their representatives regarding the difficulty of withdrawing from the Exchange Act reporting regime and in recognition of the fact that the markets have changed significantly since the existing rules were adopted, the SEC has published for comment proposed rules that are intended to make the thresholds on which the

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1 SEC Release No. 34-53020 (December 27, 2005).

2 Exchange Act Rule 12g-4(a)(2). An issuer may also seek to terminate its Section 12(g) registration obligations with respect to its equity securities if such securities are held of record by less than 300 persons or by less than 500 persons where the total assets of the issuer have not exceeded $10,000,000 on the last day of each of the issuer's last three most recent fiscal years (Rule 12g-4(a)(1)). Under this method of deregistration, issuers are generally not required to look through nominee accounts when determining record ownership but rather must simply determine whether they have less than 300 (or 500, as applicable) registered holders on a worldwide basis.

3 The Securities Act of 1933, as amended.

4 Exchange Act Rule 12h-3.

Exchange Act exit rules are based both clearer and less burdensome. The SEC stated in the proposing release that the proposed rules are intended to provide issuers with a meaningful option by which they can terminate their reporting requirements while at the same time promoting transparency in the exit process and ensuring access to ongoing home country information about issuers that deregister. Accordingly, under the proposed rules, foreign private issuers will be able to permanently terminate their reporting requirements, provided that U.S. investor interest in the issuer is relatively small and certain other conditions are met. For issuers seeking to terminate Exchange Act reporting with respect to a class of equity securities, the principal measures of U.S. investor interest under the proposed rules are based on U.S. trading volume and the percentage of worldwide public float held by U.S. residents. The deregistration thresholds applicable to debt securities remain largely unchanged compared to those under existing rules, although the method of counting holders of securities would be modified and the SEC has proposed providing issuers with the ability to terminate permanently their reporting obligations.

A. Equity Securities

Proposed Rule 12h-6 sets forth the eligibility requirements for a foreign private issuer to terminate its Exchange Act reporting obligations regarding a class of equity securities and establishes both quantitative and qualitative requirements for deregistration.

Quantitative Requirements

If the foreign private issuer is not a well-known seasoned issuer,[5] then the issuer can terminate its registration and reporting requirements as long as U.S. residents hold no more than five percent of the issuer's worldwide public float (excluding securities held by affiliates of the issuer) at a date within 120 days before the filing date of the Form 15F, a new SEC Form that foreign private issuers will be required to file to effectively terminate their reporting obligations. Well-known seasoned issuers may be eligible to terminate their Exchange Act reporting obligations if:

1. the U.S. average daily trading volume of the subject class of securities has been no greater than five percent of the average daily trading volume of that class of securities in its primary trading market during a recent 12-month period, and U.S. residents held no more than ten percent of the issuer's worldwide public float (excluding securities held by affiliates of the issuer) at a date within 60 days before the end of the same period; or

2. regardless of U.S. trading volume, U.S. residents hold no more than five percent of the issuer's worldwide public float (excluding securities held by affiliates of the issuer) measured at the times specified above.

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[5] A "well-known seasoned issuer" for purposes of proposed Rule 12h-6 means an issuer that has a worldwide market value of its outstanding voting and nonvoting common equity held by nonaffiliates of $700 million or more and meets the other requirements specified in Securities Act Rule 405.

Issuers that are unable to meet the alternative benchmarks proposed in the new rules would still be able to terminate their reporting obligations if the relevant class of equity securities is held of record by less than 300 persons on a worldwide basis or less than 300 persons resident in the United States at a date within 120 days before the filing date of the Form 15F.

Qualitative Requirements

Irrespective of whether the issuer meets the U.S. ownership, trading volume and shareholder thresholds, each company seeking to deregister must also meet the following conditions in order to deregister:

1. it must have been an Exchange Act reporting company for the past two years and filed or furnished all required reports, including at least two annual reports, during such period;

2. it must not have sold securities in the United States in either a registered *or* unregistered offering (i.e., no U.S. public offerings or private placements such as 144A offerings) during the preceding 12 months, other than sales of securities:

    a. to the issuer's employees;

    b. by selling security holders in nonunderwritten offerings;

    c. exempt from registration under Section 3 of the Securities Act, except Section 3(a)(10); and

    d. exempt from registration under Section 4(2) of the Securities Act and that have a maturity of less than nine months at the time of issuance;[6] and

3. for the preceding two years, the subject class of securities have been listed on an exchange in the company's home country and the home country exchange constitutes the primary trading market[7] for the securities.

B. Debt Securities

Proposed Rule 12h-6 permits a foreign private issuer to terminate (rather than merely suspend, as the current rules allow) its Section 15(d) reporting obligations regarding a class of debt securities if it meets the following conditions:

1. the issuer has filed or furnished all required reports under Section 15(d), including at least one annual report pursuant to the Exchange Act; and

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[6] This is an exemption for commercial paper programs.

[7] Under proposed Rule 12h-6, "primary trading market" is a market that accounted for 55 percent of the trading volume of the issuer during a recent 12-calendar-month period before the filing date of the Form 15F.

2. at a date within 120 days before the filing date of the Form 15F, the class of debt securities is held of record by either less than 300 persons on a worldwide basis or less than 300 persons resident in the United States.

C. Counting Method

Under proposed Rule 12h-6, issuers will still be required to look through the record ownership of brokers, dealers, banks and nominees (collectively, "Nominees") for purposes of determining whether U.S. residents hold more than the applicable thresholds. However, the SEC has proposed some helpful relief in the method of calculation. First, issuers will no longer be required to "look through" the record ownership of Nominees worldwide, but may instead limit their inquiry to Nominees located in the United States, in the issuer's jurisdiction of organization and, if different, in the jurisdiction of the issuer's primary trading market. This marks a departure from the current rules in that it limits the jurisdictions that must be included in the inquiry. Second, if, after reasonable inquiry and effort, an issuer is unable to determine the requisite information concerning securities held by U.S. residents through Nominee accounts, it may assume that Nominee customers are residents of the jurisdiction in which the Nominee has its principal place of business. Third, in determining the levels of security holder ownership, issuers may rely in good faith on information provided by an independent information services provider that in the regular course of its business assists issuers in collecting information regarding security holders.[8]

D. New Form 15F

Under the current rules, in order to exit the Exchange Act reporting system, foreign private issuers are required to file a form certifying that they meet the requirements for deregistration. Under proposed Rule 12h-6, issuers would be required to make a similar certification[9] in a newly proposed Form 15F and, in addition, the Form 15F would require information regarding:

1. the issuer's Exchange Act reporting history;
2. when the issuer last sold securities in the United States;
3. the issuer's primary trading market for the equity securities being deregistered;
4. whether the issuer is a well-known seasoned issuer;
5. trading volume data for a well-known seasoned issuer's securities, in both the United States and its primary trading market;
6. the issuer's worldwide public float and the portion held by U.S. residents with respect to the equity securities being deregistered, if applicable;

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[8] Proposed Rule 12h-6(e)(4).

[9] Form 15F would require an issuer to certify that (i) it meets all of the conditions for termination of Exchange Act reporting specified in Rule 12h-6; and (ii) there are no classes of securities other than those that are the subject of the Form 15F regarding which the issuer has Exchange Act reporting obligations.

7. the number of its equity or debt securities record holders, if applicable; and
8. the classes of equity and debt securities that are the subject of the Form 15F.

The filing of the Form 15F would automatically suspend the issuer's reporting duties, and if the SEC does not object, the suspension would become permanently effective 90 days after the filing of the Form 15F, unless accelerated by the SEC. The Form 15F will also require the issuer to withdraw its Form 15F if it becomes aware of information prior to the form's effectiveness (generally the 90th day after filing) that would cause it reasonably to believe that it no longer meets the conditions for deregistration. In addition, foreign private issuers will be required to publish a notice in the United States that discloses the intent to terminate their Exchange Act reporting obligations not later than 15 business days prior to the filing of the Form 15F and to submit a copy of the notice under cover of a Form 6-K or as an exhibit to the Form 15F.

E. Deregistration Permanent; Access to Issuer Information

The SEC has also proposed rule amendments that will effectively allow a foreign private issuer to terminate permanently, rather than merely suspend, its Exchange Act reporting obligations. Under the proposed rules, a foreign private issuer that has filed Form 15F would immediately receive the exemption under Rule 12g3-2(b)[10] upon the effective date of the Form 15F. Proposed Rule 12g3-2(e) would require any issuer that deregisters under Rule 12h-6 (the newly proposed deregistration rule) to 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. At a minimum, these materials would include the issuer's home country annual report, interim reports, material press releases and all other material communications distributed directly to security holders.

III. Observations and Commentary

While the SEC's proposals provide some welcome relief in relaxing the current limits on deregistration, notably by moving beyond the 300-holder standard and by effectively making deregistration permanent, many foreign private issuers seeking to exit the Exchange Act reporting system are likely to be disappointed by the proposals. In the proposing release, the SEC indicated that, based on its review of a database of 510 foreign private issuers, approximately 26 percent of these would be eligible to deregister under the current proposals. Needless to say, the remaining 74 percent would find it difficult to deregister even if they have had limited recent contacts with the U.S. capital markets. This is likely the case for both large, well followed foreign

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[10] Exchange Act Rule 12g3-2(b) provides an exemption from Section 12(g) of the Exchange Act for a foreign private issuer that establishes the exemption by providing to the SEC certain information that is made public in its home country, as well as certain information regarding its U.S. security holders. On an ongoing basis, an issuer that has established the Rule 12g3-2(b) exemption must furnish to the SEC whatever information it (A) has made or is required to make public pursuant to the law of the country of its domicile or the country in which it is incorporated or organized, (B) has filed or is required to file with a stock exchange on which its securities are traded and that was made public by such exchange, or (C) has distributed or is required to distribute to its security holders, promptly after such information is made or required to be made public.

issuers and smaller issuers that are subject to the more restrictive five percent of public float threshold. Although the SEC appears to recognize this issue and has stated expressly its desire to liberalize the exit rules, it has not, to date, accepted certain alternative quantitative thresholds that would potentially expand the universe of issuers that would be eligible to deregister. Notably, the SEC indicated in the proposing release that it had rejected proposals that utilized a benchmark based solely on trading volume on the basis that such a threshold would not accurately gauge U.S. investor interest. We anticipate that the SEC will receive significant comments in this area, both on alternative thresholds and on the method of calculation. For example, we understand that representatives of some foreign issuers have proposed modifications to the method of calculating U.S. percentage ownership that would exclude U.S. institutional security holders as well as U.S. employees from the calculation of U.S. ownership.

As regards the qualitative requirements set forth in proposed rules, the so-called "one year dormancy condition" also presents issues, given that the restriction on offerings in the year prior to deregistration constrains not only public capital-raising activity in the United States but also private placements such as 144A offerings, as well as acquisitions and corporate restructurings involving security issuances or exchanges. For example, a cross-border exchange offer made available to U.S. shareholders under the Tier I exemption[11] would render Rule 12h-6 unavailable for a year even though the Tier I exemption itself is predicated on U.S. ownership of less than ten percent.

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If you have any questions about the proposed amendments to the foreign private issuer deregistration rules, please contact John S. D'Alimonte in New York (jd'alimonte@willkie.com, 212-728-8212), Gregory B. Astrachan in London (gastrachan@willkie.com, +44 207 696 5442), or the attorney with whom you regularly work.

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[11] Under Securities Act exemptive Rule 802, securities issued in exchange offers for foreign private issuers' securities and securities issued in business combinations involving foreign private issuers are exempt from the registration requirements of the Securities Act if U.S. security holders hold ten percent or less of the subject class of securities.