

SEC Adopts Rule Changes Affecting Foreign Private Issuer Registration and Disclosure Requirements, as well as Cross-Border Business Combinations, and Proposes Roadmap for the Use of IFRS Financial Statements by US Issuers

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Introduction

At its open meeting on August 27, 2008, the US Securities and Exchange Commission (“SEC”) voted unanimously to adopt (i) changes to Rule 12g3-2(b) under the US Securities Exchange Act of 1934, as amended (the “Exchange Act”), an exemption from Exchange Act registration for equity securities of foreign private issuers¹ that meet certain requirements, (ii) changes affecting foreign private issuers’ Exchange Act disclosure obligations, and (iii) changes to exemptions for cross-border business combinations and beneficial ownership reporting rules. In addition, the SEC proposed a roadmap for the potential use of International Financial Reporting Standards as issued by the International Accounting Standards Board (“IFRS”) by US issuers.

The SEC releases containing the new rules and the proposed roadmap for the use of IFRS by US issuers have not yet been published. This client alert is primarily based on statements made by the SEC and its staff during the open meeting as well as the related SEC press releases.

Amendments to Exchange Act Rule 12g3-2(b)

Exchange Act Rule 12g3-2(b) provides an exemption from registration under Exchange Act Section 12(g) for equity securities of a foreign private issuer that submits to the SEC certain information the issuer (i) makes public pursuant to the law of its home country, (ii) files with a stock exchange on which its securities are traded and which is made public by that exchange or (iii) distributes or is required to distribute to its security holders. The SEC adopted amendments to the Rule 12g3-2(b) exemption substantially in the form proposed in February 2008² with one important exception. As proposed, the availability of the Rule 12g3-2(b) exemption would have required that the average daily trading volume (“ADTV”) of the subject class of securities in the United States was not greater than

¹ The term “foreign private issuer” is defined in Exchange Act Rule 3b-4(c).

² SEC Release No. 34-57350 (Exemption from Registration under Section 12(g) of the Securities Exchange Act of 1934 For Foreign Private Issuers) (February 19, 2008) (the “Rule 12g3-2(b) Proposing Release”), available at <http://www.sec.gov/rules/proposed/2008/34-57350.pdf>. See Dewey & LeBoeuf client alert, “SEC Proposes Rule Changes Affecting Foreign Private Issuers,” of February 22, 2008, available at <http://www.deweyleboeuf.com/news/>.

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20 percent of the worldwide ADTV of that class for the issuer's most recently completed fiscal year. The amended rules do not contain this requirement.

The amendments replace the requirement to submit paper copies of the materials required under Rule 12g3-2(b) with the requirement to make these materials available electronically. In addition, an issuer is no longer required to apply to the SEC for an exemption under Rule 12g3-2(b). Instead the exemption becomes available automatically to any foreign private issuer that meets the following requirements.

Requirements for Availability of Rule 12g3-2(b) Exemption

Listing on Primary Trading Market

The issuer must maintain a listing of the subject class of securities on one or more foreign exchanges in one or more jurisdictions comprising its primary trading market. "Primary trading market" refers to the securities market or markets (in no more than two foreign jurisdictions) in or through the facilities of which at least 55 percent of the trading in the subject class took place during the issuer's most recently completed fiscal year.

Electronic Publication of Disclosure Documents in English

The issuer must publish specified non-US disclosure documents in English on its Internet Web site or through an electronic information delivery system that is generally available to the public in its primary trading market, unless the issuer claims the Rule 12g3-2(b) exemption in connection with or recently following a deregistration of the subject class.

No Reporting Obligation under Exchange Act Section 13(a) or 15(d)

The issuer must not have any reporting obligations under Exchange Act Section 13(a) or 15(d). The amendments eliminate the requirement that an issuer must look back 18 months and determine whether it had any active or suspended reporting obligations during that period, in which case the exemption was not available prior to the rule amendments.

Potential Consequences on ADR Facilities

Equity securities of a foreign private issuer that meets the requirements of amended Rule 12g3-2(b) are automatically (i.e., without any affirmative steps taken by the issuer and possibly even without the issuer's knowledge) subject to the Rule 12g3-2(b) exemption. For example, a foreign private issuer that routinely publishes non-US disclosure documents in English on its Web site or through an electronic information delivery system in

its home country and meets the other requirements of Rule 12g3-2(b) could unintentionally cause its equity securities to become subject to the exemption. This represents a significant change from the operation of Rule 12g3-2(b) prior to the amendments, which required a foreign private issuer to make application to the SEC for the exemption to be granted.

The automatic availability of the Rule 12g3-2(b) exemption under the amended rules could have consequences for American Depositary Receipt (“ADR”) facilities for securities of foreign private issuers in the United States. If a class of securities of a foreign private issuer is subject to the Rule 12g3-2(b) exemption, depositary banks in the United States, absent an issuer-sponsored ADR facility, can establish an unsponsored ADR facility for the issuer’s securities without the issuer’s consent. The existence of an unsponsored ADR facility creates problems for an issuer if it wishes to set up a sponsored ADR facility later on. Due to the automatic availability of the Rule 12g3-2(b) exemption under the amended rules, securities of foreign private issuers that never applied for the Rule 12g3-2(b) exemption, but happen to meet its requirements could now suddenly become subject to the Rule 12g3-2(b) exemption without the issuer’s involvement (and possibly knowledge) and be eligible for unsponsored ADR facilities in the United States. Prior to the amendments, a foreign private issuer was able to restrict the ability of depositary banks to establish an unsponsored ADR facility in the United States simply by not applying to the SEC for the Rule 12g3-2(b) exemption.

The SEC recognized this potential issue in the Rule 12g3-2(b) Proposing Release and asked for comment as to whether, as a condition to the registration on Form F-6 of ADRs of a foreign private issuer, it should require (i) that the issuer give its consent to the depositary bank or (ii) that the depositary notify the issuer of its intention to register ADRs and either (a) receive an affirmative statement of no objection from the issuer or (b) not receive an affirmative statement of objection from the issuer. However, it appears that the SEC has decided not to restrict the ability of depositary banks to set up unsponsored ADR facilities. Every foreign private issuer that meets the requirements of the Rule 12g3-2(b) exemption and for whose securities a sponsored ADR facility has not been established will need to consider whether it should now set up a sponsored ADR facility to prevent the creation of an unsponsored ADR facility.

Transition Periods

There will be a three-year transition period to accommodate currently exempt foreign private issuers that will lose the exemption upon the effectiveness of the new rules. In addition, there will be a three-month transition period for foreign private issuers to comply fully with the electronic publishing requirement.

Foreign Private Issuer Reporting Enhancements

A second set of amendments changes certain disclosure requirements applicable to foreign private issuers. The SEC proposed these amendments in February 2008³ and now has adopted these amendments substantially in the form as proposed.

Acceleration of Form 20-F Reporting Deadline

The reporting deadline for annual reports filed by foreign private issuers on Form 20-F has been accelerated for all foreign private issuers from six months to four months after the issuer's fiscal year-end. There will be a three-year transition period. Accordingly, the new four-month deadline for annual reports on Form 20-F will apply for fiscal years ending on or after December 15, 2011.

Annual Assessment of Foreign Private Issuer Eligibility

SEC-registered issuers will be permitted to assess their eligibility to use the special forms and rules available to foreign private issuers once a year on the last business day of their second fiscal quarter, rather than, as prior to the amendments, on a continuous basis. If an issuer no longer qualifies as a foreign private issuer on the last business day of its second fiscal quarter, it will be required to comply with the reporting requirements and use the forms prescribed for domestic issuers beginning on the first day of the fiscal year following the determination date.⁴ An issuer that determines on the last business day of its second fiscal quarter that it qualifies as a foreign private issuer will be permitted to use the forms and rules available to foreign private issuers immediately beginning on the determination date. If on a future determination date, the issuer fails to qualify then it must comply with the regulations and forms required for domestic issuers at the beginning of the issuer's next fiscal year.

³ SEC Release No. 34-57409 (Foreign Issuer Reporting Enhancements) (February 29, 2008), available at <http://www.sec.gov/rules/proposed/2008/33-8900.pdf>. See Dewey & LeBoeuf client alert, "SEC Proposes Rule Changes Affecting Foreign Private Issuers," of February 22, 2008, available at <http://www.deweyleboeuf.com/news/>.

⁴ For example, if a foreign private issuer determines that it no longer qualifies as a foreign private issuer as of the last day of its second fiscal quarter in 2009, the issuer would be required to comply with the filing requirements for domestic companies on the first day of its 2010 fiscal year. Among other things, the issuer would need to (i) file an annual report on Form 10-K in 2010 for its 2009 fiscal year, (ii) file quarterly reports on Form 10-Q, (iii) file current reports on Form 8-K, as necessary to comply with the requirements of that form, and (iv) comply with the proxy rules and Exchange Act Section 16.

Elimination of Instruction to Item 17 of Form 20-F Permitting Omission of Segment Data from US GAAP Financial Statements

The instruction to Item 17 of Form 20-F that currently permits certain foreign private issuers to omit segment data from their financial statements prepared in accordance with US generally accepted accounting principles (“US GAAP”) has been eliminated. The SEC staff believes that this accommodation is no longer necessary or appropriate and pointed out that it has been used only by approximately five foreign private issuers in the past few years.

Additional Form 20-F Disclosure Items

Form 20-F has been amended to require, among other things, disclosure in annual reports about:

- Any changes in and disagreements with the foreign private issuer’s certifying accountants;
- Fees, payments and other charges relating to ADRs; and
- Significant differences between the foreign private issuer’s corporate governance practices and the practices required for domestic issuers by US securities exchanges on which the foreign private issuer’s securities are listed.⁵

The SEC did not adopt proposed amendments that would have required foreign private issuers to provide financial information in their annual reports for completed acquisitions that are significant at the 50 percent or greater level.

Elimination of Limited US GAAP Reconciliation Option in Item 17 of Form 20-F

The limited US GAAP reconciliation option in Item 17 of Form 20-F has been eliminated. Prior to the amendments, depending on the context, the presentation of a US GAAP reconciliation was required to meet either the conditions of Item 17 or Item 18 of Form 20-F. Item 17 applied to Exchange Act registration statements, annual reports on Form 20-F and registration statements under the US Securities Act of 1933, as amended (the “Securities Act”), for investment grade non-convertible securities and certain rights offerings. It required a narrative description of differences and a quantitative reconciliation of specific financial statement line items from non-US GAAP to US GAAP, but did

⁵ Under the rules of a number of US exchanges, listed foreign private issuers are exempt from many of the corporate governance requirements that otherwise apply to listed companies. One of the conditions for relying on the exemption is disclosure by the foreign private issuer of significant differences between its governance practices and the practices followed by domestic companies under the relevant exchange’s listing standards. See, for example, Section 303A.11 of the New York Stock Exchange Listed Company Manual.

not require all US GAAP and Regulation S-X disclosures, particularly with regard to industry segment reporting. Item 18 applies in the context of financial statements in a Securities Act registration statement for offerings of equity, convertible and other securities, and requires the Item 17 information as well as generally all other information required by US GAAP and Regulation S-X, including segment information.

Following the elimination of the limited US GAAP reconciliation option in Item 17 of Form 20-F, all foreign private issuers that are required to provide a US GAAP reconciliation will need to prepare their US GAAP reconciliation pursuant to Item 18 of Form 20-F and include segment information. There will be a three-year transition period and all foreign private issuers that are required to provide a US GAAP reconciliation will be required to prepare the reconciliation based on Item 18 for their fiscal years ending on or after December 15, 2011.

In November 2007, the SEC adopted rules that permit foreign private issuers to include in their filings with the SEC financial statements prepared in accordance with IFRS without reconciliation to US GAAP.⁶ This change could lead to fewer non-US issuers having to reconcile their financial statements to US GAAP.

Amendments to the Cross-Border Exemptions and Beneficial Ownership Reporting

The SEC also adopted changes to the exemptions from its cross-border business combination rules, as well as to the beneficial ownership reporting requirements for certain foreign institutions. These amendments are intended to expand and enhance the participation of US holders of foreign securities in cross-border tender offers and other transactions. These amendments were adopted substantially in the form proposed in May 2008.⁷

Look-Through Calculation of US Ownership

Prior to the amendments, the percentage of US ownership of foreign securities needed to be determined on the 30th day prior to the commencement of the cross-border business combination. The amendments will allow the US ownership determination to be made on any date no more than 60 days before, and no later than 30 days after, the public announcement of a cross-border business combination. An acquiror that is unable to calcu-

⁶ See Dewey & LeBoeuf client alert, "SEC Accepts IASB IFRS Financial Statements From Foreign Private Issuers Without US GAAP Reconciliation," February 7, 2008 (available at <http://www.deweyleboeuf.com/news/>).

⁷ SEC Release No. 34-57781 (Revisions to the Cross-Border Tender Offer, Exchange Offer, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions) (May 6, 2008) (the "Cross Border Proposing Release"), available at <http://www.sec.gov/rules/proposed/2008/33-8917.pdf>.

late US ownership within this period may make the calculation as of a date up to 120 days before the public announcement.

For an acquiror that is unable to perform the look-through US ownership calculation within this time frame, the amendments provide an alternative eligibility test based in part on a comparison of the average daily trading volume of the subject securities in the United States and on a worldwide basis. In addition, the acquiror must take into account US ownership figures reported in public filings with the SEC, the foreign private issuer's home country regulator or in the jurisdiction of the primary trading market for the subject securities, as well as other information about US ownership that the acquiror knows or has reason to know from other sources. The staff noted at the open meeting that the determination of whether an acquiror "is unable" to perform the look-through calculation of US ownership will be based on the specific facts and circumstances. The fact that conducting the calculation may be costly and/or time consuming will not be sufficient.

The amendments also eliminate the requirement to exclude from the look-through US ownership calculation securities that are held by persons who hold more than 10 percent of the subject securities. However, securities held by the acquiror will continue to be excluded from the calculation.

Tier I Exemption

The amendments expand the scope of the Tier I exemption to cross-border transactions currently subject to Exchange Act Rule 13e-3. The amendments eliminate the requirement that the transactions be conducted under Securities Act Rule 802, Exchange Act Rule 13e-4(h)(8) or Exchange Act Rule 14d-1(c) in order to be eligible for the exemption.

Tier II Exemption

The amendments also expand the scope of the Tier II exemption by, among other things:

- extending the availability of the exemption to tender offers for securities that are not registered under Section 12 of the Exchange Act;
- allowing multiple foreign offers to be conducted contemporaneously with the US offer and relaxing the rules as to who may be included in each offer by, for example, permitting US holders to participate in foreign offers if certain requirements are met;
- permitting the suspension of withdrawal rights after expiration of the tender offer period while tendered securities are being counted and before they have been accepted for payment by the bidder;
- modifying rules applicable to subsequent offering periods in a tender offer;

- permitting the early termination of an initial offering period in a Tier II cross-border tender offer, upon satisfaction of all offer conditions;
- codifying exemptive relief previously provided by the SEC’s Division of Trading and Markets to permit purchases outside of a tender offer conducted pursuant to the Tier II exemption;
- eliminating the current 20-business day limit on the maximum length of subsequent offering periods for both US and cross-border tender offers; and
- expanding the types of exchange offers that may commence before the effectiveness of the registration statement covering the securities being offered by the bidder for both US and cross-border tender offers.

Beneficial Ownership Reporting by Certain Foreign Institutions

The amendments also permit certain foreign institutions to file beneficial ownership reports on Form 13G to the same extent as their domestic counterparts, so long as they can certify that they are subject to regulatory schemes that are comparable to US rules and the securities are acquired and held in the ordinary course of business and without the purpose or effect of influencing control of the issuer. Corresponding changes will be made to the reporting requirements under Section 16 of the Exchange Act.

Interpretive Guidance

In addition to the other amendments relating to cross-border transactions and business combinations, the SEC also voted to issue interpretative guidance on the following issues relating to cross-border transactions, which are the subject of frequent inquiries to the SEC staff:

- limitations on prior SEC guidance concerning the ability of bidders to reduce or waive minimum acceptance conditions in a tender offer without providing withdrawal rights after this change in the terms of the offer;
- the ability of bidders in tender offers for US companies to exclude foreign target security holders in tender offers subject to US equal treatment principles;
- the ability of bidders in cross-border tender offers to exclude US target security holders without violating US tender offer rules; and
- the ability of bidders in cross-border exchange offers to provide cash to US security holders while offering shares to foreign security holders under a procedure known as “vendor placement.”

According to statements at the open meeting, this guidance will be consistent with the guidance provided in the Cross-Border Proposing Release, but will include some additional detail.

Roadmap for the Potential Use of IFRS Financial Statements by US Issuers

The SEC also voted to publish for comment a release that would propose a roadmap for the potential use by US issuers in their filings with the SEC of financial statements prepared in accordance with IFRS (the "Roadmap"). The Roadmap sets out several milestones that, if achieved, could lead to the permitted or required use of IFRS by US issuers in 2014. The SEC would make a decision in 2011 on whether to mandate the use of IFRS financial statements by US companies beginning with their 2014 fiscal years.

The proposed milestones include: (i) improvements in accounting standards; (ii) the accountability and funding of the International Accounting Standards Committee Foundation; (iii) improvement in the ability to use interactive data for IFRS reporting; (iv) education and training in the United States relating to IFRS, among investors, auditors and others; (v) the limited early use of IFRS; (vi) the timing of future rulemaking by the SEC; and (vii) the implementation of the mandatory use of IFRS, including considerations relating to whether the mandatory use of IFRS should be staged or sequenced among groups of companies based on their market capitalization.

The group of U.S issuers that might be permitted to use IFRS before their mandatory use is required may be comprised of the 20 largest issuers by market capitalization in certain industry groups. The SEC staff estimates that approximately 110 US companies in about 34 different industries would be eligible. These issuers would be required to provide some form of US GAAP-based information in addition to the IFRS financial statements.

The proposing release will also solicit comments on whether the mandatory use of IFRS by US companies should be phased in by, for example, first requiring use of IFRS by large accelerated filers, followed by accelerated filers and then non-accelerated filers.

The comment period for the proposed Roadmap will be 60 days from the date of its publication in the Public Register.

This client alert is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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