

December 14, 2006

SEC Acts on E-Proxy, Management's Evaluation of Internal Controls and Foreign Private Issuer Deregistration

At yesterday's lengthy open meeting, the SEC voted unanimously to take action on several initiatives, including:

- the adoption of final "e-proxy" rules that would, effective July 1, 2007, allow companies the option of electronically providing non-business combination related proxy materials to shareholders who have not otherwise requested paper copies, and the proposal of a mandatory version of this rule that would require, instead of merely permit, companies and other soliciting persons to make this option available to shareholders with respect to non-business combination related proxy materials;
- the proposal of new interpretive guidance to clarify management's responsibilities with respect to their evaluation of internal controls and proposal of related changes to Rules 13a-15 and 14d-15 and Regulation S-X; and
- the reproposal of a new foreign private issuer deregistration option based solely on U.S. trading volume, and the reproposal of certain amendments to the Rule 12g3-2(a) exemption.

We summarize the key aspects of these actions below, and will provide more detail on these items when the text of the various rules, proposals and guidance is available. The SEC's press releases on these items may be found on the SEC's website at <http://www.sec.gov/news/press.shtml>.

Adoption of and New Proposal on E-Proxy Process

Under final rules adopted by the SEC, companies may, but are not required to, furnish electronically proxy materials to shareholders that have not otherwise opted for paper copies. Companies choosing to use this new "notice and access" model in respect of any shareholders meeting must post their proxy materials on a website and send a "Notice of Internet Availability of Proxy Materials" (the "Notice") (setting forth certain mandated items) to shareholders at least 40 days before the shareholders meeting. A paper proxy card cannot accompany the Notice, though a paper proxy card can be sent 10 or more days after the first Notice is sent if accompanied by another copy of the Notice.

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If a company chooses to use the e-proxy process, the final rules require brokers, banks and other intermediaries to follow a similar process for distributing proxy materials to their clients. Whether or not the company uses the e-proxy process, a soliciting person other than the company may use the e-proxy process; however, its Notice must be sent by the later of 40 days before the meeting or 10 days after the company files its proxy materials.

Shareholders may permanently opt out of the e-proxy regime by sending a one-time request to the company to receive all proxy materials in paper or by e-mails with respect to proxy solicitations conducted by the company or a soliciting person, at which point the company will have three business days to send paper or e-mail copies of proxy materials to the requesting shareholder.

The final rules are effective July 1, 2007, and early compliance is prohibited.

The SEC is concurrently proposing a mandatory version of the e-proxy process, pursuant to which companies and soliciting persons would be required to give shareholders the option of receiving proxy materials electronically. The mandatory e-proxy model is substantially the same as described above, except that the Notice may be accompanied by a full set of proxy materials. Comments on this proposal are due 60 days after publication of the proposal in the Federal Register.

In all instances, the e-proxy process would not be available for proxy material related to a business combination.

Proposal of Guidance on Management's Evaluation of Internal Control over Financial Reporting and Proposal of Related Changes to Rules 13a-15 and 14d-15 and Regulation S-X

The SEC voted to propose for public comment (i) new guidance to clarify management's responsibilities with regard to their evaluations of internal control over financial reporting under Sarbanes-Oxley Act Section 404 and related SEC rules, (ii) rule amendments to clarify that a company that evaluates internal control in accordance with the new guidance would satisfy the requirements for annual evaluations of internal control under Rules 13a-15 and 15d-15 and (iii) amendments to Regulation S-X to streamline the auditor's opinion with respect to internal control attestations and management's evaluations of internal controls.

The proposed guidance on management's evaluation of internal controls is principles-based and would cover four main areas, including:

- ***Identification of risks to reliable financial reporting and the related controls that management has implemented to address those risks.*** The proposed guidance describes a risk-based approach and would provide that management should use its judgment to identify those areas that pose the biggest risk of material misstatements and then identify those company-level controls (or a minimum number of lower level controls or processes) that address those risks. Management would focus on only the most important controls rather than identifying every control. Once these controls are identified, management would not need to continue to identify all of the other controls in a particular process.

- ***Evaluation of the operating effectiveness of controls.*** Again, the proposed guidance would provide for a risk-based approach that directs management to use its judgment by focusing its evaluation on areas of operation of the identified controls that pose the greatest risk to reliable financial reporting, after taking into account the company's particular circumstances. The proposed guidance acknowledges that for certain companies, particularly smaller ones, management's daily interaction with the business may be enough to allow management to understand internal control without a separate evaluation process, and in any event should be considered in its evaluation.
- ***Reporting of the overall results of management's evaluation.*** The proposed guidance would provide management with a framework, separate from the accounting literature, for determining whether control deficiencies are material weaknesses. The proposed guidance would include examples of situations that are considered strong indicators that a material weakness exists and would describe the factors to be considered in evaluating the severity of the control deficiency. The proposed guidance would also address the disclosure requirements for internal control reports for scope limitations and restatements.
- ***Documentation of management's evaluation.*** The guidance would require that management maintain a "reasonable" level of documentation, based on the company's particular circumstances.

The SEC stresses that the guidance is not meant to disrupt existing processes, but rather is intended to offer an option for simplification of those processes.

The SEC also noted that on December 19, 2006 the PCAOB will be proposing a new standard to supersede Auditing Standard No. 2. The SEC and PCAOB proposals will have concurrent comment periods ending approximately 60 days after publication in the Federal Register.

The SEC Staff stated their hope that both this and the new PCAOB standard will be in place before companies have to evaluate their internal controls at the end of 2007.

Reproposal of Foreign Private Issuer Deregistration Based on U.S. Trading Volume

The SEC will be reproposing a new Exchange Act Rule 12h-6, pursuant to which a foreign private issuer (regardless of size) may deregister a class of securities if the average daily U.S. trading volume for that class is no greater than 5% of the average daily trading volume for that class of security in the issuer's primary trading market during a recent 12-month period. Unlike the previously proposed deregistration standard, this new proposal does not look to U.S. shareholder count or amount of U.S. public float.

In addition to the 5% U.S. trading volume benchmark, foreign private issuers wishing to rely on proposed Rule 12h-6 must meet certain other requirements, including that:

- the issuer must meet the trading volume standard when it delists from its U.S. stock exchange, otherwise it must wait 12 months after delisting before it may deregister under the proposed rule;
- the issuer must wait 12 months after terminating an ADR facility before seeking deregistration under the proposed rule;
- for equity securities, the issuer must not have effected a public offering of the class of securities being deregistered within the 12 months before deregistration (certain specified public offerings would be permitted, as would exempt offerings);
- the issuer must have been an Exchange Act reporting company for at least one year and have filed or submitted all Exchange Act reports for the one-year period (including at least one annual report); and
- the issuer must have maintained a listing for the equity security being deregistered in the security's primary non-U.S. trading market for at least 12 months before deregistration.

The repropose Rule offers two additional benefits: foreign private issuers terminating registration under existing rules prior to the effective date of new Rule 12h-6 would be entitled to achieve the benefits of Rule 12h-6 provided certain conditions are met. Also, following a business combination with another reporting issuer, a foreign private issuer could count the reporting history of the target for purposes of determining eligibility under Rule 12h-6.

Reproposal of Rule 12g3-2(b) Amendments

The repropose rule amendments would permit a foreign private issuer to claim the Rule 12g3-2(b) exemption immediately upon its termination of Exchange Act reporting under Rule 12h-6, rather than having to wait 18 months as is currently required, provided it publish in English its home country materials required by Rule 12g3-2(b) on its Internet website or through an electronic information delivery system that is generally available to the public in its primary trading market.

The proposed rule amendments would further permit a non-reporting company that has received or will receive a Rule 12g3-2(b) exemption, upon application to the SEC and not pursuant to Rule 12h-6, to publish in English its required home country documents on its Internet website or through an electronic information delivery system in its primary trading market, rather than furnishing them in paper to the SEC, as is currently required.

The SEC is proposing these rules under a short 30-day comment period, and the SEC Staff hopes that final rules will be adopted in the first quarter of 2007.

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In addition to the above, the SEC also voted to propose certain new bank broker regulations and certain rules related to hedge fund disclosure and registration and to reopen for comment the SEC's proposal with respect to investment company governance provisions.

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We note that the foregoing summary is based on oral discussions at the SEC's open meeting, and the specific language of the SEC rules, proposals and guidance will not be known until they are published. In the meantime, if you have any questions regarding the above, please contact Mark S. Bergman at +44-20-7367-1601 or Frances F. Mi at (212) 373-3185.

This summary is not intended to provide legal advice, and no legal or business decision should be based on its content.

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