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FOREIGN PRIVATE ISSUERS: STATUS AND EXCHANGE ACT REGISTRATION

Issuers organized outside the U.S. that pass certain shareholder and business contacts tests are "foreign private issuers" that benefit from significant accommodations under SEC rules. The author discusses their qualification as such, the exemptions from Exchange Act registration, and the process for deregistration.

By Guy P. Lander *

Frequently, client questions focus on how to qualify as a foreign private issuer or lose the status, what triggers registration and reporting as a public company with the Securities and Exchange Commission, and how one can get out of that system once in it. This article addresses these fundamental questions for foreign private issuers.

FOREIGN PRIVATE ISSUER STATUS

Benefits of Status

The SEC and its foreign integrated disclosure systems make important accommodations for foreign private issuers. Foreign private issuers receive the following accommodations that are not available to U.S. issuers.

(a) Accommodations under the Securities Act of 1933:

(i) confidential submission of registration statement to the SEC for first-time, registrants that are listed in their home country;

(ii) ability to use U.S. Generally Accepted Accounting Principles ("GAAP"), International Financial Reporting Standards ("IFRS"), or local GAAP (reconciled to U.S. GAAP);

(iii) ability to resell Regulation S equity securities without Rule 905 (*i.e.*, Regulation D type) resale restrictions; and

(iv) exemptions from registration for certain cross-border rights offers, exchange offers, and business combinations.

(b) Accommodations under the Securities Exchange Act of 1934:

(i) filing of annual reports on Form 20-F rather than on Form 10-K:

(A) later filing deadlines;

(B) less demanding executive compensation disclosure;.

(C) home country GAAP reconciled to U.S. GAAP or IFRS;

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(D) less extensive disclosure for related parties; and

(E) more lax filing requirements for employment or compensation plans with management or directors as exhibits;

(ii) company's choice of reporting currency in presenting its financial statements;[1]

(iii) no Form 10-Q quarterly reporting or Form 8-K current reporting obligations, instead Form 6-K, which is a "wrapper" or cover page for home country disclosure;

(iv) no Section 16 shareholder reporting or liability for short-swing profits;[2]

(v) no Section 14 proxy and information statement requirements;[3]

(vi) audit committee independence accommodations for certain foreign private issuers unable to fully comply with the independence requirement in Rule 10A-3 under the Exchange Act;

(vii) deregistration under the Exchange Act is available; and

(viii) exemptions available under cross-border tender offer rules.

What is a Foreign Private Issuer

A foreign private issuer is eligible for the benefits listed. However, a company formed and organized outside the United States may have enough shareholders resident in the United States and enough business contacts with the United States to be treated as a U.S. issuer subject to the same regulation as other U.S. issuers. The foreign private issuer test has two parts, both of which must be failed for a company to lose its status as a foreign private issuer.

A foreign private issuer is an issuer formed or organized outside of the U.S. (other than a foreign government and its political subdivisions) that either:

Shareholder Test: has 50% or less of its outstanding voting securities held of record by U.S. residents or

Shareholder and Business Contacts Test: has more than 50% of its outstanding voting securities held of record by U.S. residents but does *not* have any *one* of the following: (a) majority of its executive officers or directors are U. S. citizens or residents, (b) more than 50% of its assets are located in the U.S., or (c) its business is principally administered in the U. S.[4]

When Foreign Private Issuer Status is Determined

The basic determination of whether an issuer meets the test for foreign private issuer status occurs on the last day of the issuer's second fiscal quarter (typically June 30).

If a foreign issuer loses its status as a foreign private issuer on the last business day of its second fiscal quarter, then it must report and use the forms and rules applicable to a U.S. company on the first day of the fiscal year following the determination date (typically January 1 of the following year). This rule gives the issuer six months advance notice to prepare for the transition. If an issuer fails to qualify as a foreign private issuer as of the end of its second fiscal quarter (*e.g.*, in 2012), it would file a Form 10-K in the next year (2013), for its previous fiscal year (2012). The issuer would also begin to comply with the proxy rules and Section 16, and could become subject to reporting on Forms 8-K or 10-Q on the first day of that next year (*e.g.*, 2013). In contrast, a reporting company that requalifies as a foreign private issuer on a later determination date (*e.g.*, June 30, 2013), receives private issuer status and the related accommodations on the date it establishes its status as a foreign private issuer, *i.e.*, on that later determination date (the last day of its second fiscal quarter, *e.g.*, June 30). Accordingly, the issuer

[1] Regulation S-X, Item 3-20.

[2] Exchange Act Rule 3a12-3(b).

[3] Exchange Act Rule 3a12-3(b).

[4] Securities Act Rule 405; Exchange Act Rule 3b-4.

would be eligible to file its annual report for that fiscal year (*e.g.*, 2013) on Form 20-F, would be required to provide reports on Form 6-K, and would not need to continue to provide reports on Forms 10-Q and 8-K for the remainder of that fiscal year.

There is no specific requirement that an issuer notify the market if a change in its foreign private issuer status occurs.

Counting Method: Modified "Look Through"

To determine the percentage of outstanding voting securities held by U.S. residents under the test for foreign private issuer status above, the issuer must use the Rule 12g-3-2(a) "look through" method of calculating record ownership of its voting securities.[5] First, the issuer must count each person identified as the owner of its voting securities in its shareholders list (maintained properly and in the ordinary course). Second, for voting securities held of record by broker-dealers, banks, depositaries (*e.g.*, DTC) and other nominees located in (a) the United States, (b) the issuer's jurisdiction of incorporation, and (c) the primary trading market for the issuer's voting securities, the issuer must inquire and count the amount of voting securities they each hold in accounts of U.S. residents.

The issuer must make a good faith effort to obtain this information. If, after reasonable inquiry, the issuer cannot obtain the information from the nominee about the amount of voting securities represented by accounts of U.S. residents, including where a nominee's charge for supplying this information would be unreasonable, the issuer may presume that the customers are residents of the jurisdiction where the nominee has its principal place of business.

Last, the issuer must count shares of voting securities as beneficially owned by U.S. residents as stated in any beneficial ownership reports provided to it or filed publicly, and any beneficial ownership information otherwise provided to it (*i.e.*, information of which it should have actual knowledge).

EXCHANGE ACT REGISTRATION

Triggers for Registration under the Exchange Act

Registration or reporting under the Exchange Act is required for a class of securities of an issuer where (a) an issuer lists its securities on a U.S. stock exchange (*e.g.*, NYSE or Nasdaq);[6] (b) an issuer's securities are widely held;[7] (c) an issuer makes a public offering in the United States;[8] (d) an issuer voluntarily registers under the Exchange Act; or (e) an issuer acquires a company that is registered under the Exchange Act and is a "successor issuer."[9] Of these tests, the one that tends to catch many non-U.S. issuers without their own affirmative action is where the issuer's shares are widely held. A class of equity securities is "widely held," triggering Exchange Act registration, when it is held by at least 2,000 shareholders of record or 500 non-accredited investors, at least 300 of whom are U.S. residents and the issuer has total assets exceeding $10 million.[10] Although subject to SEC rulemaking, shareholders "of record" excludes crowd funding investors and persons who receive securities pursuant to employee compensation plans that are exempt from registration under the Securities Act.

The general method of calculating holders of record for purposes of triggering Exchange Act registration under the test above is in Rule 12g5-1. Under Rule 12g5-1, to count the shareholders of record, an issuer need only count the number of registered holders on its shareholder list (maintained properly and in the ordinary course), and if depositaries are listed, the number of holders for whom the depositaries hold securities. Generally, this means (a) counting the registered holders; (b) adding the number of participants listed in the security position listing of DTC (Cede & Co.), the principal depositary for U.S. issuers (or its non U.S. equivalent) if it is a holder; and (c) subtracting the number of depositaries "looked through." The participants are generally broker-dealers holding shares in "street name." For this purpose, Rule 12g5-1 has been interpreted to mean that an issuer does not have to also "look through" broker-dealer participants in the depositaries to the ultimate beneficial owners. Consequently, it is possible for a company to have fewer than 2,000 holders of record or 500 non-accredited investors of record, of a class of securities even though it has many more beneficial owners of that class of securities.

The issuer should obtain a shareholders list to determine whether it meets the test and is, therefore, required to register under the Exchange Act. If the issuer meets the test triggering Exchange Act registration described above, it would be required to

[5] Exchange Act Rule 12g3-2(a).

[6] Exchange Act Section 12(b).

[7] Exchange Act Section 12(g).

[8] Exchange Act Section 15(d).

[9] Exchange Act Rule 12g3-3.

[10] Exchange Act Section 12(g)(1)(A).

register within 120 days of the end of the fiscal year in which the issuer triggered registration

Exemptions from Section 12(g) Exchange Act Registration

If the issuer triggered Exchange Act registration because its shares are widely held under Section 12(g), two exemptions from Exchange Act registration might be available. However, both these exemptions are available only to foreign private issuers. So, if the issuer were to lose its status as a foreign private issuer, these exemptions would not be available to it.

Rule 12g3-2(a): Too Few U.S. Shareholders

Rule 12g3-2(a) exempts from registration under Section 12(g) of the Exchange Act any class of securities of a foreign private issuer that has fewer than 300 holders of record resident in the United States.[11] The number of holders of record resident in the United States is determined on a "look through" basis. As under Rule 12g5-1 described above, record ownership is first determined based on the records of security holders maintained properly and in the ordinary course. For securities held of record for U.S. residents in street name by broker-dealers, banks, or other nominees, the issuer must then "look through" and inquire as to the ownership of those securities. The security holders are determined based on the number of separate accounts for which the securities are held.

Rule 12g3-2(b) Information Supplying Exemption

Rule 12g3-2(b) exempts foreign private issuers from the requirement to register a class of equity securities under the Exchange Act if:

> (a) the issuer is not required to register or furnish reports under the Exchange Act;
>
> (b) the issuer lists the subject class of securities on one or more exchanges outside the U.S. that, either singly or together with the trading of the same class of the issuer's securities in another non-U.S. jurisdiction, constitutes the primary trading market for those securities (at least 55% of worldwide trading for those securities); and
>
> (c) the issuer has published in English, on its Internet Web site or through an electronic information delivery system generally available to the public in its primary trading market (which includes Canada's System for Electronic Document Analysis and Retrieval ("SEDAR")), information that since the first day of its most recently completed fiscal year, it (i) has made public or been required to make public under the laws of the country of its incorporation, organization or domicile; (ii) 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 (iii) has distributed or been required to distribute to its security holders.
>
> "Primary trading market" means that at least 55% of the worldwide trading in the subject class of securities took place on the facilities of a securities market, or markets in a single foreign jurisdiction, or in no more than two foreign jurisdictions during the issuer's most recently completed fiscal year.

Generally, the information required to be published electronically under this exemption is information that is material to an investment decision regarding the subject securities, such as information concerning: (a) results of operations or financial condition; (b) changes in business; (c) acquisitions or dispositions of assets; (d) the issuance, redemption, or acquisition of securities; (e) changes in management or control; (f) the granting of options or the payment of other remuneration to directors or officers; and (g) transactions with directors, officers, or principal security holders.

To maintain the Rule 12g3-2(b) exemption, the issuer must:

> (a) maintain its non-U.S. listing in its primary trading market;
>
> (b) publish, on an ongoing basis and for each subsequent fiscal year, in English, on its Internet Web site or through SEDAR (*i.e.*, an electronic information delivery system generally available to the public in its primary trading market), the same types of information that it used to claim the exemption (specified in paragraph 1(C) above);
>
> (c) electronically publish the information promptly after the information has been made public; and
>
> (d) not incur any Exchange Act reporting obligation.

The Rule 12g3-2(b) exemption remains in effect as long as the issuer continues to comply with its eligibility conditions. The exemption terminates when an issuer:

[11] This exemption continues until the next fiscal year end at which the 300 number is met or exceeded.

(a) no longer maintains a listing of the subject class of securities on one or more exchanges in a primary trading market;

(b) registers a class of securities under Section 12 of the Exchange Act or incurs reporting obligations under Section 15(d) of the Exchange Act; or

(c) no longer electronically publishes the specified non-U.S. disclosure documents required to maintain the exemption.

There is no cure period. A non-complying issuer must re-establish compliance with any of the Rule 12g3-2(b) conditions promptly or else register under the Exchange Act. The issuer should evaluate whether it meets these conditions on the last day of its fiscal year.

DEREGISTRATION: LEAVING THE EXCHANGE ACT REPORTING SYSTEM

If the issuer were required to register under the Exchange Act and neither of the two exemptions described above were available to it, the following are possible bases available for deregistering under the Exchange Act.

Rule 12g-4: Too Few Security Holders

Any issuer (U.S. or non-U.S.) may terminate its registration under Section 12(g) of the Exchange Act for any class of security when the number of holders of record of that class of security is (a) fewer than 300 persons or (b) fewer than 500 persons if the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's three most recent fiscal years.

This is a record ownership test that counts the broker-dealer participants in depositaries such as DTC but does not "look through" the broker-dealers to beneficial holders.

Rule 12(h)-3: Suspension of Section 15(d) Reporting

Section 15(d) reporting is automatically suspended in any fiscal year after the year of registration if at the beginning of the year the relevant class of securities is held of record by fewer than 300 persons.

An issuer that conducted a public offering in the United States may suspend its reporting under Section 15(d) of the Exchange Act for any class of securities that is held of record by (a) fewer than 300 persons resident in the United States; or (b) fewer than 500 persons resident in the United States, where the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's last three fiscal years. [12]

An issuer may not suspend its reporting obligations for a fiscal year in which: (a) a registration statement for the subject class of securities became effective under the Securities Act: or (b) such a registration statement must be updated for a continuous offering of securities.[13]

Additionally, a foreign private issuer may not suspend its reporting obligation under Section 15(d) until two fiscal years after the later of (a) the year in which the Securities Act registration statement for the subject class of securities became effective and (b) the last year in which such a registration statement had to be updated for a continuous offering of securities.[14]

The suspension of the issuer's reporting obligation under Section 15(d) is discontinued when the issuer no longer meets the suspension criteria described above on the first day of its fiscal year.[15] The issuer must then resume periodic reporting by filing an annual report for its preceding year, no later than 120 days after the end of that fiscal year.[16]

Rule 12h-6: Foreign Private Issuer Deregistration

A foreign private issuer may deregister a class of equity securities, if it meets (a) each of three general conditions set forth below and (b) either the trading volume threshold or one of the 300-holder thresholds set forth below. Consequently, this exemption will only be available to an issuer if it remains a foreign private issuer and has been reporting under the Exchange Act for at least one year.

General Conditions

Prior Exchange Act Reporting. The foreign private issuer must have (a) been an Exchange Act reporting company for at least 12 months before the deregistration; (b) filed or furnished all reports required for this period; and (c) filed at least one annual report (*i.e.*, Form 20-F, Form 40, or a special financial report under Rule 15d-2 under the Exchange Act).

Home Country Listing. For the preceding year, the issuer must have listed the subject class of securities on

[12] Exchange Act Rule 12h-3(b)(2).

[13] Exchange Act Rule 12h-3(a).

[14] Exchange Act Rule 12h-3(c).

[15] Exchange Act Rule 12h-3(e).

[16] Exchange Act Rule 12h-3(e).

one or more exchanges in a non-U.S. jurisdiction that either alone or together with the trading in one other non-U.S. jurisdiction, constitutes the primary trading market for the securities (markets in one or two jurisdictions constituting 55% of worldwide trading).

One-Year Dormancy. The issuer must not have sold its securities in the United States in a registered offering during the preceding 12 months, except for certain minor registered securities offerings.[17]

Alternative Exit Thresholds

I. Trading Volume Threshold. The U.S. average daily trading volume ("ADTV") of the relevant class of equity securities for a recent 12-month period (that ended no more than 60 days before the filing of the deregistration form) must be no greater than 5% of the ADTV of that class of securities worldwide for the same period.

One Year Ineligibility Period after Delisting or Termination of ADR Facility. A foreign private issuer that has delisted (voluntarily or involuntarily) a class of equity securities from a U.S. national securities exchange or automated inter-dealer quotation system for a class of equity securities must wait at least one year from the date of the delisting before it may deregister a class of equity securities.

The Requirement to Wait One Year Does Not Apply if when the issuer delisted the relevant class of equity securities and the U.S. ADTV of that class of securities did not exceed 5% of the worldwide ADTV of that class of securities for the preceding 12 months.

-- or --

II. 300-Holder Threshold. Alternatively, a foreign private issuer may deregister a class of equity securities if, on a date within 120 days before the filing of the deregistration form, that class of equity securities was held of record either by fewer than 300 persons worldwide or fewer than 300 persons resident in the United States.

To determine the number of U.S. residents that are holders of securities, the issuer must "look through" to the beneficial owners in the United States, its jurisdiction of incorporation, and its primary trading market. If, after reasonable inquiry, the issuer is unable to obtain information about the amount of securities represented by accounts of customers resident in the United States, it may assume that the customers are residents of the jurisdiction in which the nominee has its principal place of business. The issuer would also be required to count securities as owned by U.S. holders based on information publicly filed or based on other reliable information provided to it.

Rule 12h-6: Terminating Successor Issuer Status after an M&A Transaction

After a business combination, if a foreign private issuer that used shares as consideration for the purchase price and has succeeded to the U.S. registration or reporting obligations of the target issuer, the acquirer will be able to assume the reporting history of the acquired company and deregister immediately after that acquisition if (a) the acquired company has met the prior Exchange Act reporting condition, and (b) the acquirer meets the other deregistration conditions.

The acquirer's trading volume will be used to meet the trading volume threshold and the home country listing condition.

But if the acquirer's shares issued in a business combination must be registered under the Securities Act, the one-year dormancy condition will still have to be met.

Consequently, the ability to use the reporting history of the acquired company will only be useful in M&A transactions where the shares that are issued as consideration for the purchase price are exempt from registration under the Securities Act (*e.g.*, under Rule 802 or Section 3(a)(10)).

Debt Securities

To deregister a class of debt securities, a foreign private issuer must (a) have submitted all required Exchange Act filings, including at least one Exchange Act annual report, since the debt securities were registered under the Exchange Act and (b) have fewer than 300 record holders worldwide or that are residents of the United States, in either case on a date within 120 days before filing for deregistration. ■

[17] The permitted minor offerings are registered offerings for securities that are issued (a) to the issuer's employees; (b) by selling security holders in non-underwritten offerings; (c) upon the exercise of outstanding rights granted by the issuer if the rights had been granted pro rata to all existing security holders of the relevant class; (d) under a dividend or interest reinvestment plan; or (e) upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer.

Note: Exceptions (c)-(e) do not apply when the securities were issued in a standby underwritten offering or other similar arrangement in the United States.