CAHILL GORDON & REINDEL LLP
EIGHTY PINE STREET
NEW YORK, NEW YORK 10005-1702
TELEPHONE: (212) 701-3000
FACSIMILE: (212) 269-5420

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SEC Eases De-registration Rules for Foreign Private Issuers

On March 21, 2007, the Securities Exchange Commission ("SEC") adopted a new set of rules that simplify the de-registration process for foreign private issuers ("FPI").[1] The adoption of the new rules has been well received since the procedures which FPIs were previously required to follow to terminate or suspend their reporting obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act") had been viewed as unduly cumbersome and costly to the point where they have acted as a deterrent to foreign companies which would otherwise avail themselves of the U.S. capital markets. The new rules represent the culmination of a two year effort by the SEC to develop methods that would facilitate the exit strategy of FPIs from United States exchanges. The new rules will become effective 60 days from their publication in the Federal Register. A brief discussion of the background of the new rules and a summary of their provisions follows.

1. Foreign Private Issuers and Termination of Reporting Obligations

As defined in the rules under the Exchange Act, a foreign private issuer is an issuer (other than a foreign government) incorporated or organized in a foreign country which does not have more than 50% of its outstanding voting securities directly or indirectly held of record by residents of the United States; and which does not have: (i) a majority of executive officers or directors who are United States citizens or residents; (ii) more than 50% of its assets located in the United States; or (iii) its main business administered principally in the United States.[2] FPIs that

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1 SEC Release No. 34-55540; International Series Release No. 1301; File No. S7-12-05 (March 27, 2007) available at http://www.sec.gov/rules/final/2007/34-55540.pdf (the "Adopting Release").

2 Exchange Act Rule 3b–4(c).

access the U.S. capital markets through public offerings of securities in the United States and list their securities on United States exchanges must comply with certain of the reporting requirements of the Exchange Act and certain of the corporate governance provisions of the exchanges.[3]

Some FPIs that have publicly sold their securities in the United States and listed them on a U.S. exchange have found that the level of market interest in their securities declines post-offering to a point where it no longer justifies the compliance cost incurred in meeting the reporting and other requirements of the U.S. securities laws and related regulations. In such circumstances, an FPI may wish to delist its securities in the U.S. to eliminate these costs. The SEC rules governing such procedure heretofore in effect have been viewed as unduly burdensome.

Specifically, an exchange-listed FPI would first have to delist its exchange traded securities, which would terminate its registration under Exchange Act Section 12(b). The FPI would then have to consider whether it still had Exchange Act reporting obligations under Exchange Act Section 12(g).

Until the adoption of the new rule, Exchange Act Rule 12g-4 governed whether an issuer could terminate its registration of a class of securities under Section 12(g) of the Exchange Act and its corresponding Section 13(a) reporting obligations. Under this rule, an FPI could seek termination of its registration of a class of securities under Section 12(g) by certifying on Form 15 that the subject class of securities was held by less than 300 residents in the United States or by less than 500 U.S. residents where 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. For the purpose of determining the number of U.S. resident shareholders, an FPI was required to use the method of counting provided under Exchange Act Rule 12g3-2(a). This method requires looking through the record ownership of brokers, dealers, banks or other nominees on a worldwide basis and counting the number of separate accounts of customers resident in the United States for which the securities are held. Issuers are required to make inquiries of all nominees, wherever located and wherever in the chain of ownership, for the purpose of assessing the number of U.S. resident holders.

An issuer that has determined that it meets the threshold requirements for termination of registration of a class of securities under Rule 12g-4, and has also never engaged in a registered offering under the Securities Act, may seek termination of its Exchange Act reporting obligations by filing a certification on Form 15. However, an issuer that has sold securities in a public offering registered under the Securities Act of 1933, as amended (the "Securities Act"), must determine if it has any suspended reporting obligations under Section 15(d) that will become operative after it has terminated the registration of a class of securities under Exchange Act Section 12(g).

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[3] For example, an FPI that has registered a class of its securities with the SEC must file annual reports on Form 20-F or Form 40-F in the case of Canadian issuers, make further filings on Form 6-K and, if its securities are listed on the New York Stock Exchange ("NYSE"), must have an audit committee comprised of independent directors and comply with certain disclosure and certification requirements of the NYSE.

Rule 12h-3 is the Exchange Act rule governing when an issuer may suspend its reporting obligations under Section 15(d). While Rule 12h-3's standards are substantially similar to those under Rule 12g-4, there are two important differences. First, an issuer may generally not suspend its Section 15(d) reporting obligations until it has filed one Exchange Act annual report after the offering in question. Second, an issuer cannot permanently terminate its reporting obligations under Section 15(d) but can only suspend those obligations. Therefore, for as long as the subject class of securities is outstanding, an FPI must also determine at the end of each fiscal year whether the number of U.S. resident security holders or total number of record holders has increased enough to trigger anew its Section 15(d) reporting obligations.

New Rule 12h-6, together with the related amendments to existing Exchange Act rules, is designed to eliminate these complex analyses in the case of FPIs seeking to terminate their Exchange Act reporting obligations. The SEC anticipates that FPIs will likely choose the procedures under the new rule rather than those set forth under Rule 12g-4.[4]

2. Highlights of New Rule 12h-6

A. Average Daily Trading Volume Benchmark as Trigger for Termination

Under new Rule 12h-6, an FPI would be able to terminate the registration of a class of securities under Section 12(g) and hence its reporting obligations regarding a class of equity securities by certifying on new Form 15F filed with the SEC that the U.S. average daily trading volume of the subject class of securities has not been greater than 5% of the average daily trading volume of that class of securities in the FPI's primary trading market[5] during a recent 12 month period, regardless of the size of its U.S. public float. The FPI would also have to meet certain other requirements of the new rule which are summarized in Section 2.B below.

According to the SEC, the standard adopted is viewed as superior to other benchmarks that the SEC had been considering[6] because it is a direct measure of the FPI's nexus with the

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4 As a result, the SEC eliminated Rules 12g-4(a)(2) and 12h-3(b)(2), the provisions permitting termination or suspension, respectively, of Exchange Act reporting obligations in the event an FPI's securities are held by less than 300 U.S. residents, or by less than 500 U.S. residents where the FPI's total assets had not exceeded $10 million on the last day of each of its most recent three fiscal years. Adopting Release at 59-60.

5 A primary trading market is that where at least 55% of the trading in the FPI's class of securities that is the subject of Form 15F took place in, on or through the facilities of a securities market or markets in a single foreign jurisdiction or in no more than two foreign jurisdictions during a recent 12-month period, as long as the trading in at least one of the two foreign jurisdictions is larger than the trading in the United States for the same class of the FPI's securities.

6 The original standard proposed by the SEC included alternative tests one of which was based upon a percentage comparison of an FPI's U.S. public float and its worldwide public float, to-

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U.S. capital markets, and because trading volume data is easier to obtain than public float or record holder data. In applying an exit standard based on trading volume data for the U.S. and an FPI's primary trading market, FPIs should face reduced costs when determining whether they can terminate their registration and reporting obligations under the Exchange Act, compared to the earlier proposed measures that would have required an FPI to assess the U.S. residence of its security holders.

Note also, that Rule 12h-6 will permit an FPI to include off-market transactions, including transactions through alternative trading systems, when calculating its worldwide average daily trading volume for a class of equity securities as long as the trading volume information regarding the off-market transactions is reasonably reliable and does not duplicate other trading volume information regarding the subject class of securities.

B. Additional Conditions

The new rules set forth, among others, certain key requirements that must be met by an FPI in order for it to be able to delist its securities from any U.S. exchange. In such respect, an FPI will be required to:

- Have been an Exchange Act reporting company for at least a year, to be current for that period and to have filed at least one annual report before filing for deregistration. Note that, in certain cases, an FPI will be allowed to consider a special financial report (which will include financial statements and other information as of and for the most recent FPI's fiscal year end) filed pursuant to Exchange Act Rule 15d-2 as an Exchange Act annual report for the purpose of the new rule's prior reporting condition.

- Wait 12 months before filing its Form 15F if (a) the FPI has delisted its class of equity securities from a national U.S. exchange or automated interdealer quotation system in the U.S. and, at the time of delisting, the U.S. average daily trading volume of the subject class of securities exceeded 5% of the average daily trading volume of that class of securities in the FPI's primary trading market for the preceding 12 months, or (b) the FPI has terminated an ADR facility. The required waiting period prevents Rule 12h-6 from creating an incentive for an FPI to terminate its trading facilities for the purpose of decreasing its U.S. trading volume at a time when the U.S. market is still active.

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gether with a percentage comparison of the number of its U.S. resident security holders and its non-U.S resident security holder; the other of which involved only a percentage comparison (at a lower percentage level than in the first alternative) of its U.S. resident security holders with its non-U.S. resident security holders. Either of these tests required an FPI to determine the residence of its security holders, a task not easily accomplished. See SEC Release No. 34-53020; International Series Release No. 1295; File No. S7-12-05 (December 23, 2005) proposing Rule 12h-6, available at http://www.sec.gov/rules/proposed/34-53020.pdf at 14-15.

- Publish a notice, such as a press release, announcing its intention to terminate its Exchange Act reporting obligations under Rule 12h-6, before or at the time of filing its Form 15F.

- Maintain a listing of the subject class of securities on one or more exchanges in its primary trading market for at least the 12 months before filing for deregistration under new Rule 12h-6. This requirement will assist investors in assuring that there is a foreign regulator overseeing the FPI, which makes more likely the availability of a set of non-U.S. disclosure documents to which U.S. investors may turn following the FPI's deregistration from the U.S.

- Refrain from selling its securities in a registered offering during the 12 months preceding the proposed delisting (the "Dormancy Period") but permitting the FPI to sell securities in transactions exempt from registration under the Securities Act during the Dormancy Period, including, among others things, Rule 144A offerings and securities issued to the FPI's employees. The main purpose of the Dormancy Period is to preclude an FPI from exiting the Exchange Act reporting system shortly after it has engaged in U.S. capital raising.

- Publish, as a condition to the exemption granted under Exchange Act Rule 12g3–2(b)[7], in English, material home country documents required by Rule 12g3-2(b) on the FPI's website or an electronic delivery system in its primary trading market. Also, an FPI would be able to maintain a sponsored American Depositary Receipt ("ADR") facility with respect to its securities. This condition would facilitate resales of the FPI's securities to qualified institutional buyers under Rule 144A. Moreover, having an FPI's key home country documents posted in English on its website would assist U.S. investors who are interested in trading the FPI's securities in its primary securities market.

C. Effect of Filing Form 15F

Under the new rules, the filing of a Form 15F will result in the immediate suspension of the filing FPI's Exchange Act reporting obligations. If the SEC does not raise any objections to the filing within 90 days after the filing is made, the following will become effective[8]:

- Termination of the FPI's registration of a class of equity under Section 12(g) and the resulting Section 13(a) reporting obligations under the Exchange Act.

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7 Provides an exemption from registration under Exchange Act Section 12(g) with respect to an FPI that submits to the SEC, on a current basis, the home country materials required by the rule.

8 If the SEC does object and deny the effectiveness of the filing, the FPI must file all required re ports within 60 days of such denial.

- Termination of the FPI's reporting obligations regarding a class of equity or debt securities under Section 15(d) of the Exchange Act.

- An automatic exemption under Exchange Act Rule 12g3–2(b), rather than having to wait 18 months as otherwise required by Rule 12g3-2(d).[9]

An FPI which has filed a Form 15 prior to the effective date of the new rules, may file a Form 15F to terminate its Exchange Act reporting obligations as provided under Rule 12h-6.

The SEC believes that with the new Rule 12h-6, FPIs will have a meaningful option of terminating their Exchange Act reporting obligations when, after accessing the U.S. public capital markets, they find that there is relatively little interest in their U.S. registered securities. In consequence, it is hoped that FPIs will be more willing to initially register their securities with the SEC for the benefit of U.S. investors who will also have more investment choices.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jonathan I. Mark at (212) 701-3100 or jmark@cahill.com; or Maria Brito at (212) 701-3668 or mbrito@cahill.com.

9 Such automatic exemption is available under new Rule 12g3-2(e).