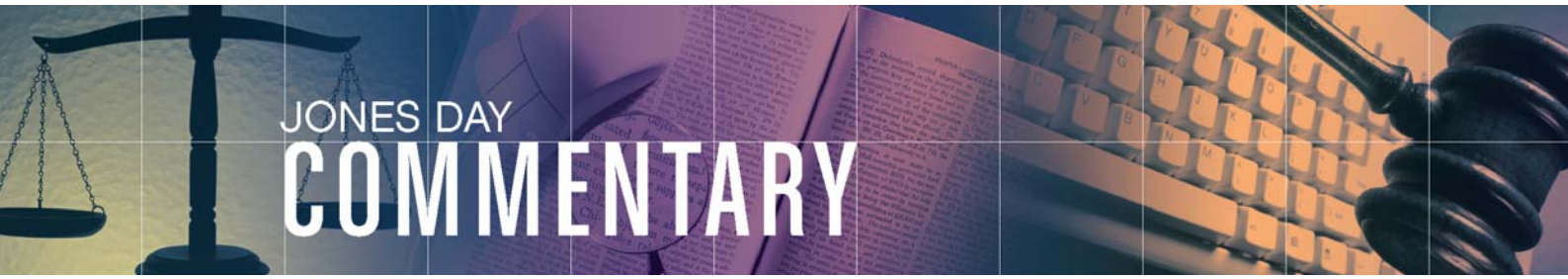
November 2009



CHANGES TO U.S. SECURITIES LAWS FACILITATE U.S. MARKET FOR UNSPONSORED ADRs OF LISTED JAPANESE COMPANIES WITH ENGLISH WEB SITES

Since October 2008, there has been a flood of new "unsponsored" U.S. American Depositary Receipt ("ADR") programs with respect to the shares of "foreign private issuers" that only are listed outside of the U.S. but meet certain English disclosure requirements under the U.S. securities laws. While these shares and the related "unsponsored" ADRs are not listed on a U.S. stock exchange, the ADRs may trade on the over-the-counter market, including the so-called Pink Sheets in the U.S. This is a limited, relatively illiquid market.

Due to changes in U.S. securities regulations that became effective on October 10, 2008, these unsponsored ADR programs may now be more easily established by a depositary bank without the consent of, or even notice to, the applicable foreign private issuers. Because a foreign private issuer has no contractual relationship with the depositary bank running an unsponsored ADR program, it may have concerns that the program provides a trading facility for its equity securities that could have consequences for its investor relations and shareholder base, but which is not under its control or influence. In particular, the programs may increase the number of U.S. shareholders-investors of the issuer. While this increase could raise the demand and price for the issuer's shares, it also changes the composition of its shareholder base with possible implications for shareholder voting. In addition, this increase ultimately may trigger certain registration, reporting, and other obligations under the U.S. securities laws with respect to foreign private issuers.

This *Commentary* highlights the changes to the U.S. securities regulations that have led to the increase in unsponsored ADR programs. It discusses possible legal and business issues relating to this increase that should be considered by foreign private issuers, particularly Japanese companies.

Background Information on ADR Programs

An ADR facility may be "sponsored" or "unsponsored." An unsponsored program is set up by a depositary bank unilaterally without the participation or, oftentimes, the consent of the foreign private issuer. In a sponsored or unsponsored program, the depositary bank issues to investors receipts that represent interests in the shares of the foreign private issuer (and can be exchanged with the depositary for such shares). These securities are denominated in dollar amounts that facilitate trading in the U.S. markets.

A depositary will typically undertake to perform, in exchange for certain fees from the ADR holders, certain services such as distributing dividends in U.S. dollars. Unlike the depositary of a sponsored ADR program, the depositary of an unsponsored program will typically not be obligated to disseminate shareholder communications to ADR holders or to vote on their behalf at shareholder meetings.

More generally, foreign private issuers lack control over the commercial terms, services, and administration of unsponsored ADR programs, which may differ among multiple unsponsored ADR programs. Furthermore, the foreign private issuer has no right to terminate unsponsored programs.

Currently, the SEC permits multiple unsponsored programs but only one sponsored program. If a sponsored program is established, no unsponsored programs may be established. On the other hand, the existence of one or more unsponsored programs would prevent a foreign private issuer from being able to enter into an exclusive sponsored program unless the depositary bank(s) agree to withdraw the unsponsored program(s). This in the normal course would likely involve negotiation and the payment of fees by the foreign private issuer (or by the depositary bank of the sponsored program) to the depositaries of the unsponsored programs.

The Basis for Unsponsored ADR Programs: The Rule 12g3-2(b) Exemption from U.S. Registration Requirements for Foreign Private Issuers

"Unsponsored" ADR programs are targeted at a subset of "foreign private issuers" that (i) are listed outside the U.S. on exchanges which are their "primary trading market," (ii) have neither publicly offered nor registered their shares for trading in the United States, and (iii) provide investors with information in English to certain standards set forth in Rule 12g3-2(b) under the U.S. Securities Exchange Act of 1934.

The Definition of "Foreign Private Issuer." Many Japanese companies will fall within the meaning of a foreign private issuer. A "foreign private issuer" is, generally, *any* company formed outside of the U.S. unless that foreign company has more than 50 percent of its voting securities held of record by U.S. residents and also satisfies certain criteria intended to show a significant nexus to the U.S. (*i.e.*, a majority of executives or directors are U.S. citizens or residents, a majority of assets are in the U.S., or its business is administered mainly in the U.S.).[1] Given the broad definition, it is fair to say that most Japanese companies are "foreign private issuers."

Rule 12g3-2(b) under the U.S. Securities Exchange Act of 1934. As indicated above, an important predicate to the establishment of an unsponsored ADR program is found in the Rule 12g3-2(b) exemption from the registration requirements of the U.S. Securities Exchange Act for a foreign private issuer. This rule is not only specifically relevant to unsponsored ADR programs but is generally pertinent to Japanese companies with a significant number of U.S. shareholders. U.S. investment in Japanese listed companies is substantial, so many Japanese

[1] *See* Rule 3b-4(c) of the Securities Exchange Act of 1934 (the "Exchange Act"). Note also that the measuring date is the last business day of the issuer's most recent second fiscal quarter.

companies should have some understanding of Rule 12g3-2(b). Since this rule is an exemption from registration, understanding of it begins with a summary description of the registration requirements under the U.S. Securities Exchange Act, potentially applicable both to foreign private issuers as well as U.S. issuers.

General Requirement to Register Securities under Section 12(g). In general, Section 12(g) of the Exchange Act requires all U.S. *and non-U.S.* issuers to register with the SEC under the Exchange Act if the number of record holders of a class of the issuer's equity securities is *500 or more* and its total assets exceed $10 million.[2] Issuers that are required to register must comply with annual and other reporting requirements under Section 12(g). Registration under Section 12(g) also triggers certain corporate governance requirements under the U.S. securities laws, including parts of the U.S. Sarbanes-Oxley Act of 2002 ("SOX"). Requirements relating to U.S. registration are further discussed below.

Under Exchange Act Rule 12g3-2(a), however, even if a company surpasses the record holder and asset thresholds discussed above and would otherwise be required to register under Section 12(g), a "foreign private issuer"[3] with *less than 300 holders* of a class of its equity securities that are resident in the U.S.[4] is exempt from the broader Section 12(g) registration requirement. Accordingly, foreign private issuers wishing to avoid Section 12(g) registration requirements try not to exceed the threshold of 300 U.S. resident holders.

Rule 12g3-2(b) Exemption—General Requirements. Nevertheless, if the number of a foreign private issuer's U.S. resident holders is 300 or more, it may still be exempt from the Section 12(g) registration requirement above if it meets the exemption set forth under Exchange Act Rule 12g3-2(b). This rule was amended in October 2008 by the SEC.

The following conditions must be satisfied under the new Rule 12g3-2(b) exemption:[5]

- **No Reporting Obligations under the Exchange Act.** The foreign private issuer must not be listed in the U.S. or otherwise required to file or furnish reports under Section 13(a) or Section 15(d) of the Exchange Act.[6] Essentially, this means that the foreign private issuer (i) has not listed or publicly offered its securities in the U.S. or (ii) has deregistered its securities in the U.S. The recent changes did not affect this requirement.

- **Primary Listing Outside the United States.** The foreign private issuer must maintain a listing of the subject class of equity securities on one or more foreign exchanges that, either singly or together, constitute the primary trading market for those securities. "Primary trading market" means that at least 55 percent of the trading in the subject class of securities on a worldwide basis took place through securities markets in one or two foreign (*i.e.*, non-US) jurisdictions during the issuer's most recently completed fiscal year.[7] This determination is made by reference to average daily trading volume.

---

[2] *See* Exchange Act Section 12(g)(1) and Exchange Act Rule 12(g)-1. Note that this registration requirement applies to issuers that are engaged in interstate commerce, which includes any trade or commerce between any state of the U.S. and any foreign country. However, the Section 12(g) registration requirement does not apply to equity or debt securities while they are listed on a U.S. exchange, and, accordingly, the Section 12g3-2(b) exemption is irrelevant to such exchange listed securities during such period. If securities are listed on a U.S. exchange, a separate registration requirement pursuant to Section 12(b) of the Exchange Act applies.

[3] *See infra* text accompanying note 1 regarding the definition of "foreign private issuer."

[4] *See supra* text accompanying note 15 regarding the calculation of the number of holders resident in the U.S.

[5] *See generally* Exchange Act Rule 12g3-2(b).

[6] *See* Exchange Act Rule 12g3-2(b)(1)(i).

[7] *See* Exchange Act Rule 12g3-2(b)(1)(ii) and Note 1 to Paragraph (b)(1).

- **Disclosure Requirements.** Under the amended Exchange Act Rule 12g3-2(b), a foreign private issuer must publish *in English* on its internet web site (or through an electronic information delivery system generally available to the public in its primary trading market) certain information that it is required to, or does, make public in its "home country." [8] Under Rule 12g3-2(b), required disclosure is limited to information material to an investment decision regarding the issuer's securities.[9] The rule specifies that a foreign private issuer shall electronically publish English translations of the following documents if required to be filed otherwise pursuant to the rule: (i) its annual report, including financial statements, (ii) interim reports that include financial statements, (iii) press releases, and (iv) all other communications and documents distributed directly to security holders of each class of securities to which the exemption relates.[10] The information referred to above must be posted on an *ongoing basis*, *promptly* after it is made or required to be made public.[11]

Key Revision to Rule 12g3-2(b) Exemption. *Automatic Nature of the Exemption.* A foreign private issuer had to make a paper filing and submit documents with the SEC to establish its compliance with prior Rule 12g3-2(b). After the recent changes, a foreign private issuer is not required to make any filing with the SEC to obtain this exemption, and the exemption may be obtained automatically.[12] Consequently, a foreign private issuer following its standard reporting practices may now find that, without any additional action on its part, it meets the requirements of the new Rule 12g3-2(b) even though it does not technically need, or even wish, to satisfy them. Many foreign private issuers will likely now qualify for the Rule 12g3-2(b) exemption that did not qualify before.

Good Faith Belief by a Depositary. Pursuant to related changes to the Form F-6 registration statement under which a depositary is required to register ADRs with the SEC, a depositary may unilaterally establish an unsponsored ADR program if it believes in reasonable good faith, after exercising reasonable diligence, that an issuer meets the requirements of Rule 12g3-2(b),[13] even if the issuer does not apply for such exemption. This has led to a significant increase in the number of unsponsored ADR programs.

Issues for Japanese Foreign Private Issuers Relating to Unsponsored ADR Programs

[8] Specifically, the rule requires that the following information be made available since the first day of its most recently completed fiscal year: (i) information that the issuer has made or is required to make public pursuant to the law of the country of its incorporation, organization, or domicile; (ii) information that the issuer 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 such exchange; and (iii) information that the issuer has distributed or is required to distribute to its security holders. *See* Exchange Act Rule 12g3-2(b)(1)(iii). Accordingly, as an initial matter, a Japanese foreign private issuer that regularly publishes in English information on its web site that it otherwise publishes pursuant to the laws of Japan and its principal exchange, for example, could qualify for the Rule 12g3-2(b) exemption depending on its disclosure policies, and consequently, be a possible candidate for an unsponsored ADR program given the recent rule change.

[9] This may include information concerning the following: (i) results of operations or financial condition, (ii) changes in business, (iii) acquisition or disposition of assets, (iv) the issuance, redemption, or acquisition of securities, (v) changes in management or control, (vi) granting of options or the payment of other remuneration to directors or officers; and (vii) transactions with directors, officers, or principal security holders. *See* Exchange Act Rule 12g3-2(b)(3)(i).

[10] *See* Exchange Act Rule 12g3-2(b)(3)(ii).

[11] *See* Exchange Act Rule 12g3-2(b)(2).

[12] *See generally* SEC adopting release No. 34-58465; International Series Release No. 1309 (September 5, 2008)("SEC Adoption Release"), http://www.sec.gov/rules/final/2008/34-58465.pdf, at 16, 17, and 33.

[13] *See* SEC Adoption Release at 43-45.

In connection with the recent changes to the U.S. securities laws and resulting proliferation of unsponsored ADR programs, Japanese foreign private issuers that are listed outside of the U.S., but not in the U.S., may wish to consider the following questions.

Are there any unsponsored ADR programs in effect with respect to our shares? If the foreign private issuer already has a sponsored ADR program, a depositary will not be able to establish an unsponsored ADR program. On the other hand, if there are unsponsored ADR programs in existence, a foreign private issuer will be prevented from establishing a sponsored ADR program until the unsponsored programs are cancelled and the deposited shares underlying the unsponsored program are transferred to the sponsored depositary. Often, it is necessary for the issuer to pay the depositary a fee to cancel an unsponsored ADR program. As a defensive measure, a foreign private issuer may consider instituting an exclusive sponsored ADR program if no unsponsored ADR programs are then in place. This would prevent the establishment of unsponsored ADR programs for the duration of the exclusive sponsored program.

Should we care whether there is an unsponsored ADR program in effect with respect to our shares? By expanding U.S. ownership of an issuer's securities, an unsponsored ADR program may (i) bolster its price, (ii) diversify the issuer's shareholder base, and (iii) if certain U.S. ownership thresholds are exceeded (*i.e.*, 10 percent and 40 percent), cause certain exemptions from U.S. tender offer regulation to be unavailable and thereby have an antitakeover effect. These potential benefits must be weighed against the possible drawbacks of an unsponsored ADR program for a foreign private issuer:

- diminishing its control over shareholder relations;
- in combination with other factors, preventing it from attaining quorums at shareholder meetings (as a result of voting abstention by the ADR depositary);[14] or
- as explained above, triggering the applicability of regulation under the U.S. Exchange Act (*e.g.*, the necessity of complying with the Exchange Act Rule 12g-3-2(b) exemption).

In any case, a foreign private issuer should monitor the number of its U.S. shareholders and compliance status with appropriate exemptions from registration in the U.S.

How may we determine whether we have 300 or more shareholders resident in the U.S.? To determine the number of "record" holders resident in the United States, Exchange Act Rule 12g3-2(a) requires that the issuer conduct a "look through" analysis.[15] Securities held of record by a broker, dealer, bank, or nominee on behalf of beneficial owners must be counted as held in the U.S. by the number of separate accounts for which the securities are held. This calculation must be done as of the end of each fiscal year to determine whether a foreign private issuer will be considered for the following fiscal year to have exceeded the 300 resident holder threshold. In practice, this calculation may take some effort and expense to perform, often requiring the use of an outside expert who specializes in such calculations.

If we have 300 or more U.S. resident shareholders, do we qualify for the Rule 12g3-2(b) exemption from the requirement to register our shares under Section 12(g)? As noted above, there is a general exemption from registration under Rule 12g3-2(a) for any foreign private issuer that has less than 300 U.S. shareholders. ADR programs may substantially

[14] Ordinarily, unsponsored ADR programs are of limited size and will not be the main reason for the absence of a quorum at a shareholder meeting. Nevertheless, they could, at the margin, be one of the causes for a lack of quorum.

[15] *See generally* Exchange Act Rule 12g3-2(a)(1) and (2) regarding the method for determining the number of holders resident in the U.S.

increase the number of U.S. shareholders. If the number rises to 300 or more, it is necessary to consider whether another exemption, usually Rule 12g3-2(b), applies. Foreign private issuers that already disclose material investment information in English promptly on their web sites may already be in general compliance with the disclosure requirements of Rule 12g3-2(b). However, to confirm, it is prudent to review a foreign private issuer's disclosure practices, especially if some of its investor communications are not made in English, but might be judged material.

What can we do if we find that there are already unsponsored ADR programs in place for our securities, but we conclude that we do not want our shares to trade in this manner in the U.S.? Negotiating with depositaries to cancel unsponsored ADRs is one alternative, although, as noted above, the depositaries are under no obligation to cancel the programs and it may be necessary to pay them cancellation fees. As a means of preventing the depositary banks from continuing the ADR programs, foreign private issuers with less than 300 U.S. resident shareholders may consider intentionally not complying with the requirements of Rule 12g3-2(b). For example, a foreign private issuer might not translate its financial statements into English. However, we expect that most foreign private issuer shareholders would be reluctant to no longer provide an English translation of their financial statements to their existing foreign shareholders. After analysis, sophisticated U.S. counsel may be able to discern other, more palatable options for discontinuing an unsponsored ADR program.

What are the main possible areas of concern for us if we decide to register our shares under Section 12(g)? A significant number of foreign private issuers have concluded that U.S. listing and registration are advantageous, offering such benefits as improved share price, greater access to capital, and the possibility of share acquisitions of U.S. public companies. However, such benefits come with the following obligations, which a foreign private issuer with 300 or more U.S. resident holders must satisfy, unless it qualifies for the 12g3-2(b) exemption. A foreign private issuer that is required to register under Section 12(g) must comply with the periodic reporting requirements of Section 12 of the Exchange Act, the U.S. Foreign Corrupt Practices Act, and other requirements under U.S. securities laws. For example, the U.S. SOX will apply, mainly the requirements relating to an independent audit committee (assuming the company is listed on a U.S. national securities exchange) and certification of internal controls by management and the auditor. Shareholders of a registered issuer will be subject to the beneficial ownership reporting requirements under Section 13 of the Exchange Act. Regardless of whether a foreign private issuer's shares are registered under Section 12(g) of the Exchange Act, U.S. extraterritorial jurisdiction and the anti-fraud provisions under the Exchange Act (*e.g.*, Rule 10b-5) may apply. This risk is, however, greater for a registered foreign private issuer, as opposed to an unregistered one.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below.

Stephen J. DeCosse
Tokyo
+81.3.6800.1819
sdecosse@jonesday.com

Anthony J. Luna
Tokyo
+81.3.6800.1807
aluna@jonesday.com

Richard M. Kosnik
New York
+1.212.326.3437
rkosnik@jonesday.com

Ted Kamman
New York
+1.212.326.3906
tkamman@jonesday.com