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News Bulletin

September 2, 2008

SEC Amends Reporting, Registration and Business Combination Rules for Foreign Private Issuers

Introduction

On August 27, 2008, the SEC announced that it had adopted three sets of rule amendments relating to foreign private issuers ("FPIs").[1] These new rules are based on proposals that the SEC issued earlier this year.[2]

The rule changes address:

- the periodic reporting obligations of FPIs;
- the availability of the exemption from registration provided by Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"); and
- the SEC's exemptions relating to cross-border transactions.

The SEC stated that the new rules are intended to make it easier for U.S. investors to obtain timely financial information with respect to FPIs, and for U.S. investors to participate in international tender offers and other business combinations.

The SEC will shortly release the full text of the new rules. This client alert is based upon the SEC's press release, and the oral remarks made at the SEC's open meeting at which the amendments were approved. We will issue a more detailed client alert regarding the proposed amendments after the SEC has released the full text of the new rules.

Exchange Act Reporting Requirements

Filing Deadline for Form 20-F. The SEC refers to these changes to the FPI reporting requirements as the "Foreign Issuer Reporting Enhancements." Following a transition period, FPIs will be required to file their annual reports on Form 20-F within *four months* after the end of their fiscal year end. This amendment reflects a two month reduction from the existing six-month deadline. However, the final rules do not impose the three-month deadline that the SEC had initially proposed for "accelerated filers" and "large accelerated filers." The SEC had received a substantial number of comment letters suggesting that a three-month deadline was not practical for

[1] A "foreign private issuer" is a corporation or other entity organized outside of the U.S. that either has (a) 50% or less of its outstanding voting securities held of record by U.S. residents or (b) if more than 50% of its voting securities are held by U.S. residents, none of the following are true: (1) a majority of its executive officers or directors are U.S. citizens or residents; (2) more than 50% of its assets are located in the U.S.; and (3) the issuer's business is administered principally in the U.S. The SEC's press release announcing the rule changes, together with a video clip of Chairman Christopher Cox's remarks, may be found at: http://www.sec.gov/news/press/2008/2008-183.htm

[2] Morrison & Foerster LLP's summary of the initial proposals may be found at: http://www.mofo.com/news/updates/files/13546.html

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FPIs, particularly those that needed to translate their financial statements and other disclosures to English from another language.

Timing of Determination of FPI Status. Qualifying as an FPI enables a foreign issuer to use the SEC's special forms and rules that apply to FPI's, such as Form 20-F for annual reports. As described in the SEC's initial proposals, the new rules provide that a foreign issuer will only need to determine once each year whether it satisfies the SEC's definition of FPI.[3]

In contrast, under the current rules, an FPI's failure to qualify as an FPI at any time during the fiscal year will result in the immediate loss of FPI status. The change will ease the monitoring burden, and provide greater certainty, to those FPIs that are on the borderline of qualifying. For example, under the current rules, an issuer that has slightly less than 50% of its shareholders located in the U.S. could immediately lose its FPI status if transactions in the secondary market, the exercise of stock options by U.S. employees or other transactions result in increased U.S. ownership. Under the new rules, therefore, an issuer of this kind will only need to evaluate its FPI status once each year, and may seek to rectify any issues that arise during the year that would otherwise jeopardize its FPI status.

Additional Disclosure Requirements. The "Foreign Issuer Reporting Enhancements" are also designed to enhance (i.e., "increase") the disclosures that FPIs must make in their registration statements and Exchange Act reports. For example, FPIs will now be required to report:

- changes in, and disagreements with, their auditors;[4]
- payments and other charges relating to ADRs; and
- disclosures about significant differences in corporate governance practices in their home countries as compared to the U.S.[5]

Amendments to Financial Reporting Requirements. The amendments will include several revisions to the financial reporting requirements of FPIs:

- The amendments will eliminate in most cases the limited U.S. GAAP reconciliation option set forth in Item 17 of Form 20-F.[6] Under this amendment, all FPIs that are required to provide a U.S. GAAP reconciliation will need to do so under Item 18 of Form 20-F.[7]
- Item 17 of Form 20-F will be modified to eliminate the instruction that permits certain FPIs to omit segment data from their U.S. GAAP financial statements, and to have a qualified U.S. GAAP audit report.[8]

In its proposing release, the SEC considered whether FPIs should provide financial information in their annual reports for completed acquisitions that reach the "50% significance test." However, the SEC did not adopt this change, mainly in light of commenters' concerns about the timeliness and usefulness of the information.

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[3] The status will be tested on the last business day of the company's second fiscal quarter.

[4] This requirement is already generally applicable to U.S. issuers.

[5] The NYSE and Nasdaq already require listed companies to disclose this information as a condition to listing (although the information may be posted on a website); accordingly, this change appears not likely to have a material impact on listed FPIs.

[6] Item 17 is primarily used by FPIs that are only listing a class of securities on a U.S. securities exchange, or only registering a class of equity securities under Section 12(g) of the Exchange Act, but are not conducting a public offering.

[7] However, required third-party financial statements, such as those shown for acquisitions, may continue to be prepared under Item 17.

[8] The SEC has indicated that this narrow accommodation has been used by approximately five FPIs in the past few years.

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Going Private Transactions. Finally, as part of these amendments, Rule 13e-3 under the Exchange Act, relating to "going private transactions," will be modified to reference the SEC's March 2007 deregistration rules that are applicable to FPIs.[9]

Amendments to Rule 12g3-2(b)

Rule 12g3-2(b) provides an exemption from registration and reporting under the Exchange Act for FPIs that do not have shares traded on a U.S. stock exchange, but could nonetheless otherwise be required to register because their number of U.S. shareholders exceeds the applicable thresholds in Section 12(g) of the Exchange Act and the SEC related rules. For these companies, compliance with Rule 12g3-2(b) allows them to avoid following the SEC's reporting requirements for publicly-traded companies, including many provisions of the Sarbanes-Oxley Act. Many of these companies have shares that trade over-the-counter in the U.S. (often in the form of Level I ADRs) or have engaged in private offerings to institutional investors in the U.S.; accordingly, their business and financial results are of interest to some U.S. investors.

Currently, in order to obtain this exemption, an FPI must initially submit written materials to the SEC, including paper copies of its non-U.S. disclosure documents, and information as to the number of its shareholders in the U.S. Thereafter, under paragraph (b)(1) of the Rule, the issuer must submit certain disclosures made outside of the U.S. to the SEC by mail on an ongoing basis.

The amendments to the rule will eliminate the current requirements that FPIs provide a written application of their intent to comply with the rule, and to submit paper copies of their documents. Instead, FPIs will automatically qualify for the exemption provided by the rule if they satisfy the specified conditions. For example, FPIs will be required to electronically publish (for example, through posting on the FPI's Internet home page), in English, certain non-U.S. disclosure documents on an ongoing basis, so that they may be easily accessed by U.S. investors.

The amendments to Rule 12g3-2(b) will require an issuer to maintain a listing of the relevant securities on at least one non-U.S. exchange that constitutes its primary trading market. The amended rule will define "primary trading market" to mean that at least 55% percent of the trading in the issuer's securities occurred in no more than two non-U.S. jurisdictions during the most recently completed fiscal year. Accordingly, the amendments remove the provision from the proposed rules that would have limited the U.S. average daily trading volume of the securities to 20% of the average daily trading volume on a worldwide basis. As proposed, the rule could have subjected a significant number of non-U.S. companies to Exchange Act registration and reporting if a substantial amount of their trading occurred in the U.S.

Cross-Border Exemptions

In the third set of amendments, the SEC adopted changes to its cross-border transaction exemptions. These amendments are designed to expand and enhance the utility of the SEC's existing exemptions for business combination transactions, tender offers and rights offerings. The SEC intends for these rule changes to encourage offerors and issuers to permit U.S. security holders to participate in these transactions on the same terms as non-U.S. security holders, as opposed to excluding them, or subjecting them to different transaction terms, due to the burdensome requirements of certain existing SEC rules. These amendments also address in part the regulatory conflicts that arise in cross-border transactions, and may reduce the need for companies to request no-action relief from the SEC for their proposed transactions.

[9] These rules may be found at: http://www.sec.gov/rules/final/2007/34-55540.pdf

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The amendments include:

- codifications of existing interpretive positions and exemptive orders;
- amendments to allow specified types of foreign investors to report their beneficial ownership of U.S. public companies on short-form Schedule 13G, as opposed to the more detailed Schedule 13D, to the same extent as their U.S. institutional counterparts;
- additional interpretive guidance as to several issues that frequently arise in cross-border transactions, including important changes to the method of calculating the percentage of U.S. resident shareholders under Rule 800(h) for purposes of qualifying for the registration exemption available in Rule 802; and
- broadening the relief available in so-called "Tier I" and "Tier II" transactions to additional types of transactions.

Following the publication of the final rules, we intend to issue a client alert that describes them in detail, including their anticipated impact on the structuring of cross-border transactions.

Conclusion

The SEC intends to post the final rules, and its interpretive guidance, on its website as soon as feasible. At that point, foreign issuers will be able to more precisely determine the impact of the additional required disclosures they will need to make under the amendments to the disclosure rules. In addition, those who structure cross-border acquisitions will be very interested in carefully evaluating these rules to assess their likely impact on transaction planning and execution.

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