# US

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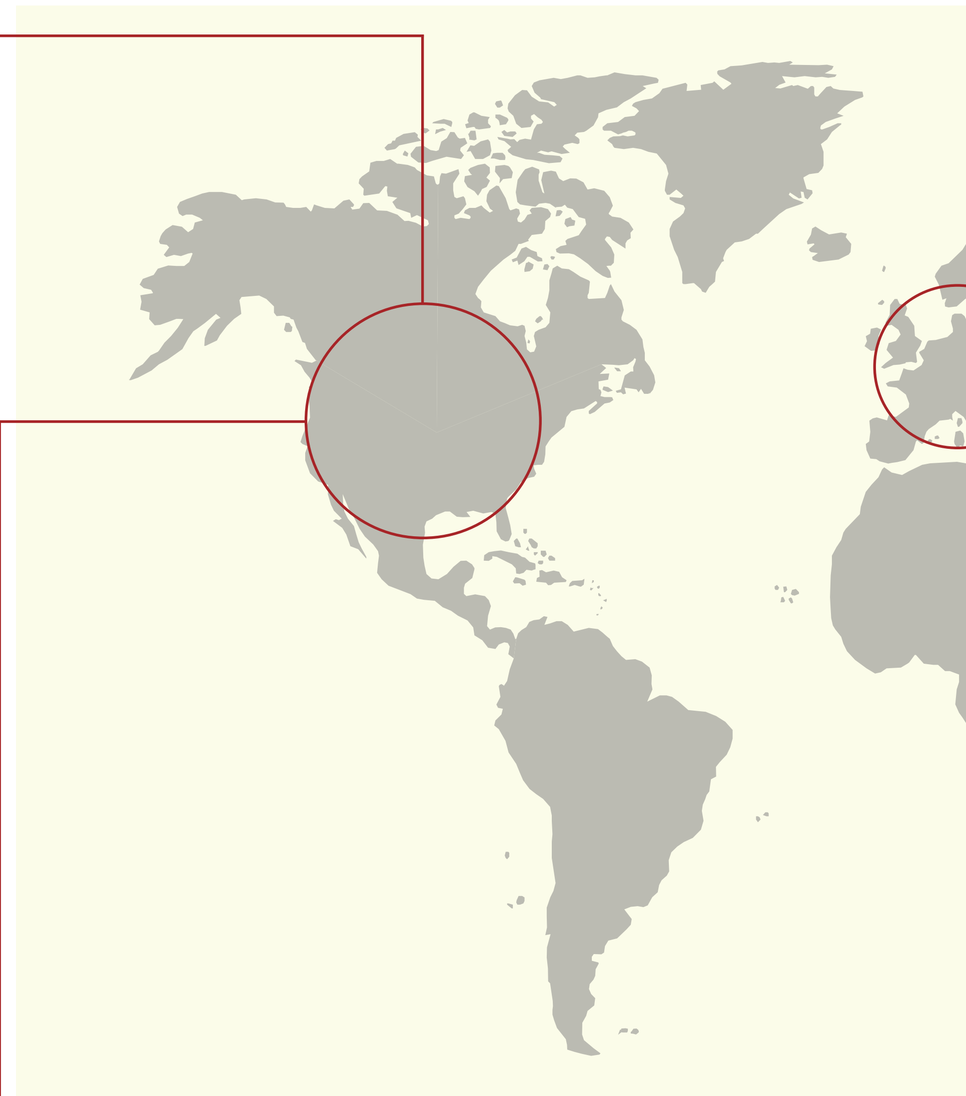
## Security concerns

Non-US companies may soon be able to terminate their obligations to the SEC and parts of the Sarbanes-Oxley Act



In December 2005, the Securities and Exchange Commission (SEC) proposed rule amendments that would enhance the ability of non-US companies to terminate the registration of their securities under the US Securities Exchange Act, cease providing annual and other reports to the SEC and discontinue their compliance with certain provisions of the US Sarbanes-Oxley Act. By easing requirements for non-US companies wishing to exit the Exchange Act registration and reporting system, the proposed rules would address aspects of SEC regulation that have made it difficult for companies subject to Exchange Act reporting obligations to terminate such obligations and have consequently discouraged foreign companies from accessing US public capital markets. The proposed rules follow significant lobbying efforts by European trade groups, including the Confederation of British Industry, and are currently open for public comment.

Under current SEC rules, a non-US company will incur an obligation to provide reports to the SEC and become subject to certain provisions of the Sarbanes-Oxley Act if:

● it must register under the Exchange Act in connection with the listing of its securities on a US national securities exchange;

● it must register under the Exchange Act because at its fiscal year end it has 300 or more US resident equity security holders and meets certain minimum asset tests or has sought a quotation of its securities on NASDAQ; or

● it has filed a registration statement in connection with a public securities offering in the US.

Currently, if a non-US company wants to terminate or suspend its Exchange Act registration and reporting obligations (and discontinue its compliance with the Sarbanes-Oxley Act), it must terminate its US listing or quotation, if any, and must ensure that upon such a termination it has fewer than 300 US-resident security holders.

Current SEC rules have proved problematic for a number of reasons. Firstly, the 300 US holder test is perceived as too easily exceeded by companies that have engaged in little or no selling activity in the US. Secondly, calculating the number of US holders for purposes of SEC rules requires a 'look through' analysis of securities held by financial intermediaries, which may be difficult or impossible to effect in practice. Thirdly, if a company has filed a registration statement in the US, its reporting obligations can at best be suspended, not terminated — potentially arising again when the number of US holders reaches or exceeds 300. Finally, the so-called Rule 12g3-2(b) exemption (by which a company is able to avoid Exchange Act registration notwithstanding having 300 or more US holders) is not immediately available after a termination of Exchange Act registration.

The SEC has proposed new Rule 12h-6 under the Exchange Act and amendments to its existing rules to address the foregoing. For equity securities, the changes would permit a non-US company to terminate its Exchange Act registration and reporting obligations on the basis of three alternative tests: one (for so-called 'well-known seasoned issuers') based principally on the percentage of trading of the company's securities that occurs in the US (US average daily trading volume is no greater than 5%, with US residents holding no more than 10%); a second based on the percentage of securities held by US residents (no more than 5%); and a third based on a 300 US holder test.

In each case, the company would also have to satisfy other conditions, namely; it must have complied with Exchange Act reporting obligations (including having filed two annual reports) and maintained a listing of its securities on a non-US exchange — which constitutes the principal trading market for the securities — for two years, and it must not have sold any securities in the US in the preceding 12 months (with certain exceptions).

For debt securities, the test would be based on there being fewer than 300 holders on a worldwide basis, or 300 holders resident in the US. In each case, the 'look through' rules for calculating the number of US holders would be simplified: inquiries would need be made only of intermediaries in the US and in the company's place of organisation/establishment and its primary trading market, if different. The SEC proposes to amend Rule 12g3-2(b) to make the rule available immediately upon termination of the company's Exchange Act registration.

As is currently the case of termination or suspension of Exchange Act registration and reporting obligations, reliance on the new rule would require the filing with the SEC of a form. In this case, the filing would be made on Form 15F.

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# US

Raphael Grunfeld

## Laying the blame for Enron

Major players are currently making their testimony in court, as the Enron case rumbles on

When Enron imploded in late 2001, the word out was that it was the 'Raptors', the 'Chewcos', and the 'LJMs,' those special purpose entities that were used to offload debts from Enron's books, that did Enron in. It was explained that a transaction with a special purpose entity could only be legitimate if a third party, unrelated to Enron, owned a 3% equity interest in such entity, and that due to certain guarantees given by Enron, such third party never assumed any risk and therefore never really owned any equity at all. Accordingly, the special purpose entities were unwound and all that debt and all those ailing assets were re-transferred to Enron, which then sunk under the weight of it all.

Try to explain that to a Texas jury.

I remember asking the former managing partner of one of the big four accounting firms whether he understood why the special purpose entities were improper. He responded that, to the present day, he still did not understand it.

Meanwhile, the US Government lost its first case against the directors of Tyco because the prosecutors put the jury to sleep with arcane accounting lessons.

So, in pursuing former Enron chairman Ken Lay and former chief executive Jeff Skilling, the Government is using different tactics. Now the strategy is to keep the charges simple so that the jury is able to understand. Based on this, Skilling is charged with a 'pump and dump' scheme in which he allegedly lied about the state of Enron to analysts and in press releases to get the stock up and then sell his shares before the truth would out. Lay is charged with lying to investors and Enron employees about the financial health of Enron after Skilling resigned as CEO in August 2001, and before Enron filed for bankruptcy in December 2001. The Government is claiming that Enron entered into side deals with the special purpose entities, in which it promised to buy back the distressed assets at higher prices. Furthermore, the special purpose entities were run by Andrew Fastow, who also served as the chief financial officer (CFO) of Enron so that Enron was — allegedly — dealing with itself.

Since neither Skilling nor Lay left behind any paper trail of their alleged wrongdoing, the US Government is compelled to rely on 'he said, she said' testimony. To bolster this effort, the Government has entered into plea agreements with 16 ex-Enron officers under which it may reward them for their testimony against Skilling and Lay by asking the court to hand them a more lenient sentence.

Among the witnesses that have testified for the Government so far are former Enron officers, including Fastow and Sherron Watkins, a former Enron vice president who became something of a national hero when she warned Kenneth Lay in August 2001 that Enron "might implode in a wave of accounting scandals". The thrust of their testimony is that the revenues and performance of Enron were artificially inflated in the following ways:

● there were the last-minute scrambles before the end of the quarter to move earnings per share in line with analysts' expectations;

● there were transfers of losses incurred by the struggling Enron Broadband unit to the profitable Enron Energy unit which could absorb the losses;

● there were the sales of broadband assets to special purpose entities for prices that no-one would pay in an 'arm's length' transaction;

● there were statements to analysts to the effect that the broadband unit was making money from operations when it was not;

● there were various side deals made with the special purpose entities that Fastow testified he recorded in a document to which Richard Causey, Enron's former chief accounting officer, added his initials; and

● there was Lay's efforts to tout the strength of Enron to the market a few months before its implosion when he knew, or should have known, that Enron was terminally sick.

The defence is responding with a three-pronged strategy. First, nobody did anything illegal. Everything that was done was in accordance with accounting rules and blessed by the lawyers,