

# ADVISORY

## **SULLIVAN & WORCESTER CORPORATE ADVISORY**

### **New SEC Rules to Make Deregistering and Exiting U.S. Reporting System Easier for Foreign Companies**

The Securities and Exchange Commission has adopted new rules, effective on June 4, 2007, that make it easier for foreign private issuers to terminate their registration of securities and reporting obligations under the Securities Exchange Act of 1934. The new rules will allow a foreign private issuer who meets specified criteria to terminate (and not merely suspend) its reporting obligations regarding a class of equity or debt securities under the Exchange Act.

Under the new rules, a foreign private issuer may deregister its equity securities when it can show that its average U.S. daily trading volume has been 5% or less of its total worldwide daily trading volume for the past 12 months. Alternatively, for debt or equity securities, the foreign private issuer may certify that the securities are held by fewer than 300 holders either in the United States or worldwide. For deregistration of equity securities, the foreign private issuer must meet several other conditions, as described below.

#### **Background - Current Rules for Deregistering**

Some foreign private issuers whose securities are traded in the United States may discover that, despite their initial hopes and plans, there is little U.S. market interest in their securities. To avoid the high costs to comply with U.S. securities rules and regulations, such companies may want to deregister their securities and terminate their reporting obligations under the Exchange Act.

Under current SEC rules, registration and reporting obligations may arise under one of the following situations: (1) if a company has securities listed on a U.S. exchange, (2) if a company offers its securities to the public in the United States, or (3) if a company has more than a specified number of holders in the United States.

Current SEC rules provide that a foreign private issuer may terminate its registration of a class of securities and suspend its reporting obligations when the subject class of securities is held

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by fewer than 300 persons resident in the United States (or 500 persons, if the issuer's total assets did not exceed \$10,000,000 in the most recent three fiscal years). In determining the number of record holders who are U.S. residents, the foreign private issuer must use the "look through" method, which requires a global inquiry of brokers, dealers, banks and nominees for the individual accounts held by such persons. Although foreign private issuers may rely in good faith on information provided to them by such nominees, many foreign private issuers find it challenging to make the required global inquiries and determine with a sufficient degree of comfort that they have fewer than 300 U.S. holders. In addition, even after terminating their registration, as long as the previously registered class of securities is outstanding, foreign private issuers are required to determine at the end of each fiscal year whether the number of U.S. holders has increased above 300, and if it did, they may once again become subject to the reporting obligations of the Exchange Act.

### **New Rules for Deregistering**

The new rules are designed to provide clear tests for deregistering that more directly measure U.S. market interest in a foreign company's equity securities than a test based on the number of holders. Under the new rules, a foreign private issuer may deregister a class of equity securities and terminate its Exchange Act reporting obligations if it meets the following conditions and publicly announces its intention to terminate such reporting:

- **Average Daily Trading Volume Test** - the foreign private issuer must demonstrate that the average daily trading volume in the United States, of the class of equity securities which is being deregistered, has been 5% or less of such class's worldwide average daily trading volume during the past 12 months. When measuring its U.S. trading volume, the company must take into consideration both on-exchange and off-exchange transactions. When measuring its worldwide trading volume, the company may take into consideration both on-exchange and off-exchange transactions, provided that the information regarding off-exchange transactions is reasonably reliable and not duplicative of other trading volume data.
- **Waiting Period Test** - the foreign private issuer which delisted a class of equity securities from a U.S. exchange or terminated a sponsored American Depositary Receipts facility, will be subject to a 12-month waiting period before it may deregister such class of equity securities or ADRs, unless it satisfied the trading volume test on the date of its delisting and over the preceding year.
- **One-Year Reporting Period Test** - the foreign private issuer (1) must have been an Exchange Act reporting company for at least one year, (2) be current on all of its reporting obligations during such period, and (3) must have filed at least one annual report.
- **One-Year Dormancy Test** - the foreign private issuer must not have made a public offering of securities, with limited exceptions, in the United States during the preceding 12 months.
- **Foreign Listing Test** - to ensure that the company is subject to regulatory oversight outside of the United States after deregistering its securities, the foreign private issuer must have maintained a listing of the deregistered class of securities on one or more foreign exchanges that constitute its "primary" trading market, for at least one year.

As an alternative to the Average Daily Trading Volume Test, a foreign private issuer may instead certify that it has fewer than 300 holders of the class of equity securities in the United States or worldwide. This alternative is also available to foreign private issuers with debt securities registered in the United States or with reporting obligations relating to debt securities, but without the need for such issuers to meet the other conditions described above that apply to equity securities. The SEC has revised the look through method for determining the number of U.S. holders. Under the amended rules, a foreign private issuer may limit its inquiry to brokers, dealers, banks and nominees located in the United States, the company's home jurisdiction and the jurisdiction of its primary trading market, if different. If after reasonable inquiry, a foreign private issuer is unable without unreasonable effort to obtain information about the amount held by nominees for the accounts of U.S. customers, the foreign private issuer may assume that the customers are residents of the jurisdiction in which the nominee has its principal place of business. Companies may also rely on independent information service providers.

After certifying to the SEC that these requirements are met, the company's reporting obligations will be suspended and, absent objection by the SEC within 90 days, terminated. For foreign private issuers that deregister under the new rules, but have over 300 U.S. holders, the securities rules could require the company to keep reporting under the Exchange Act despite deregistration. To avoid this anomaly, existing SEC rules provide an exemption from reporting obligations upon satisfying certain criteria. Under current rules, this exemption is not effective for 18 months, even after deregistration. The new rules allow companies that deregister to take advantage of this exemption immediately. To maintain the exemption, a foreign private issuer must publish in English certain required home-country information on its website or an electronic information delivery system in its primary trading market.

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The SEC states that the new rules will:

- make it easier for foreign private issuers to exit the Exchange Act registration and reporting regime when they find a diminished level of U.S. investors' interest in their securities;
- create an incentive to foreign private issuers to initially register their securities with the SEC, because there is a clear and defined process and benchmarks for termination of their reporting obligations; and
- provide meaningful protection to U.S. investors who invested and continue to invest in the exiting company.

The new rules will not be helpful to all foreign private issuers. Companies must carefully consider their applicability when weighing decisions regarding potential securities activities in the United States.

The summary above is meant to describe the major changes affecting the deregistration process for foreign private issuers reporting in the United States. For a more comprehensive discussion of these changes, or further information about the impact of U.S. securities laws on foreign companies, please contact the lawyer at Sullivan & Worcester LLP with whom you regularly consult, or the lawyers listed above.

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