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Client Alert

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SEC PROPOSES AMENDMENTS TO RULE 12g3-2(b)

On February 19, 2008, the United States Securities and Exchange Commission published the first of two sets of proposed amendments that are intended to modernize disclosure requirements for foreign companies. The published proposals are aimed at enhancing the ability of foreign private issuers to qualify for the Rule 12g3-2(b) exemption, which exempts foreign private issuers from the reporting requirements of the Securities Exchange Act of 1934, but for the first time would impose a U.S. trading volume limit that could require previously exempt companies to register.

Rule 12g3-2(b) provides for an exemption that allows a foreign private issuer to exceed the registration thresholds of Section 12(g), which hinge on the number of U.S. holders of the issuer's securities. Among other things, this exemption effectively allows a foreign private issuer to have its equity securities traded on a limited basis in the over-the-counter-markets in the United States. Currently, in order to obtain the exemption under Exchange Act Rule 12g3-2(b), a non-reporting foreign issuer must submit to the SEC written materials in paper, including a list of information that the issuer must disclose

publicly pursuant to its home jurisdiction laws or stock exchange requirements, or that is sent to its security holders, along with paper copies of documents containing the required information that the issuer has published for its last fiscal year. A successful applicant may maintain the exemption by submitting to the SEC paper copies of these documents on an ongoing basis.

The proposed amendments would eliminate paper submission requirements and effectively provide for an automatic exemption from SEC registration for foreign private issuers that do not list or publicly offer securities in the United States. To claim the exemption, a foreign private issuer must be a non-reporting company under the Exchange Act, must maintain a foreign listing, must meet a quantitative standard tied to trading volume and must electronically publish certain non-U.S. disclosure documents, all as summarized below.

Non-Reporting Condition. The issuer must not otherwise have any Exchange Act reporting obligations under Section 13(a) or 15(d) of the Exchange Act. Under the proposals, a foreign private issuer (including a foreign private issuer that has succeeded to the Exchange Act

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reporting obligations of another issuer) that meets the proposed requirements absent the electronic publication condition for the most recent fiscal year could also automatically claim the Rule 12g3-2(b) exemption upon the effectiveness of or following its recent Exchange Act deregistration under Rule 12g-4, 12h-3 or 12h-6 or upon the suspension of its reporting obligations under Section 15(d), without having to look back over the previous 18 months to determine whether it had Exchange Act reporting obligations during such period.

Foreign Listing Condition. The issuer must maintain a listing of the subject class of securities on one or more exchanges in a foreign jurisdiction that, either singly or together with the trading of the same class of the issuer's securities in one other foreign jurisdiction, comprises the primary trading market for those securities. Such listing need not have been maintained for any specified period of time, which means that newly listed securities may qualify for the exemption. The proposals define "primary trading market" to mean that at least 55% of the trading in such securities must take place in a single foreign jurisdiction or in no more than two foreign jurisdictions in the issuer's most recent fiscal year; when aggregating trading volumes in two jurisdictions for these purposes, the trading volume for the securities in at least one of the jurisdictions must be larger than the trading volume for the same class of securities in the United States.

Quantitative Standard. The issuer must either:

- not have an average U.S. daily trading volume in the subject class of securities in excess of 20% of the average worldwide daily trading volume for such securities in its most recent fiscal year; or
- have terminated its registration of a class of securities under Section 12(g) of the Securities Act of 1933 or terminated its obligation to file or furnish reports under Section 15(d) of the Exchange Act pursuant to Rule 12h-6, which requires that U.S.

average trading volume in the subject securities in the issuer's most recent fiscal year be no greater than 5% of the average worldwide daily trading volume for such securities or that the issuer's worldwide or U.S. holders be less than 300.

Electronic Publishing of Non-U.S. Disclosure Documents. The issuer must publish in English, on its website or through an electronic information delivery system generally available to the public in its primary trading market, information that, from the first day of its most recent fiscal year, it:

- has made public or been required to make public pursuant to the laws of the country of its incorporation, organization or domicile;
- has filed or been required to file with the principal stock exchange in its primary trading market on which its securities are traded and which has been made public by that exchange; and
- has distributed or been required to distribute to its security holders.

These are the same categories of information that the SEC has historically required a non-reporting company to submit when applying for the Rule 12g3-2(b) exemption. As is required under the current rule, only information that is material to an investment decision regarding the subject securities need be published, and English translations must be provided for at least the following documents: annual reports, interim reports that include financial statements, press releases and any other communications and documents sent directly to security holders.

All foreign issuers that meet the above requirements would be immediately exempt from Exchange Act registration under Rule 12g3-2(b) without having to apply to or otherwise notify the SEC. Moreover, the proposals would no longer require that an issuer claim the Rule 12g3-2(b)

exemption within the statutory 120-day period for filing a Section 12(g) registration statement after having exceeded the 300 shareholder threshold set forth in Section 12(g). Under the proposed rules, foreign issuers could also immediately claim the exemption upon deregistration if they meet the above requirements other than the electronic publication requirement for the last fiscal year since those documents would presumably be available on EDGAR.

To maintain the exemption, the proposal would require that the non-U.S. disclosures specified above be made on an ongoing basis electronically, that the foreign listing be maintained, that the trading volume thresholds continue to be met and that the issuer not otherwise incur any Exchange Act reporting obligations. An issuer that continues to make Rule 12g3-2(b) submissions in paper after a proposed three-month transition period, and does not publish such documents electronically as required, would no longer be able to claim the exemption.

The SEC has stated that allowing foreign private issuers to claim the Rule 12g3-2(b) exemption automatically and without regard to the number of U.S. shareholders should encourage more foreign private issuers to claim the exemption, which would in turn facilitate the establishment of more ADR facilities, the resale of a foreign private issuer's securities in the United States pursuant to Rule 144A under the Securities Act and the ability of broker-dealers to fulfill their obligations pursuant to Rule 15c2-11 under the Exchange Act with regard to the equity securities of non-reporting foreign private issuers.

However, the proposals also pose several potential drawbacks for foreign private issuers. In particular, the SEC has solicited comment on whether a transition period or "grandfather" provision should be provided to companies that would otherwise lose the exemption upon the effectiveness of the proposed amendments because their U.S. trading volume exceeds the proposed threshold and the number of their U.S. holders is 300 or greater. The SEC is currently contemplating a three-year transition period to

accommodate issuers that are currently exempt under the rule but may not be under the rule as amended. Absent a grandfathering provision, the proposals effectively could cause a foreign private issuer that does not fit within the trading volume exception to become an SEC reporting company.

The continuous nature of the trading volume requirement may prove to be of great concern to a number of foreign private issuers. Issuers of equity securities sold in Rule 144A and other exempt offerings could become subject to SEC reporting requirements if their U.S. trading volumes exceed 20% without having taken any other steps to access the U.S. public markets. Foreign private issuers selling their equity securities entirely outside the United States or pursuant to Regulation S could also potentially trigger the 20% U.S. trading volume test. We expect the SEC will receive substantial comments on this issue.

The SEC has also solicited comment on whether a foreign private issuer should, as is currently proposed, be required to maintain a listing in its primary trading market to claim the Rule 12g3-2(b) exemption, even if it meets the other requirements, including a U.S. trading volume of less than 20% of its worldwide trading volume. If such a requirement is included in the final proposals, foreign companies that are not listed in their home and other jurisdictions could potentially be required to become SEC reporting companies even though such issuers might have been prepared to furnish the required information to the SEC under current rules.

The SEC's proposals are currently open to comment and may change substantially before they are adopted in final form. Comments on the proposals must be received on or before April 25, 2008.

The proposals can be viewed at <http://www.sec.gov/rules/proposed/2008/34-57350.pdf>.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Global Securities Group, whose names and contact information are provided below.

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