What Non-Financial Foreign Private Issuers Need to Know About the Dodd-Frank Wall Street Reform and Consumer Protection Act

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The United States has implemented new legislation in response to the financial crisis: The Dodd-Frank Wall Street Reform and Consumer Protection Act, or "Dodd-Frank". While Dodd-Frank generally focuses on regulation of financial institutions and U.S. companies, it also impacts foreign private issuers that are not financial institutions. Following is a brief summary of what foreign private issuers need to know about provisions explicitly applicable to them, those which may become applicable upon further rulemaking by the U.S. Securities and Exchange Commission (SEC), and those from which they will be explicitly exempt. Dodd-Frank also directs the SEC and other U.S. government regulators to engage in extensive new rulemaking, public consultation and studies the results of which will manifest themselves over the next 12-18 months.

First, a brief refresher on foreign private issuers. A “foreign private issuer”, or FPI, is a company that is incorporated outside the United States and which meets the following conditions: (i) U.S. residents do not hold a majority of the shares; *and* (ii) *any* of the following: (a) a majority of its directors and officers are not U.S. citizens or residents; (b) its business is administered from outside the United States; *or* (c) a majority of its assets are located outside the United States. A foreign private issuer benefits from less-restrictive rules under many of the federal securities laws and listing standards of U.S. national securities exchanges, including:

- the ability to follow certain corporate governance practices that conform to its home-country requirements rather than those of the U.S. securities exchanges on which its securities are listed,
- exemptions from certain rules applicable to audit committees of U.S.-domestic registrants,
- exemptions from the proxy rules,
- exemptions from Section 16 trading restrictions applicable to insiders of U.S.-domestic registrants, and
- extended phase-in periods for compliance with certain existing and new rules.

Several provisions of Dodd-Frank apply to FPIs, including the following:

- *Exemption from Sarbanes-Oxley Section 404.* Section 989G of Dodd-Frank exempts non-accelerated filers and smaller reporting companies from the requirement to provide an auditor attestation report on internal controls pursuant to Section 404(b) of the Sarbanes Oxley Act of 2002. The SEC will conduct a study focused on reducing the burden of complying with

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the auditor attestation requirement in Section 404(b) for companies whose market capitalization is between $75 million and $250 million and whether a reduction in this burden would encourage companies to list on U.S. exchanges. This relief applies to FPIs who qualify as either non-accelerated reporting companies or smaller reporting companies.

- *Beneficial Ownership Reporting*. Section 929R of Dodd-Frank amends Section 13 of the Exchange Act to empower the SEC to accelerate the current 10-day deadline for initial reports on Schedule 13D (or, as applicable, Schedule 13G). Additionally, FPIs, like U.S.-domestic issuers, are no longer required to send these reports to the company or the exchange on which the applicable securities are traded.

- *Whistleblower Protection*. Section 922 of Dodd-Frank provides new incentives to whistleblowers, including a payment of between 10% and 30% of amounts collected in proceedings where the SEC collects more than $1,000,000. Section 922 also provides whistleblowers a new express private right of action against employers who retaliate against them. The SEC must issue final rules implementing Section 922 within 270 days of Dodd-Frank's enactment. Section 929A of Dodd-Frank extends the whistleblower provisions to employees of subsidiaries of publicly traded companies, effective immediately.

- *Broker Discretionary Voting*. Section 957 of Dodd-Frank codifies in the Securities Act of 1933 the prohibition on broker discretionary voting for director elections. The New York Stock Exchange's amended Rule 452, effective for the 2010 proxy season, had already achieved effectively the same result. Dodd-Frank also enables the SEC to determine other matters where brokers cannot exercise discretionary voting.

- *Private Placement Exemption*. For the purpose of determining qualification of an accredited investor, Dodd-Frank excludes the value of a primary residence from the calculation of the net worth of a natural person. This provision was effective on enactment. Issuers, including FPIs, should amend the definition of "accredited investor" in their subscription documentation accordingly. For more information on the change to the "accredited investor" definition, see Sheppard Mullin's blog postings entitled Dodd-Frank Redefines "Accredited Investor (July 23, 2010) and SEC Provides New Guidance (September 3, 2010).[1]

- *New Required Disclosures by Manufacturers and Extraction Issuer*s. Sections 1502, 1503 and 1504 of Dodd-Frank require certain new disclosures for reporting companies if any of the following apply: (i) specified minerals determined by the Secretary of State to be funding conflict in the Democratic Republic of the Congo, known as conflict minerals, are necessary to the manufacturing of the reporting company's products, (ii) the reporting company is an operator of a coal or other mine, or (iii) the reporting company is a resource extractor.

- *Credit Rating Agency Reforms*. Various provisions of Dodd-Frank impose new governance and compliance requirements, penalties and liability on nationally recognized statistical rating organizations, or NRSROs. The full extent of the impact on NRSRO's business and customer relationships is not yet known. Among other things, Dodd-Frank increases internal controls, requires greater transparency of rating procedures and methodologies, provides investors with a private right of action, and provides the SEC with greater enforcement and examination tools. Section 939G repeals Rule 436(g) under the Securities Act and in so doing removes the exemption that issuers and ratings agencies relied upon to avoid the need for NRSRO consent to use of ratings information in a prospectus. For more information on the repeal of Rule 436(g) under the Securities Act, see Sheppard Mullin's blog posting entitled Registered Public Offerings Of Debt Securities And The Use Of Credit Ratings Information In SEC Filings After Dodd-Frank (August 17, 2010).[2]

The following corporate governance reforms in Dodd-Frank may become applicable to FPI's, subject to the results of public consultation and rulemaking by the SEC:

- *Independent Compensation Committee*. Section 952 of Dodd-Frank directs the SEC to require U.S. securities exchanges to incorporate into their rules higher thresholds of independence for compensation committees, with certain exceptions. Section 952 states that the SEC does not need to make this requirement applicable to FPIs that disclose annually the reasons why they do not have an independent compensation committee in place. Section 952 also requires certain disclosures relating to compensation consultants and other advisors. While it is yet to be determined whether these requirements will apply to FPIs, FPIs are required to make disclosures in their annual reports on Form 20-F as to the differences between their compensation committee practices and new U.S. securities exchange rules.

- *Executive Compensation and Clawback*. Section 954 of Dodd-Frank directs the SEC to require U.S. securities exchanges to incorporate into their rules clawback policies enabling the recovery of incentive-based compensation from current or former executive officers following a restatement of financial results. The trigger would be based on material noncompliance with any financial reporting requirements that led to a restatement, during the three-year period preceding the date on which a company is required to prepare the restatement. Wrongdoing is not required. The amount to be clawed back is the amount in excess of what would have been paid under the restated results.

Provisions of Dodd-Frank requiring say-on-pay, new executive compensation disclosures and *disclosure of CEO/Chairman structure* are not expected to apply to FPIs. This is because FPIs have not historically been subject to proxy rules or to Regulation S-K, Item 402 rules concerning executive compensation, and Dodd-Frank does not require that FPIs be subject to these new rules.

In addition to new regulations, Dodd-Frank clarified the jurisdictional reach of the antifraud provisions of the U.S. federal securities laws in the wake of the U.S. Supreme Court's decision in Morrison v. National Australia Bank Ltd., U.S., No. 08-1191 (decided June 24, 2010). In that case, the U.S. Supreme Court held that the principal antifraud provisions of the U.S. securities laws, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, apply only to transactions in securities that take place in the United States or transactions in securities listed on a U.S. securities exchange. The U.S. Supreme Court stated that these key provisions do not have extraterritorial application since Section 10(b) lacks an explicit statement of extraterritorial effect. The decision, written by Justice Scalia on behalf of a five justice majority, departed from decades of precedent from the United States Courts of Appeals that allowed such claims to be brought when substantial aspects of the misconduct occurred in the United States or when the misconduct had a substantial effect on U.S. investors.

In response to this ruling, Dodd-Frank explicitly extends the reach of the jurisdiction of the antifraud provisions of the securities laws with respect to actions brought by the SEC or the United States in connection with "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or conduct occurring outside the United States that has a foreseeable substantial effect within the United States." Dodd-Frank directs the SEC to study whether this right should extend to private rights of action, which could lead to regulation overturning the U.S. Supreme Court's ruling in *Morrison*.

Additional enforcement powers bestowed upon the SEC in Dodd-Frank include the powers to:

- force non-U.S. public accounting firms to produce their audit work papers to the extent relied upon by a U.S. registered public accounting firm;

- share privileged information with other U.S. and non-U.S. law enforcement agencies; and

- bring enforcement actions against other secondary actors and control persons.

Over the next 12 to 18 months, additional studies, public consultation and rulemaking from the SEC and other U.S. government regulators may yet further extend the extra-territorial reach of U.S. laws to non-U.S. actors.

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[1] www.corporatesecuritieslawblog.com.
[2] Id.