

## **Non-U.S. Issuers – Best Approaches to Delisting and Exiting the U.S. Reporting System through Deregistration under the U.S. Securities Exchange Act of 1934**

### **Introduction**

Non-U.S. issuers may have compelling reasons to voluntarily delist their securities from U.S. stock exchanges and exit the Securities and Exchange Commission (“SEC”) reporting system under the U.S. Securities Exchange Act of 1934 (the “Exchange Act”). Among the incentives to leave the system are cumbersome and expensive Sarbanes-Oxley governance and reporting requirements, the risk of U.S. securities law liabilities, the availability of improved foreign exchanges on which to list outside of the U.S., sufficient availability of capital overseas and in the private market, limited interest in the company’s shares resulting in low trading volumes and continuing management distractions that arise from the significant efforts needed to comply with U.S. disclosure and reporting rules.<sup>1</sup> While there is no question that a U.S. listing can provide important benefits to some non-U.S. issuers, in many cases the costs and burdens of complying with U.S. requirements clearly outweigh these advantages.

Leaving the U.S. reporting system should not be confused with “going dark” or “going private.” After exiting the U.S. SEC regulatory and reporting scheme, foreign private issuers will often continue to maintain non-U.S. listing and trading markets which require public disclosure of material information irrespective of U.S. SEC requirements. In fact the most commonly used method of Exchange Act deregistration by foreign private issuers (Rule 12h-6) and the most commonly used exemption from the initial requirement to register under the Exchange Act (Rule 12g3-2(b)) both require that the issuer maintain a primary non-U.S. trading market. As a recent example, Allianz joined the list of substantial foreign issuers exiting the U.S. system by announcing a voluntary delisting on September 22, 2009. Allianz will focus its trading in Frankfurt, Germany and has delisted from the NYSE and plans to deregister under Rule 12h-6.<sup>2</sup>

Foreign private issuers may leave the U.S. reporting system in connection with mergers, acquisitions or going private transactions or they may do so through a voluntary exit from the U.S. reporting system.<sup>3</sup> This memorandum explains the complicated steps necessary for a non-

U.S. issuer to delist and deregister under the Exchange Act with a focus on issuers that choose to leave the system voluntarily.

### **The Thresholds for Exchange Act Registration**

To determine how to deregister under the Exchange Act and relieve an issuer from its U.S. reporting obligations it is important to understand how Exchange Act reporting obligations arise in the first place. Exchange Act reporting requirements for a U.S. or overseas issuer can be triggered in any or all of the following different and sometimes overlapping ways:

- under Section 12(b) if the issuer has shares or ADRs listed on a national securities exchange (such as NYSE or NASDAQ);<sup>4</sup>
- under Section 12(g) based on having over 500 record holders of a class of securities on a worldwide basis and total assets exceeding \$10 million on the last day of its fiscal year;<sup>5</sup> or
- under Section 15(d) by having had a registration statement declared effective under the Securities Act.

Reporting obligations under Sections 12(g) and 15(d) are suspended while obligations under Section 12(b) are in effect. By the same token, obligations under Section 15(d) are suspended while Section 12(g) reporting obligations remain in effect. As a result, each of the three different predicates for registration must be dealt with in turn and Section 12(b) obligations must first be eliminated before those under Sections 12(g) and 15(d) can be attacked.

### **Delisting and Deregistration under Section 12(b) is the First Step in Leaving the U.S. Reporting System**

Foreign private issuers wishing to exit the U.S. equity markets must first voluntarily delist their shares from any national securities exchanges on which they may be listed and deregister them under Section 12(b). This is accomplished under Exchange Act Rule 12d2-2. The issuer is entitled as of right to voluntarily delist its shares or ADSs at any time, and to deregister them under Section 12(b) of the Exchange Act by filing a Form 25 with the SEC pursuant to Rule 12d2-2(c).<sup>6</sup> The issuer must give notice of its intention to file the Form 25 and issue a press release announcing and explaining that intention ten days prior to filing the Form 25. The delisting from the NYSE, NASDAQ or other trading market will become effective ten (10) days after filing the Form 25. There is no requirement that the issuer be current on its SEC

reporting obligations to delist under Rule 12d2-2(c). The actual termination of registration under Section 12(b) of the Exchange Act does not occur until 90 days after effectiveness of the delisting. Such delisting (and deregistration under Section 12(b)), however, does not suspend the issuer's SEC reporting obligations under Sections 12(g) or 15(d) of the Exchange Act, and those obligations, including obligations to file Form 20-Fs and Form 6-Ks will continue until the issuer deregisters under those other Exchange Act sections. Once the delisting is completed, the issuer must deregister the shares under the Exchange Act under one of the methods referred to above, and only then will it have suspended or terminated the company's public reporting obligations under the Exchange Act.

### **Deregistration under Section 12(g) and Section 15(d)**

Once delisting and deregistration has been accomplished under Section 12(b), then registration and reporting obligations under Section 12(g) may be triggered. Non-U.S. issuers with U.S. listings or Exchange Act reporting obligations have two different regulatory schemes under which they can deregister and cease reporting under both Sections 12(g) and, if applicable, Section 15(d) of the Exchange Act. The first path to exiting the U.S. reporting system following a delisting is under Exchange Act Rules 12g-4 and 12h-3 which are applicable to both U.S. domestic and non-U.S. issuers. Under those rules, an issuer's ability to deregister depends on its having less than 300 holders of record of the relevant class of equity securities on a worldwide basis. In computing the number of record holders, issuers are permitted to use the counting method set forth in Rule 12g5-1 that does not look through the holdings of brokers, dealers, banks or other nominees to beneficial owners. As a result, a company may have many hundreds or even thousands of security holders and still have less than 300 holders of record for this purpose.

The second path to Exchange Act deregistration is available only to foreign private issuers and is provided by Rule 12h-6 which requires that the issuer have a primary trading market outside the U.S. that constitutes at least 55% of its trading in a recent 12-month period. In addition, the issuer must meet either a U.S. trading volume test (the issuer must have had less than 5% of its average worldwide daily trading volume in the U.S. over a recent 12-month period), or show that it has less than 300 holders of record (or less than 300 U.S. resident holders

of record) computed using a method of counting record holders resident in the U.S. that requires a modified look through of nominee holders to the underlying beneficial owners.

Which method of deregistration an eligible foreign issuer chooses will depend on its specific circumstances. A company will only rarely meet the criteria for both paths to deregistration. In some unusual cases, however, it could be advantageous for non-U.S. issuers which have suspended their U.S. reporting obligations under the first path to subsequently comply with Rule 12h-6 which affords a more permanent termination (as opposed to just a suspension) of Section 15(d) reporting obligations. Companies with substantial U.S. trading or that lack a primary non-U.S. trading market or which do not meet the definition of “foreign private issuer” are not eligible to use Rule 12h-6. And companies that cannot meet the 300 worldwide holders of record test computed under Rule 12g5-1 will be unable to use the older rules designed to allow companies to suspend or terminate their Exchange Act registration.

Both paths to deregistration are complex, technical and in some respects inconsistent and are described in detail below. For most large companies with widely held shares, Rule 12h-6 will be the path of choice. However, it is important to carefully consider the company’s precise situation and all of the facts and circumstances affecting the company before choosing a path to voluntary deregistration.

### **Definition of a Foreign Private Issuer**

Before choosing a path to deregistration, a non-U.S. issuer must first determine whether it qualifies as a “foreign private issuer” as only those companies are eligible to use Rule 12h-6. The term “foreign private issuer” is defined in Rule 3b-4 as any foreign issuer, other than a foreign government, *unless* it meets the following conditions as of the last business day of its most recently completed second fiscal quarter:

- (1) more than 50% of the issuer’s outstanding voting securities are directly or indirectly held of record by residents of the U.S.; and
- (2) any one of the following:
  - (a) the majority of the issuer’s executive officers or directors are U.S. citizens or residents;

- (b) more than 50% of the issuer's assets are located in the U.S.; or
- (c) the business of the issuer is administered principally in the U.S.

There can be many interpretive issues in determining whether an issuer qualifies under the criteria in clauses 2(b) and 2(c) above, including questions as to the valuation of the assets, the treatment of non-operating assets or the significance of cash in accounts at U.S. banks and the meaning of “administered principally” in the U.S. when applied to diverse fact situations.

### **Deregistration under the Exchange Act Sections 12(g) using Rule 12g-4 and Section 15(d) using Rule 12h-3**

Prior to the promulgation of Rule 12h-6, a foreign private issuer wanting to deregister would have had to use old Exchange Act Rule 12g-4 to deregister under Section 12(g) and Rule 12h-3 to deregister under Section 15(d) after delisting from any national securities exchange. Under the current versions of those rules which were amended when Rule 12h-6 was adopted,<sup>7</sup> an issuer will have to first consider terminating its Section 12(g) reporting requirements using Rule 12g-4, and then must determine whether it has reporting obligations under Section 15(d). If so, then the issuer would need to use Rule 12h-3 to suspend any reporting obligations the issuer may have under Section 15(d) as a result of having filed a registration statement under the Securities Act. Section 15(d) obligations cannot be terminated under Rule 12h-3, so an issuer that uses this rule will have to continually test that it has less than 300 record holders on a worldwide basis on the first day of each fiscal year subsequent to deregistration unless it takes advantage of the Rule 12g3-2 exemptions explained below.

Rule 12g-4 and Rule 12h-3 are the only deregistration rules currently available for U.S. issuers and equally available to non-U.S. issuers, whether or not they qualify under the definition of foreign private issuer and whether or not they are eligible for the Rule 12g3-2(b) exemption described below. Rule 12g-4 can be used if there are less than 300 holders of record on a worldwide basis<sup>8</sup> with the number of record holders being counted pursuant to Rule 12g5-1 which does not require a look through to beneficial owners.

The criteria to suspend Section 15(d) reporting obligations under Rule 12h-3 are similar to those under Rule 12g-4. However, under Rule 12h-3(c), a company may not suspend its Section 15(d) reporting obligations in any fiscal year where it has a registration statement

declared effective under the Securities Act or “that is required to be updated” pursuant to Section 10(a)(3) of the Securities Act. The SEC has granted no action relief for certain types of registration statements of domestic issuers in this regard. The SEC staff have issued no action letters to the effect that a company can deregister under Section 15(d) using Rule 12h-3 after the first day of its fiscal year if the company withdraws or files post-effective amendments terminating all effective registration statements requiring updates under Section 10(a)(3) (for a foreign private issuer this would be Form F-3 or F-10) before filing its Annual Report (on Form 20-F or 40-F). Once the Annual Report has been filed and incorporated by reference in such a registration statement, then the company would be required to make all mandated filings for that fiscal year, including the Form 20-F or 40-F due after the close of that fiscal year unless it will have no more public shareholders due to a merger or similar transaction or unless it obtains no action relief from the SEC. These issues have been eliminated for issuers deregistering under Rule 12h-6 which focuses on whether a registered public offering has been made in the 12 months prior to deregistration (rather than on the technical question of whether a registration statement has become effective or been updated under Section 10(a)(3) of the Securities Act).

Under Rules 12g-4 and 12h-3, it is possible for a company to be under the 300 holder threshold requirement for holders of record even though it has many hundreds or even thousands of U.S. beneficial owners of that class of securities. This is because, in counting record holders under Rule 12g-4 and Rule 12h-3, in general, under Rule 12g5-1, the issuer need only count the number of registered holders on its shareholder list, those specifically listed in Rule 12g5-1 and the number of participants in DTC (the principal U.S. securities depository) listed as holding the securities on the issuer’s DTC security position listing.<sup>9</sup> The logic of this approach is that Rule 12g5-1 provides the same method of counting the number of record holders used for determining whether registration is required in the first place under Section 12(g).

By contrast, Rule 12h-6 has a different and far more onerous method of calculating the 300 record holder threshold for foreign private issuers which requires that the issuer make a limited look through of brokers, dealers, banks and other nominee holders in the U.S., its home country and the country of its primary trading market, to the ultimate beneficial owners. The

scope of this inquiry is explained below under “*Deregistration of a Foreign Private Issuer under Rule 12h-6*”.<sup>10</sup>

Once an issuer has determined that it meets the requirements of Rule 12g-4 and wishes to use that rule to terminate its Section 12(g) reporting obligations, the issuer would have to file a Form 15 certifying the foregoing. The issuer’s reporting obligations under Section 12(g) are suspended immediately upon filing the Form 15, and (unless the SEC seeks to challenge the certification) termination of registration under Section 12(g) takes effect 90 days after filing the Form 15 or on an earlier date determined by the SEC. The SEC has the authority to deny such a request for termination, but has rarely done so. The SEC will almost never accelerate the 90-day period.

Furthermore, an issuer may suspend, but not terminate, its reporting obligations under Section 15(d) with respect to a class of securities that was registered, but is held by fewer than 300 record holders as of the beginning of the fiscal year (computed under Rule 12g5-1 without a look through). To rely on the automatic statutory exemption in Section 15(d), Rule 15d-6 requires that the issuer notify the SEC of such suspension within 30 days of its fiscal year end on a Form 15. Alternatively, if the issuer has fewer than 300 security holders at any time (*i.e.*, not just on the first day of its fiscal year), the issuer may rely on Rule 12h-3. That Rule provides that an issuer may suspend its Section 15(d) reporting obligation with respect to a class of securities at any time that such securities are held by fewer than 300 record holders (again as computed under Rule 12g5-1).

In order to be eligible to use Rule 12h-3, an issuer must certify that it has made all of the required filings for the most recent three fiscal years and the portion of the current year preceding reliance on the rule. In addition, the company must have a good faith belief that it has under 300 shareholders of record when it files its Form 15. The Form 15 required under both Rule 12g-4 and Rule 12h-3 can be and almost always is filed at the same time on the same filing. Please note that because of the timing of notice, filing and effectiveness of Form 25 described above, a listed company cannot file a Form 15 until a minimum of 20 days after it announces its intention to delist. If the company’s shareholders of record change during that period so that the company has more than 300 record holders due to broker distributions or “kick-outs” of shares to

beneficial owners, due to ordinary trading or because of the intentional actions of the company's shareholders, the company may not be able to file the Form 15 and may find itself trapped as a U.S. reporting company.

Although Rule 12g-4 allows the termination, rather than the suspension of an issuer's Section 12(g) reporting obligations, in the event that the number of record holders worldwide again rises above the 500 record holder threshold under Section 12(g) or the 300 record holder threshold under Section 15(d), a foreign private issuer would need to re-register its shares under Section 12(g).<sup>11</sup> To avoid this result the issuer can take advantage of the information supplying exemption provided by Rule 12g3-2(b), or the less than 300 U.S. beneficial owner exemption in Rule 12g3-2(a) (each of which are described below), to avoid having to reregister even if it crosses these thresholds. The Section 15(d) threshold obviously is the one most likely to be applicable since it is triggered at 300 record holders on the first day of any fiscal year. Thus if the number of record holders of the class of equity securities with respect to which Section 15(d) reporting obligations have been suspended subsequently exceeds the 300 record holder threshold at the beginning of any fiscal year, the issuer's reporting obligations are automatically reactivated.<sup>12</sup> However, since this is only an annual calculation it gives issuers time to take steps in the interim to reduce the number of holders (such as a reverse split, merger, stock repurchase program or tender offer to avoid exceeding the threshold), or, if eligible, to take advantage of either the Rule 12g3-2(a) or Rule 12g3-2(b) exemptions described below.

Issuers should be aware that certain company Exchange Act obligations continue for an additional 90 days after filing a Form 15 (or Form 15F) until effectiveness of the deregistration, including obligations to file certain tender offer statements. What obligations the issuer is subject to during this period depends on whether it was registered under Section 12(g) or Section 15(d). As a result, if a Regulation 14D tender offer is conducted during this 90-day waiting period, third parties may still be subject to the rules and disclosure obligations governing tender offers if the issuer is registered under Section 12(g). In addition, shareholders continue to be required to file Schedule 13Ds and Schedule 13Gs until expiration of the 90-day period following filing of the Form 15 or Form 15F if those requirements were in effect prior to such filing because the issuer was subject to Section 12(g). Issuers registered only pursuant to Section 15(d) would not be subject to these requirements. Issuers that did not qualify as foreign

private issuers when they deregistered would also continue to be subject to the proxy rules and Section 16 reporting, as applicable, for the 90-day period prior to effectiveness of the Form 15 if they were subject to those rules prior to filing the Form 15.

### **Deregistration of a Foreign Private Issuer under Rule 12h-6**

Rule 12h-6 is available only to foreign private issuers. It is available neither to foreign governments nor to U.S. domestic companies. Rule 12h-6 is particularly advantageous for foreign private issuers in that it provides an alternative quantitative benchmark for measuring relative U.S. market interest for the issuer's securities based on the U.S. trading volume of such securities. While previously, the 300 record holder test was the only such measure, Rule 12h-6 includes a test for terminating registration under Sections 12(g) and 15(d) if a foreign private issuer's U.S. average daily trading volume is less than 5% of its worldwide average daily trading volume. The Rule also provides an alternative 300 record holder test with a look through provision that is easier to administer than the look through provision under Rule 12g3-2(a). Furthermore, it allows termination rather than just suspension of Section 15(d) reporting obligations.

Foreign private issuers wishing to use Rule 12h-6 to deregister must meet the following basic criteria:

*First – All required SEC filings must have been made:* An issuer must have had reporting obligations under Section 13(a) or 15(d) of the Exchange Act, and must have made all required filings for 12 months prior to the deregistration including its Form 20-F for the prior fiscal year ended if due prior thereto.

*Second – No registered offerings in the last 12 months:* The issuer must not have sold any securities in the U.S. in a registered offering during the 12 months prior to the deregistration filing other than (i) to its employees; (ii) through sales by security holders in non-underwritten offerings; (iii) upon the exercise of pro rata rights; (iv) under a dividend reinvestment plan; or (v) on conversion of convertible securities or exercise of warrants. This formulation resolves many of the issues surrounding use of Rule 12h-3(c) which is not available to issuers that have

had a registration statement (such as a Form S-3, F-3 or F-10) recently updated pursuant to Section 10(a)(3) of the Securities Act by filing of an Annual Report.

*Third – Non-U.S. primary trading market:* The issuer must have maintained a non-U.S. listing that constituted at least 55 percent of the trading (based on the number of underlying equity shares) during a recent 12-month period ending no more than 60 days before the deregistration form (Form 15F) is filed with the SEC.

*Fourth – Deregistration criteria of either less than 5% ADTV or less than 300 (US or worldwide) record holders:* A foreign private issuer meeting these three basic requirements may use Rule 12h-6 if it meets either of the following tests, which are explained in further detail below:

- (1) *5% U.S. average daily trading volume test (“ADTV”):* The average daily trading volume of the issuer’s shares in the United States for a recent 12-month period ending within 60 days of filing the required Form 15F must be no more than 5% of the ADTV in the issuer’s equity shares on a worldwide basis for the same period;
- (2) *300 record holders tests:* Within 120 days prior to the date on which the issuer files a Form 5F, the class of securities that is the subject of the filing is held of record by (i) less than 300 holders of record on a worldwide basis, or (ii) less than 300 holders of record resident in the United States;

*Calculation of 5% U.S. trading volume test:* When calculating U.S. trading volume, an issuer must take into account all trading of the subject class of securities, including off exchange transactions, trading in the Pink Sheets and OTC Bulletin Board markets. When calculating worldwide trading volume, an issuer is permitted to include off-exchange transactions from sources that are reasonably reliable and not duplicative of other trading volume information, including those transactions that may occur through alternative trading systems. Sources of information for off-exchange transactions may include market vendors, commercial service providers and publicly available sources of market information; or

*Record holders test under Rule 12h-6:* In counting record holders under Rule 12h-6 (as opposed to Rule 12g-4), the issuer must make an inquiry to nominees to look through to the number of holders of securities held by U.S. residents in the accounts of brokers, dealers, banks

and other nominees, except that the inquiry can be limited to brokers, dealers, banks and other nominees located in the U.S., in the issuers' jurisdiction of organization and in its primary trading market. The issuer must count as U.S. residents securities indicated in publicly filed reports as being owned by U.S. persons or where other reliable information provided to it indicates that the securities are held by U.S. residents. Good faith reliance on information service providers in the business of assisting issuers with counting security holders is permitted. If notwithstanding a reasonable inquiry, the issuer is unable to determine U.S. holdings for certain accounts, the issuer can assume the customers are residents of the country where the nominee has its principal place of business.

*Fifth – Twelve-month waiting period:* Finally, if the issuer has delisted from a U.S. exchange or terminated a sponsored ADR facility, and if in either case it did not meet the U.S. average daily trading volume condition at such time, then at least 12 months must have passed since such delisting or sponsored ADR facility termination before the company can deregister under Rule 12h-6 in reliance on the 5% ADTV test. It should be noted that this waiting period does not apply if the deregistration under Rule 12h-6 is based on the issuer having less than 300 record holders. However, a company that is prevented from deregistering under Rule 12h-6 because of the 12-month waiting period, can nevertheless proceed to deregister under Rules 12g-4 and 12h-3 during the waiting period if the company has less than 300 record holders worldwide and then immediately take advantage of the Rule 12g3-2(b) information supplying exemption. Those rules (unlike Rule 12h-6) do not require any look through to U.S. beneficial owners and therefore an issuer may be eligible to use Rule 12g-4 even though it was not eligible to use Rule 12h-6's less than 300 record holder criteria. Once the 12-month waiting period has passed, the issuer may be able to file a Form 15F and permanently terminate its Section 15(d) obligations which could have an advantage if the issuer is not able to benefit from the Rule 12g3-2 exemptions. Note that the procedure is expressly provided for in the Rule only for issuers that deregistered prior to adoption of Rule 12h-6. That procedure still requires that the 5% ADTV test (if used) be met for a 12-month period but eliminates the 12-month waiting period if at the time of delisting, or sponsored ADR facility termination, the ADTV test was not met.<sup>13</sup> Issuers that deregister under Rule 12g-4 and 12h-3 subsequent to the adoption of Rule 12h-6 would not have the benefit of this special provision and therefore presumably would

still be subject to the 12-month waiting period if they delisted when they did not meet the ADTV test.

### **Procedure and Timeline**

*Filing requirement:* In order to deregister under Rule 12h-6, a foreign private issuer must file a Form 15F certifying that it meets the above requirements to suspend reporting requirements under Rule 12h-6, as listed above. An issuer's reporting obligations are immediately suspended upon the filing of the Form 15F. A 90-day waiting period follows, after which, if the SEC has not objected, the Form 15F becomes effective and the issuer's reporting obligations are permanently terminated. As noted above under the discussion of Rule 12g-4 and 12h-3, during this 90-day period, the issuer may be subject to certain tender offer and other rules which it was subject to prior to filing the Form 15F.

*Notice of termination requirement:* Either before or at the time the Form 15 is filed, the issuer must provide public notice of its intent to deregister. The notice must be published through a means "designed to provide broad dissemination of the information to the public in the United States," such as a press release. The issuer is also required to submit a copy of such notice to the SEC, either as a Form 6-K filing, or as an exhibit to the Form 15F when it is filed.

If the SEC denies the Form 15F or the issuer withdraws it, the issuer is required to file or submit all reports that would have been required had the Form 15F not been within 60 days of the date of the denial or withdrawal.

### **U.S. Pink Sheets**

After delisting and continuing after deregistration, the company's shares or ADSs often continue trading in the U.S. in the over-the-counter market in the Pink Sheets. This trading does not subject the company to any Exchange Act reporting requirements. If securities that are delisted from the NYSE or NASDAQ are already quoted in the Pink Sheets, any market maker that had been quoting the security for the 30 days prior to delisting could continue to make a market in the Pink Sheets after delisting. The security would then become "piggy-back qualified" the same day it is delisted, which means that any other market maker can then enter its quotes in the Pink Sheets without going through the usual procedures for initiating a quote. If a

“piggy-back qualification” is not available, then the company can choose whether to undertake the fairly simple process of initiating a quote on the Pink Sheets. Once delisted from an Exchange, the Company will typically get a new Pink Sheets trading symbol.

Because Pink Sheets companies need not be subject to SEC reporting requirements, the level of information available about them varies greatly. There are several different market tiers to denote the level of information that is available about each Pink Sheets company. Despite an issuer’s best intentions, it is not always possible to prevent trading in the Pink Sheets. However, most foreign private issuers with non-U.S. primary trading markets will not make any effort to facilitate Pink Sheets trading following delisting and deregistration under the Exchange Act.

### **ADR Programs**

Listed companies with outstanding ADRs will generally want to terminate their sponsored ADR programs in connection with delisting and deregistering under the Exchange Act.<sup>14</sup> Termination of an ADR program is governed by the deposit agreement itself rather than any SEC rules and such programs can typically be terminated on 30 days’ notice to the depository bank. However, companies can choose to continue level one sponsored (or unsponsored) ADR programs without triggering Exchange Act reporting, provided that the issuer complies with the Rule 12g3-2(b) information supplying exemption. Such ADR programs can trade in the over-the-counter market (*i.e.*, in the Pink Sheets) but not on the OTC Bulletin Board or any national securities exchange.

### **Rule 12g3-2(a) – Exemption from Registration**

Rule 12g3-2(a) provides a separate exemption from Exchange Act registration under Section 12(g) exclusively for foreign private issuers that would otherwise be required to register under Section 12(g) because they have more than 500 holders of record, provided that each class of the foreign private issuer’s equity securities are held by less than 300 U.S. residents. Rule 12g3-2(a) is an exemption for companies that are not yet registered under Section 12(g). It is not a method of deregistering under the Exchange Act and a Form 15 or Form 15F cannot be filed solely on the basis of compliance with Rule 12g3-2(a). Companies utilizing the exemption from registration provided by Rule 12g3-2(a) should monitor their compliance with that rule and should consider the need or desirability of complying with the Rule 12g3-2(b) information

publication exemption described below in order to indefinitely maintain their exemption from registration.

Rule 12g3-2(a) requires that an issuer count any securities held by a broker, dealer, bank or nominee for the accounts on U.S. residents. The issuer can rely on the nominee holders as to the number of such separate accounts.

As a result, an issuer with less than 300 U.S. resident holders (computed using the look through in 12g3-2(a)) will be exempt from registration even though it has more than 500 record holders worldwide (computed without the look through pursuant to Rule 12g5-1).

### **Rule 12g3-2(b) – Information Publication Exemption**

Rule 12g3-2(b) provides a self-executing exemption from SEC reporting for foreign private issuers that have a primary foreign listing and that publish material information they make public in their home country. Issuers deregistering under Rule 12g-4 or Rule 12h-6 may immediately claim the Rule 12g3-2(b) exemption upon the effectiveness of their Form 15 or Form 15F. Among other things, the exemption provided by Rule 12g3-2(b) effectively allows a foreign private issuer to have its equity securities traded on a limited basis in the U.S. over-the-counter markets, such as a so-called level one ADR program,<sup>13</sup> even though the issuer has not registered and is not reporting under the Exchange Act.

Compliance with the Rule 12g3-2(b) exemption also is also designed to make available sufficient public information so that a broker-dealer can quote the securities under Rule 15c2-11 and so that the securities will be deemed eligible for resale under Rule 144A.<sup>15</sup>

The Rule 12g3-2(b) exemption is self-executing and requires that the issuer make public specified home country disclosure documents on its website in English or through a public electronic delivery system. The Rule requires that:

- (1) the issuer maintain a foreign listing in its primary trading market such that 55% of the issuer's trading is in that market (in certain instances two foreign markets can be aggregated so long as the trading in at least one of those two markets is larger than the trading in the U.S.);
- (2) (a) the issuer publish any information that it has:

- (i) made public or been required to make public pursuant to the laws of its home country;
  - (ii) filed or been required to file with, and made publicly available by, the principal stock exchange in its primary trading market; and
  - (iii) distributed or is required to distribute to its security holders.
- (b) Only material information is required to be published, but at a minimum the issuer must publish:
- (i) its annual report;
  - (ii) interim reports that include financial statements;
  - (iii) press releases; and
  - (iv) communications and documents distributed to security holders.

In some cases, an English summary may be submitted rather than a full translation.

- (3) the issuer must not have an existing Exchange Act reporting obligation; and
- (4) the issuer, to maintain the exemption, must keep publishing in compliance with the rule, must maintain its foreign listing and must not become subject to Exchange Act reporting obligations.

The Rule is not available to Canadian MJDS issuers that have filed an effective MJDS registration statement. However, a Canadian issuer can claim the exemption if it has exited from the U.S. reporting system as described in this Memorandum.

**Alternatives if the Issuer Cannot Meet the Tests for Deregistration in Rules 12g-4 and 12h-3 or 12h-6.**

If an issuer cannot meet any of the criteria for deregistration and is unable to take advantage of the exemption provided by Rule 12g3-2(a) or (b), its options are somewhat limited and can involve complex and intrusive disclosure requirements. A reverse stock split, tender offer or open market purchases by the issuer or any affiliate designed to reduce the number of shareholders (or U.S. resident shareholders) of record or to reduce U.S. trading volume below the benchmark for deregistration in Rule 12h-6 would most likely trigger the extensive going private

requirements for filing and disclosure mandated by Exchange Act Rule 13e-3 and Schedule 13E-3. Rule 13e-3 is intended to give security holders one last chance to get detailed information about an issuer before it deregisters under the Exchange Act and take action in connection therewith. Rule 13e-3 requires, among many other things, extensive disclosures regarding the fairness of the transaction and the alternatives considered, and requires the issuer and any other participant in the Rule 13e-3 transaction to take a public position on the fairness of the transaction. It is expensive and time consuming to make a Schedule 13e-3 filing and such filings are almost always reviewed by the SEC. However, for an issuer determined to escape the U.S. reporting regime, the burdens of a Rule 13e-3 filing may be well worth the effort and expense.

## Conclusion

The considerations for the Board of Directors of a foreign private issuer in making the decision to deregister a class of its securities are complex and require careful consideration. Because the methods of deregistering can be quite technical, it is important to have an experienced adviser help with the process. The Board's duties in connection with any such decision would be matters of the laws of the issuer's home jurisdiction.

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*Dorsey Associate Rebecca Chung contributed valuable research and assistance in connection with this article.*

<sup>1</sup> For example, Tumi Resources Limited, a Canadian company that deregistered under Rule 12h-6 in May 2009, stated in its 6-K announcing the decision to deregister that “in deciding to terminate the registration of its common shares under the Exchange Act, Tumi found that the preparation time and costs associated with preparing U.S. filings and meeting SEC regulatory requirements was substantial and [Tumi's] management believed that these administrative burdens and their associated costs outweighed the benefits derived from [Tumi's] registration with the SEC.” Tag Oil Ltd., in deciding to deregister, considered that “the TSX Venture Exchange has been the Company's primary trading market since 2005 and has accounted for 98% of trading volumes over the past year. Further, administrative burdens and costs associated with being a U.S. reporting company have significantly increased in the past few years and will continue to increase in coming years, particularly in light of SEC Sarbanes–Oxley requirements. The Company believes that these administrative burdens and their associated costs outweigh the benefits derived from the Company's registration with the SEC.” Big foreign firms bid adieu to U.S. markets, <http://www.usatoday.com/money/markets>.

<sup>2</sup> Deregistrations by non-U.S. issuers were relatively rare events prior to Rule 12h-6. Doidge, Craig G., Andrew Karolyi, and René M. Stulz, (2008), “*Why do foreign firms leave U.S. equity markets? An analysis of deregistrations under SEC Exchange Act Rule 12h-6*”. However, in the approximately 18-month period between its effective date and December 31, 2008, 200 firms filed for termination of registration under Rule 12h-6. Fernandes,

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Nuno, Ugur Lel, and Darius P. Miller, (2008), “*Escape from New York: The market impact of SEC Rule 12h-6*,” International Finance Discussion Papers, Number 945, Board of Governors of the Federal Reserve System. Through September 30, 2009, 22 additional firms deregistered under Rule 12h-6. Mitsui Sumitomo Insurance Group Holding, Inc., a large Japanese issuer, filed a Form 15F to terminate its reporting obligations on April 1, 2009.

<sup>3</sup> Rule 12h-6, which became effective on June 4, 2007, eased conditions for qualifying foreign private issuers to terminate their Exchange Act reporting obligations. Prior to Rule 12h-6, the methods available for deregistration made it difficult, if not impossible for foreign firms cross-listed on a U.S. exchange to terminate their U.S. reporting obligations, once they became subject to them. Companies referred to the U.S. reporting system as a “roach motel” or “venus flytrap” – reflecting difficulties of discontinuing the expensive and time-consuming obligations associated with U.S. disclosure and reporting requirements. *Karolyi and Stulz, supra*. One study found that excluding deregistrations as a result of a corporate event such as a merger or acquisition, or subsequent to an involuntary delisting, terminations of debt registrations, issuers that had previously suspended their reporting obligations under the old deregistration rules, and other issuers that were determined unlikely to have been influenced by the adoption of Rule 12h-6 in their decision to deregister, approximately 73 of the 200 deregistrations through December 31, 2008 were the result of voluntary deregistration procedures undertaken by the issuer following the adoption of Rule 12h-6. *Escape from New York, supra*.

<sup>4</sup> Section 12 registration is also required for an issuer with shares listed on the OTC Bulletin Board.

<sup>5</sup> The issuer must also be making use of the facilities of interstate commerce which provides the jurisdictional nexus with the U.S. It is important to note that foreign private issuers with less than 300 U.S. resident beneficial owners will be exempt under Rule 12g3-2(a) even if they meet the 500 worldwide record holders trigger.

<sup>6</sup> There is also an Exchange initiated delisting procedure under Rule 12d2-2(b). Issuers being delisted due to failure to meet Exchange requirements or due to a merger or acquisition can use this procedure. Rule 12g-3 sets forth a successor company’s reporting obligations in connection with a merger with or acquisition involving an Exchange Act reporting company. In general under Rule 12g-3, an acquiring company issuing securities to a target’s shareholders will inherit any reporting obligations of the target company unless each class of equity securities of the survivor is held by less than 300 persons or is otherwise exempt.

<sup>7</sup> The amendment removed the test previously relied on by foreign private issuers based on having less than 300 U.S. resident holders of record. This criteria for deregistration was carried forward in Rule 12h-6 in a different Form.

<sup>8</sup> Alternatively, less than 500 holders of record if the issuer’s assets are less than \$10 million.

<sup>9</sup> Institutional custodians, such as Cede & Co. and other commercial depositories, are not single holders of record for purposes of the Exchange Act’s registration and periodic reporting provisions. Instead, each of the depository’s accounts for which the securities are held is a single record holder. However, under Rule 12g5-1 there is no need to look beyond the DTC participants in Cede & Co. Rule 12g5-1 requires that the following be counted as holders of record: (i) any holder that would have been counted if the issuer had maintained its records in accordance with accepted practice and did not do so, (ii) securities held by an entity such as a corporation, partnership or trust or held by trustees, executors, guardians or co-owners are deemed held by only one person, (iii) bearer securities are each deemed held by a separate person unless the issuer establishes otherwise, (iv) securities registered in similar names which appear and are believed to be held by the same person are treated as held by only one person, (v) securities held by a voting trust or deposit arrangement are deemed held of record by the record holder of the interests in the voting trust or deposit arrangement (this is why issuers must count the DTC participant holders of securities held by Cede & Co.), or (vi) if the issuer knows or has reason to know that the holding is “used primarily to circumvent” Exchange Act registration, then each beneficial owner is counted as a record holder.

<sup>10</sup> This distinction between the different counting methods can be confusing. There are three different counting methods: (i) Rule 12g5-1 (no look through), (ii) Rule 12g3-2(a) (full look through), and (iii) Rule 12h-6 (limited look through of nominees in the U.S. and the issuer’s home country and the jurisdiction of its primary trading market).

<sup>11</sup> For example, brokers and other institutions holding shares in street name can elect to cease holding the shares in that capacity, and cause the transfer agent to record the shares directly in the name of the persons for whom they hold the securities. It is not clear to what extent, if at all, brokers would be likely to kick out shares especially for

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issuers that continue to maintain a primary foreign listing. In any event, in such a case, each beneficial owner will become a record holder, and the stockholder count may exceed the limits. To avoid having to reregister, companies which have deregistered and which are not able to use the Rule 12g3-2(b) exemption (*e.g.*, because of the lack of a primary foreign listing) should carefully monitor the number of record holders they have during the year, and take steps (such as a reverse stock split or stock repurchase or tender) to ensure that they continue to have less than 500 or 300 record holders before the applicable test dates under Sections 12(g) and 15(d).

<sup>12</sup> Rule 12h-3(e)

<sup>13</sup> The Rule provides that companies that deregistered under Rule 12g-4 and/or Rule 12h-3 prior to the June 2007 adoption of Rule 12h-6 can use Rule 12h-6 to permanently terminate their Section 15(d) reporting obligations provided that they are in compliance with all the other requirements of Rule 12h-6. See Rule 12h-6(i). This provision is now of diminishing importance as Rule 12h-6 has now been in effect for some time. However, there appears no reason why issuers that have subsequently deregistered under Rule 12g-4 and 12h-3 cannot use it, provided they meet all of the requirements of Rule 12h-6.

<sup>14</sup> An ADR or American Depositary Receipt is a receipt issued by a Depositary Bank. The ADR represents a specified amount of a foreign security that has been deposited with an overseas branch or agency of the Depositary. The ADR is traded while the underlying securities remain immobilized at the Depositary. Holders of ADRs can generally cancel their ADRs and withdraw the underlying securities at any time. An “unsponsored” ADR program may be set up by a Depositary bank without the company’s participation or even its consent. A sponsored ADR facility, on the other hand, is established jointly by an issuer and a Depositary bank. In a sponsored program, the issuer becomes a party to the Deposit Agreement and also signs the Form F-6 registration statement filed with the SEC to register the ADRs. In an unsponsored program, the issuer is neither a party to the Deposit Agreement, nor does it sign the Form F-6 Registration Statement.

<sup>15</sup> Rule 15c2-11(a)(4) and Rule 144A(d)(4).

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