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Finding the Exit:
SEC Proposes to Streamline Deregistration Rules for Foreign Private Issuers

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Introduction

In response to the increased regulatory burdens and the growing competition from foreign markets, the Securities and Exchange Commission ("SEC" or "Commission") recently reproposed deregistration rules to make it easier for a foreign private issuer to terminate its reporting obligations under the Securities Exchange Act of 1934, as amended ("Exchange Act"). First, this article will examine changes in the SEC's approach to regulating foreign private issuers and the increased regulatory burdens being placed on them. Next, this article will discuss the ways a foreign private issuer becomes subject to registration and reporting requirements under the Exchange Act. This article will then analyze the current degregistration rules and common criticisms of these rules. Finally, this article will highlight major proposed changes to the SEC's deregistration rules.

Increased Regulatory Burden on Foreign Private Issuers

Beginning in the late 1980's and throughout the 1990's, the SEC actively sought to accommodate foreign private issuers and facilitate access to the U.S. capital markets.[1] In so

[1] A foreign private issuer means any foreign issuer other than a foreign government, except an issuer that meets the following conditions: (1) more than 50% of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States and (2) (i) the majority of the executive officers or directors are United

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doing, the SEC focused on the need to be "mindful and respectful of existing national regulatory frameworks" and emphasized concepts of accommodation and comparability in dealing with differences existing between these regulatory frameworks.[2] As a practical matter, the SEC responded to the growing globalization of the capital markets and U.S. investors' appetite for investing in foreign entities. The SEC premised its approach on removing impediments to transnational capital formation without unduly disadvantaging U.S. issuers in the U.S. markets or failing to afford protections under the U.S. federal securities laws to those buying securities in the U.S. capital markets.[3]

SEC accommodations for foreign issuers have included:

- The Multijurisdictional Disclosure System for certain Canadian issuers;[4]
- Revised disclosure requirements for foreign issuers to conform to international disclosure standards;[5] and
- Tender offer and registration exemptions for cross-border tender and exchange offers, business combinations, and rights offerings.[6]

Foreign private issuers also have long been exempt from rules governing proxy statements and reports by insiders of transactions in their company's securities.[7]

Despite these and other accommodations, once a foreign private issuer is registered under the Exchange Act, it becomes subject to many reporting and other substantive requirements.[8] Foreign private issuers, for example, are subject to the reporting requirements under Section 13 of the Exchange Act, which includes filing an annual report on Form 20-F and interim reports on

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States citizens or residents, (ii) more than 50% of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States. 17 C.F.R. § 240.3b-4(c).

[2] Regulation of International Securities Markets, Release No. 33-6807, 53 Fed. Reg. 46963 (Nov. 21, 1988).

[3] Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Release No. 33-6902, 56 Fed. Reg. 30036 (Jul. 1, 1991).

[4] *Id.*

[5] International Disclosure Standards, Release No. 33-7745, 64 Fed. Reg. 53900 (Oct. 5, 1999).

[6] Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, Release No. 33-7759, 64 Fed. Reg. 61382 (Nov. 10, 1999).

[7] 17 C.F.R. § 240.3a12-3(b).

[8] Section 15(d) of the Exchange Act only subjects foreign private issuers to the periodic reporting obligations of Section 13 and Sarbanes-Oxley. Guy P. Lander, U.S. Securities Law for International Financial Transactions and Capital Markets § 6:20 (2d ed. 2006). *See* 15 U.S.C. § 78o(d).

Form 6-K with the Commission.[9] Also under Section 13, a foreign private issuer must keep reasonably detailed books, records, and accounts, and maintain a system of internal accounting controls so that transactions and dispositions of the issuer's assets are accurately reflected.[10] Foreign private issuers must also comply with issuer self-tender rules under Section 13(e)[11] and the tender offer provisions of the Williams Act under Sections 14(d) and (e).[12]

The regulatory burden on foreign private issuers increased significantly with the enactment of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the related SEC, New York Stock Exchange ("NYSE") and NASDAQ rules. Sarbanes-Oxley imposes many new and expanded requirements concerning, among other things, corporate governance, management accountability, and auditor independence.[13] As the reporting burden has increased, so have the costs of compliance.[14] These costs not only include direct costs such as legal fees, management time for preparation, and audit fees, but also include indirect costs such as increased litigation risk, personal liability risk, and risks associated with being subject to an additional regulator.[15]

Among the most burdensome requirements imposed on foreign private issuers by Sarbanes-Oxley is Section 404.[16] Section 404 mandates that management assess the effectiveness of internal control over financial reporting and that the independent auditors provide an attestation report on that assessment.[17] Preparing for that assessment requires documentation, testing, and remediation of internal controls. Even U.S. issuers have found the effort challenging, time-consuming, and, perhaps most importantly, expensive. In effect, Section 404 exports U.S. internal control standards to other jurisdictions regardless of the existing requirements of those jurisdictions.

In addition to the increased burden and costs of compliance, the benefits of U.S. registration and listing may have declined.[18] Foreign private issuers may no longer need to

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[9] 15 U.S.C. § 78m; Exchange Act Form 20-F, General Instruction A(a)-(b), 5 Fed. Sec. L. Rep. (CCH) ¶ 29,701; Exchange Act Form 6-K, General Instruction B, 5 Fed. Sec. L. Rep. (CCH) ¶ 30,971; Lander, *supra* note 8, §§ 6:23-6:25.

[10] 15 U.S.C. § 78m(b)(2).

[11] 15 U.S.C. § 78m(e); Lander, *supra* note 8, § 6:20.

[12] 15 U.S.C. § 78n(d), (e); Lander, *supra* note 8, § 6:20.

[13] Lander, *supra* note 8, § 6:1.

[14] Comment Letter from PricewaterhouseCoopers LLC dated March 3, 2006, p. 6 [hereinafter PwC Letter], http://www.sec.gov/rules/proposed/s71205/pricewaterhouse030306.pdf; Letter from members of European Association for Listed Companies dated February 9, 2004, p. 2 [hereinafter EALC Letter], http://www.sec.gov/rules/proposed/s71205/eurocompanies020904.pdf.

[15] PwC Letter, *supra* note 14, at p.6.

[16] 15 U.S.C. § 7262.

[17] *Id*.

[18] EALC Letter, *supra* note 14, at p. 2; PwC Letter, *supra* note 14, at p. 6; Comment Letter from the New York Stock Exchange dated March 10, 2006, p. 3 [hereinafter NYSE Letter], http://www.sec.gov/rules/proposed/s71205/myeager031006.pdf.

access the U.S. capital markets to satisfy their capital needs.[19] Due to technological advances, such as electronic linkages between markets and investors, foreign companies can raise large amounts of capital and have access to deep and liquid trading markets on their local exchanges.[20] U.S. investors can also easily invest in foreign securities directly, thus, foreign companies can readily access the U.S. market without listing on a U.S. exchange.[21]

In light of these factors, more foreign private issuers are determining that the costs of compliance outweigh the benefits of listing.[22] Since the adoption of Sarbanes-Oxley, the number of foreign private issuers entering the U.S. markets has decreased.[23] In fact, during 2005, there were 129 international IPO's in the European markets compared to only 23 international IPO's in the U.S.[24] The London Stock Exchange ("LSE") often cites the high cost of Sarbanes-Oxley compliance as a leading competitive factor in obtaining international listings.[25] The LSE has stated that 90% of foreign companies that consider listing on a U.S. exchange felt that the demands of Sarbanes-Oxley made listing on the LSE more attractive.[26]

Some foreign private issuers that are already listed on a U.S. exchange have also begun to conclude that the regulatory costs and burdens outweigh the benefits.[27] In early 2006, Vivendi Universal S.A. announced that it would delist from the NYSE as a first step towards deregistration.[28] The company cited the regulatory costs of being a U.S. registered company.[29] However, even though a foreign private issuer may be able to delist from a U.S. exchange, the current deregistration rules may still subject the issuer to reporting and other compliance obligations under the Exchange Act even if there is little U.S. investor interest in their securities.[30]

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[19] NYSE Letter, *supra* note 18, at p. 3.

[20] *Id*.

[21] EALC Letter, *supra* note 14, at p. 2; PwC Letter, *supra* note 14, at p. 6.

[22] NYSE Letter, *supra* note 18, at p. 3, PwC Letter, *supra* note 14, at p. 7, EALC Letter, *supra* note 14, at p. 2.

[23] NYSE Letter, *supra* note 18, at p. 3; PwC Letter, *supra* note 14, at p. 6.

[24] PwC Letter, *supra* note 14, at p. 7.

[25] NYSE Letter, *supra* note 18, at p. 3.

[26] *Id*.

[27] EALC Letter, *supra* note 14, at p. 2.

[28] NYSE Letter, *supra* note 18, at p. 3-4. The following companies have terminated their U.S. listings: Cable & Wireless plc (terminated January 2006), O2 plc (terminated September 2005), Enodis plc (terminated August 2005), The Rank Group plc (terminated August 2005), Alstom (terminated June 2005), and LVMH Moet Hennessy Louis Vuitton (terminated March 2004). Comment Letter from American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities dated March 8, 2006, p. 2 fn. 4, [hereinafter ABA Letter] http://www.sec.gov/rules/proposed/s71205/abacfrs030806.pdf.

[29] NYSE Letter, *supra* note 18, at p.3-4.

[30] EALC Letter, *supra* note 14, at p. 2; Termination of a Foreign Private Issuer's Registration, Exchange Act Release No. 34-55005, 72 Fed. Reg. 1384, 1386 (Jan. 11, 2007) [hereinafter Re-proposed Rules].

Although the SEC has the authority to exempt foreign private issuers from some provisions of Sarbanes-Oxley, it has exercised that authority sparingly. The SEC's reluctance likely is attributable, in part, to the prominence of the U.S. financial scandals that gave rise to Sarbanes-Oxley. Financial scandals in other countries have also caused the SEC to move cautiously. Royal Ahold's and Parmalat's financial problems in 2003 due to corporate governance and accounting failures dismissed the notion that these problems were specific to the U.S.[31] As a result, accommodations under Sarbanes-Oxley generally have been limited but have included a longer phase-in (although not a waiver) for Section 404 attestations, limited exceptions for the composition of the audit committee, and leniency for certain non-GAAP communications made outside of the U.S.

In contrast to its earlier policies of accommodation and recognition of conflicting regulatory frameworks, with the enactment of Sarbanes-Oxley, the SEC is requiring foreign private issuers to meet heightened U.S. regulatory requirements. Recognizing the burden that this may place on some foreign private issuers, more recently, the SEC has begun to consider an easier deregistration process. Former SEC Chairman Donaldson characterized this initiative as seeking a "solution that will preserve investor protections without inappropriately designing the U.S. capital market as one with no exit."[32]

Registration and Reporting under the Securities Exchange Act of 1934

There are three ways that a foreign private issuer becomes subject to the reporting requirements of the Exchange Act.[33] First, a foreign private issuer lists its securities on a U.S. exchange or with NASDAQ and registers these securities under Section 12(b) or Section 12(g) of the Exchange Act.[34] Second, a foreign private issuer that registers securities under a Securities Act registration statement and has 300 or more shareholders that are U.S. residents is subject to reporting obligations under Section 15(d) of the Exchange Act.[35] In each of the above instances, a foreign private issuer has acted affirmatively to access the U.S. capital markets. Third, a foreign private issuer's equity securities may be widely held in the U.S. and is thus subject to registration under Section 12(g) of the Exchange Act.[36] Widely held means that the foreign private issuer has more than $10 million in assets and 500 or more shareholders of record worldwide, of whom 300 or more are U.S. residents.[37] Although not traditionally enforced by

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[31] Abe de Jong et al., Royal Ahold: A Failure of Corporate Governance and an Accounting Scandal, 3 (2005), http://greywww.kub.nl:2080/greyfiles/center/2005/doc/57.pdf; Kavaljit Singh, Parmalat's Fall: Europe's Enron?, 1 (2004), http://www.fern.org/pubs/briefs/Parmalat%20Aug%202004.pdf.

[32] Press Release, U.S. Securities and Exchange Commission, Chairman Donaldson Meets with EU Internal Market Commissioner McCreevy (April 21, 2005), http://www.sec.gov/news/press/2005-62.htm.

[33] Lander, *supra* note 8, § 6:1.

[34] 15 U.S.C. § 78l(b); Lander, *supra* note 8, § 3:6.

[35] 15 U.S.C. § 78o(d); Lander, *supra* note 8, § 6.1.

[36] 15 U.S.C. § 78l(g)(1); Lander, *supra* note 8, § 6:1.

[37] 17 C.F.R. §§ 240.12g-1, 240.12g3-2(a); Lander, *supra* note 8, § 6:1.

the SEC, this means that foreign private issuers can have a SEC reporting obligation even through it has not taken any action to enter the U.S.

A foreign private issuer can avoid registration under Section 12(g) of the Exchange Act by meeting the requirements under Exchange Act Rule 12g3-2(b).[38] Under this section, securities of a foreign private issuer are exempt from Section 12(g) of the Exchange Act if certain specified information is supplied to the SEC by the issuer, or a government official or agency of the country of the issuer's domicile or in which the issuer is incorporated or organized.[39] While there is no prescribed form for this information, it must be furnished to the Commission on or before the date on which a registration statement under Section 12(g) would otherwise be required to be filed.[40] However, this exemption does not apply to the following:

(1) securities issued by a foreign private issuer who, during the previous 18 months, has had a class of securities registered under Section 12 or a reporting obligation, suspended or active, under Section 15(d) of the Exchange Act,

(2) securities issued by a foreign private issuer in a transaction to acquire by merger, consolidation, exchange of securities, or acquisition of assets, another issuer that had securities registered under Section 12 or a reporting obligation, suspended or active, under Section 15(d) of the Exchange Act, and

(3) securities quoted on NASDAQ or securities represented by American Depository Receipts quoted on NASDAQ unless: (a) the securities were quoted on NASDAQ on October 5, 1983 and have been continuously traded since, (b) the issuer was in compliance with this Exchange Act Rule 12g3-2(b) exemption on October 5, 1983 and has continuously maintained the exemption since, and (c) after January 2, 1986, the issuer was organized under the laws of a country other than Canada or a political subdivision thereof.[41]

Current Deregistration Rules under the Exchange Act

Just as there are three ways a foreign private issuer becomes subject to the reporting requirements of the Exchange Act, there are three possible methods for deregistration. First, securities registered under Section 12(b) of the Exchange Act can be delisted in accordance with Section 12(d) of the Exchange Act and Exchange Act Rule 12d2-2.[42] Second, securities registered under Section 12(g) of the Exchange Act can be deregistered under Exchange Act

[38] 17 C.F.R. § 240.12g3-2(b).

[39] *See* 17 C.F.R. § 240.12g3-2(b); Lander, *supra* note 8, § 3:7.

[40] 17 C.F.R. §§ 240.12g3-2(b)(2), (b)(4).

[41] 17 C.F.R. § 240.12g3-2(d); Lander, *supra* note 8, § 3:7.

[42] 15 U.S.C. § 78l(d); 17 C.F.R. § 240.12d2-2.

Rule 12g-4.[43] Third, securities registered under Section 15(d) of the Exchange Act can be deregistered under Exchange Act Rule 12h-3.[44]

In practice, the deregistration process for a foreign private issuer can be complex. Even though an issuer is only subject to active reporting requirements under the Exchange Act section in which it registered, when it seeks to exit the Exchange Act reporting system, it must determine whether it is subject to any reporting obligations under the other two Exchange Act registration sections before it can completely terminate its reporting obligations.[45] For example, a foreign private issuer may have active reporting requirements because it has securities listed on a U.S. exchange and is registered with the SEC under Section 12(b) of the Exchange Act.[46] When this issuer attempts to exit from the Exchange Act reporting system, it not only must delist in accordance with Section 12(d) of the Exchange Act, but also must consider whether it has any reporting obligations under Section 12(g) or Section 15(d) of the Exchange Act.[47]

Securities listed on a U.S. exchange and registered pursuant to Section 12(b) of the Exchange Act can be delisted in accordance with Section 12(d) of the Exchange Act and Exchange Act Rule 12d2-2.[48] Section 12(d) authorizes the delisting of securities listed on a U.S. exchange in accordance with the rules of the exchange and the Commission.[49] Exchange Act Rule 12d2-2 provides specific guidelines for delisting and deregistering securities.[50] Foreign private issuers are generally able to delist their securities without significant restrictions; however, they may continue to have reporting obligations under Section 12(g) and Section 15(d) of the Exchange Act.[51]

Securities registered pursuant to Section 12(g) of the Exchange Act can be terminated in accordance with Exchange Act Rule 12g-4.[52] Under this rule, a foreign private issuer can terminate its registration of a class of securities under Section 12(g) when the class of securities is held by: (a) less than 300 U.S. residents or (b) less than 500 U.S. residents when the issuer's total assets have not exceeded $10 million on the last day of each of the issuer's most recent three fiscal years.[53] To determine the number of U.S. residents, a foreign private issuer must use

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[43] 17 C.F.R. § 240.12g-4.

[44] 17 C.F.R. § 240.12h-3.

[45] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[46] *Id*.

[47] *Id*.

[48] 15 U.S.C. § 78l(d); 17 C.F.R. § 240.12d2-2.

[49] 15 U.S.C. § 78l(d).

[50] *See* 17 C.F.R. § 240.12d2-2.

[51] Re-proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[52] 17 C.F.R. § 240.12g-4.

[53] 17 C.F.R. § 240.12g-4(a)(2). Alternatively, a foreign private issuer may terminate its registration of a class of securities under Section 12(g) when the class of securities is held by: (a) less than 300 persons worldwide or (b) less

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the method of counting provided under Exchange Act Rule 12g3-2(a).[54] This method requires examining the record ownership of brokers, dealers, banks, or other nominees and counting the number of separate accounts of customers resident in the U.S. for which the securities are held.[55] This rule also requires that issuers make inquires of all nominees, wherever located and wherever in the chain of ownership.[56]

Termination under Exchange Act Rule 12g-4 takes effect 90 days, or such shorter period as the SEC may determine, after the issuer certifies to the SEC on Form 15 that either of the above tests have been met.[57] The issuer's duty to file any reports required under Section 13(a) is suspended immediately upon filing Form 15.[58] If the certification on Form 15 is subsequently withdrawn or denied, the issuer must file with the SEC within 60 days all reports which would have been required had it not filed Form 15.[59]

A foreign private issuer subject to reporting obligations under Section 15(d) of the Exchange Act may suspend these obligations in accordance with Exchange Act Rule 12h-3.[60] The provisions of this rule are similar to those in Exchange Act Rule 12g-4; however, there are two important differences.[61] First, an issuer generally may not suspend its reporting obligations until it has filed one Exchange Act annual report after the subject offering.[62] Second, an issuer can only suspend its reporting obligations under this section; it cannot permanently terminate those obligations.[63] If the issuer ceases to meet the suspension requirements under this rule on the first day of the issuer's fiscal year, it must resume periodic reporting under Section 15(d) of the Exchange Act.[64] The issuer must then file an annual report for its preceding fiscal year, not later than 120 days after the end of such fiscal year.[65]

Criticisms of the Current Deregistration Rules

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than 500 persons worldwide when the issuer's total assets have not exceeded $10 million on the last day of each of the issuer's most recent three fiscal years. 17 C.F.R. § 240.12g-4(a)(1).

[54] 17 C.F.R. § 240.12g3-2(a).

[55] 17 C.F.R. § 240.12g3-2(a)(1); Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[56] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[57] 17 C.F.R. § 240.12g-4(a).

[58] 17 C.F.R. § 240.12g-4(b).

[59] *Id*.

[60] 17 C.F.R. § 240.12h-3.

[61] *See* 17 C.F.R. § 240.12h-3(b)(2).

[62] 17 C.F.R. § 240.12h-3(c); Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[63] 17 C.F.R. § 240.12h-3(d); Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[64] 17 C.F.R. § 240.12h-3(e).

[65] *Id*.

More foreign private issuers are turning to the deregistration rules as they conclude that the regulatory burden and costs of compliance with the Exchange Act outweighs the benefits of a U.S. listing.[66] These rules were designed many years ago before significant cross-border listings. As a result, even though a foreign private issuer may be able to delist from a U.S. exchange, the current deregistration rules may continue to subject the issuer to reporting and other compliance obligations under the Exchange Act even if there is little U.S. investor interest in their securities.[67] Even those foreign private issuers that do not list their securities on a U.S. exchange may be subject to the Exchange Act reporting system if their securities are considered "widely held" under Section 12(g) of the Exchange Act.[68] In light of these burdens, foreign company and industry association representatives have voiced their concerns to the SEC.[69]

Increased globalization and advances in information technology, among other factors, have made the current deregistration rules obsolete.[70] Specifically, the "300 U.S. resident shareholder" standard under Exchange Act Rules 12g-4 and 12h-3 can make it difficult for a foreign private issuer to terminate its Exchange Act reporting obligations despite the fact that there is relatively little interest in the issuer's securities among U.S. investors.[71] For example, U.S. investors can easily access European securities markets, thus, trading in an issuer's home market can cause it to exceed the 300 U.S. resident shareholder standard, even if the company does not actively solicit U.S. interest.[72] Exchange Act Rule 12g-4's reliance on U.S. resident shareholders presents another problem because it is difficult and costly to determine the number of U.S. resident shareholders with the development of electronic book-entry recording.[73]

Under Exchange Act Section 15(d), if a foreign private issuer has ever registered securities under an effective Securities Act registration statement, Exchange Act Rule 12h-3 will not permit the issuer to permanently terminate its reporting obligations.[74] The issuer must determine at the end of each fiscal year whether the number of U.S. resident shareholders increased enough to renew its Section 15(d) reporting obligations.[75] Finally, as noted above, the current rules do not permit a foreign private issuer to obtain the Exchange Act Rule 12g3-2(b) exemption if, during the previous 18 months, it has had a class of securities registered under

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[66] *See supra* notes 8-30 and accompanying text.

[67] EALC Letter, *supra* note 14, at p. 2; Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[68] 15 U.S.C. § 78l(g)(1); *see supra* notes 36 and 37 and accompanying text.

[69] EALC Letter, *supra* note 14, at p. 2-3; Letter from members of Association Francaise des Entreprises Privees dated March 18, 2005, p. 2 [hereinafter AFEP Letter], http://www.sec.gov/rules/proposed/s71205/eurocomp031805.pdf.

[70] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386.

[71] *Id.*; EALC Letter, *supra* note 14, at p. 2.

[72] EALC Letter, *supra* note 14, p.2.

[73] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386; AFEP Letter, *supra* note 69, at p. 2.

[74] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1386; EALC Letter, *supra* note 14, at p. 3.

[75] *Id*.

Section 12 or a reporting obligation, suspended or active, under Section 15(d) of the Exchange Act.[76]

Proposed Deregistration Rules

In response to foreign private issuers' concerns regarding the difficulty of exiting from the Exchange Act reporting system and to increasing competitive pressures from foreign markets, on December 23, 2005, the Commission proposed Exchange Act Rule 12h-6 as an amendment to Exchange Act Rules 12g-4 and 12h-3, among other provisions.[77] The Commission received over 50 letters commenting on the proposed rule amendments.[78] Commentators agreed that new deregistration rules were necessary; however, many expressed concern that the Commission's proposed amendments would not fully address the current concerns.[79] After considering the commentators' suggestions, the SEC reproposed Exchange Act Rule 12h-6 on December 22, 2006.[80]

Reproposed Deregistration Rules

The following section discusses the highlights of the Commission's reproposed Exchange Act Rule 12h-6. The Commission is taking comments from the public until February 12, 2007. The Commission anticipates taking further action as expeditiously as possible after the end of the comment period.[81]

Equity Securities

Under reproposed Exchange Act Rule 12h-6, a foreign private issuer, regardless of size, can terminate its Exchange Act reporting obligations regarding a class of equity securities under either Section 12(g) or Section 15(d) of the Exchange Act, assuming it meets all the other conditions of Rule 12h-6, by meeting a quantitative benchmark that does not depend on the number of its U.S. record holders.[82] This benchmark requires that the U.S. average daily trading volume of the subject class of securities has been 5 percent or less of the average daily trading volume of that class of securities in the issuer's primary trading market during the most recent 12

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[76] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1387; 17 C.F.R. § 240.12g3-2(d)(1). *See* 17 C.F.R. §§ 240.12g3-2(d)(2) and (d)(3) for additional restrictions.

[77] *See* Termination of a Foreign Private Issuer's Registration, Exchange Act Release No. 34-53020, 70 Fed. Reg. 77,688 (Dec. 30, 2005).

[78] These comments are available on the SEC's website at http://www.sec.gov/rules/proposed/s71205.shtml and in the SEC's Public Reference Room in its Washington, DC headquarters.

[79] Comment letter from New York State Bar Association, Business Law Section, Committee on Securities Regulation dated March 3, 2006, p. 2-4 [hereinafter NYSBA Letter], http://www.sec.gov/rules/proposed/s71205/mjholliday2517.pdf; PwC Letter, *supra* note 14, at p. 1.

[80] *See* Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1387-89.

[81] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1384.

[82] Re-proposed Rule 12h-6(a).

month period.[83] A benchmark based solely on trading volume provides a more direct measure of U.S. market interest in a foreign private issuer's securities than the current rules and avoids the problems caused by the current rule's "300 U.S. resident" shareholder standard.[84] Additionally, foreign private issuers registered under Section 15(d) of the Exchange Act would be able to permanently terminate, rather than merely suspend, its reporting obligations.[85]

For a foreign private issuer that delists from a U.S. exchange, Rule 12h-6 would require that issuer to meet the trading volume benchmark as of the date of delisting in order to deregister.[86] If this benchmark is not met, the issuer would still be able to delist, but it would have to wait 12 months, assuming the benchmark is satisfied during this period, before it could deregister under Rule 12h-6.[87]

Rule 12h-6 would also require a foreign private issuer that terminates an American Depository Receipts facility to wait 12 months before seeking deregistration in reliance on the trading volume standard.[88]

Other Conditions for Equity Securities

In addition to meeting the trading volume benchmark, a foreign private issuer must:

(1) have had Exchange Act reporting obligations for at least one year, filed or submitted all required reports for that year, and filed at least one Exchange Act annual report;[89]

(2) not have sold its securities in the U.S. in a registered offering under the Securities Act, except for specified offerings, during the preceding 12 months (exempt offerings would be permitted);[90] and

(3) have maintained a listing during the preceding 12 months in a foreign jurisdiction that, either singly or together with one other foreign jurisdiction, constitutes the primary trading market for the issuer's subject class of securities.[91]

Expanded Scope of Rule 12h-6

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[83] Re-proposed Rule 12h-6(a)(4)(i).

[84] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1390; *see supra* notes 71-73 and accompanying text.

[85] *See supra* notes 74-75 and accompanying text.

[86] Proposed Note 1 to Re-proposed Rule 12h-6(a)(4).

[87] Proposed Note 1 to Re-proposed Rule 12h-6(a)(4).

[88] Proposed Note 2 to Re-proposed Rule 12h-6(a)(4).

[89] Re-proposed Rule 12h-6(a)(1).

[90] Re-proposed Rule 12h-6(a)(2).

[91] Re-proposed Rule 12h-6(a)(3).

Reproposed Rule 12h-6 would expand the scope of the originally proposed rule in two ways:

(1) a foreign private issuer that succeeds to the reporting obligations under the Exchange Act of another issuer following a merger, acquisition, or other similar transaction could take into account the Exchange Act reporting history of its predecessor in determining whether it is eligible to deregister under Rule 12h-6; and[92]

(2) a foreign private issuer that terminates or suspends its reporting obligations under the current deregistration rules before the effective date of Rule 12h-6 would be able to obtain the benefits of termination under Rule 12h-6 provided it met specified conditions.[93]

Reproposed Changes to Rule 12g3-2(b) Exemption

The Commission also has reproposed amendments that would permit a foreign private issuer to claim the Rule 12g3-2(b) exemption:

(1) immediately upon its termination of Exchange Act reporting under Rule 12h-6, rather than having to wait 18 months as is currently required;[94] and

(2) upon the condition that the issuer publish in English its 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.[95]

The reproposed amendments would further permit a foreign private issuer that has obtained or will obtain the Rule 12g3-2(b) exemption, upon application to the Commission, and not pursuant to Rule 12h-6, to publish in English its required home country documents on its Internet website or through an electronic information delivery system in its primary trading market, rather than submitting them in paper form to the SEC, as is currently required.[96]

Conclusion

Given the increased regulatory burden with the enactment of Sarbanes-Oxley and the greater competition from foreign markets, more foreign private issuers are concluding that the costs of compliance outweigh the benefits of listing or maintaining a listing on a U.S. exchange.

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[92] Re-proposed Rule 12h-6(c)(2).

[93] Re-proposed Rule 12h-6(h).

[94] Re-proposed Rule 12g3-2(e)(1). Currently, foreign private issuers that registered a class of securities under Section 12 must wait at least 18 months following their termination of reporting before they are eligible for the Rule 12g3-2(b) exemption. 17 C.F.R. § 240.12g3-2(d)(1). Foreign private issuers with an active or suspended reporting obligation under Section 15(d) are not currently eligible to claim the Rule 12g3-2(b) exemption. *Id*.

[95] Re-proposed Rule 12g3-2(e)(2).

[96] Re-proposed Rule 12g3-2(f).

In response, the Commission has reproposed deregistration rules to make it easier for foreign private issuers to terminate their reporting obligations under the Exchange Act. The SEC believes that these reproposed rules would provide benefits to U.S. investors by re-attracting foreign private issuers to the U.S. markets, while still protecting U.S. investors.[97]

[97] Re-Proposed Rules, *supra* note 30, 72 Fed. Reg. at 1406.