The U.S. Legal Environment for Sponsored and Unsponsored ADR Programs

A White Paper created by

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Background -- Rule 12g3-2(b)

This white paper summarizes the key legal considerations applicable to unsponsored and Level 1 sponsored American depositary receipt ("ADR") programs under the U.S federal securities laws.

The principal provision that makes possible the operation of both unsponsored and Level 1 sponsored ADR programs is Rule 12g3-2(b) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Rule 12g3-2(b) provides an exemption from the registration and reporting requirements of the Exchange Act. Companies organized outside the U.S. are generally required to register their securities under the Exchange Act and file periodic reports thereunder if they have more than 300 security holders (including ADR holders) resident in the U.S. But for the Rule 12g3-2(b) exemption, the existence of an ADR program, whether sponsored or unsponsored, could expose a non-U.S. issuer to Exchange Act reporting obligations if the number of ADR holders in the U.S. exceeds 300. By maintaining the exemption afforded under Rule 12g3-2(b), a foreign issuer is relieved from compliance with such Exchange Act reporting obligations irrespective of the number of U.S. security holders such foreign issuer might have.

In order to be eligible for the Rule 12g3-2(b) exemption, a company must be organized outside the U.S. and it must otherwise constitute a "foreign private issuer" (a term defined in the Exchange Act). In addition, to the extent the company's securities trade at all in the United States, such trading must only occur in the over-the-counter markets. Historically, the exemption was established by submitting an application to the U.S. Securities and Exchange Commission ("SEC") and furnishing copies of certain home country disclosure documents to the SEC both at the time the application is submitted, and subsequently on a continuing basis. As a result of certain amendments to Rule 12g3-2(b) that came into effect on October 10, 2008, the application process has been eliminated and the method of providing information about the foreign issuer has been simplified and modernized. These changes have impacted both the unsponsored and sponsored ADR markets, as it is now easier for depositary banks to establish unsponsored ADR programs and for foreign issuers to sponsor Level 1 ADR programs.

Amendments to Rule 12g3-2(b)

Under the amendments to Rule 12g3-2(b), the exemption from Exchange Act reporting requirements is now automatically available to any foreign issuer that meets the conditions of the Rule. Accordingly no application needs to be submitted to the SEC. Under the amended rule, an issuer must make its own determination as to whether it meets the applicable requirements and, in the case of unsponsored ADR programs, the depositary must have a good faith belief that the applicable requirements have been met. Once the foreign issuer qualifies for the Rule 12g3-2(b) exemption, the exemption will remain in effect until such time as the foreign issuer fails to maintain compliance. In order to remain exempt under Rule 12g3-2(b) going forward, foreign issuers are no longer required (or permitted) to provide paper copies of their home country disclosure documents to the SEC, and must instead electronically publish such documents on a public website.

The requirements for establishing an exemption under Rule 12g3-2(b) are identical for both sponsored and unsponsored programs. A foreign issuer must meet the following conditions in order to qualify for the exemption under the amended rules:

- Foreign Listing Condition. The issuer's securities must be listed in a foreign jurisdiction which, either alone or together with a second foreign jurisdiction, accounted for at least 55% of the issuer's trading volume during the most recently completed fiscal year. For purposes of meeting the 55% threshold, trading in two foreign jurisdictions can be combined, so long as one of the two had greater trading volume than the U.S. market. This is a new requirement that did not exist prior to the October 2008 amendments.

- Electronic Publication Requirement. The foreign issuer must post certain home country disclosure documents on a public website or through a publicly available electronic information delivery system in its primary trading market (such as an electronic disclosure system maintained by a foreign securities exchange or regulatory authority). The documents covered by the electronic publication requirement include all material information that a foreign issuer (i) has made or is required to make public under the laws of its home country, (ii) has filed or is required to file with a stock exchange, to the extent the exchange makes such information public, or (iii) has distributed or is required to distribute to its shareholders. These are the same categories of information that foreign issuers were historically required to furnish to the SEC under Rule 12g3-2(b). The amendments did not change the scope of the informational requirements, but only modified the method of delivery from paper to electronic posting format. When initially establishing the Rule 12g3-2(b) exemption, a foreign issuer must

ensure that it has posted all of the specified information from the first day of its last full fiscal year.

- English Translation Requirement. When publishing the information required under Rule 12g3-2(b), the foreign issuer must provide English translations of at least the following documents: (i) its annual report including audited financial statements; (ii) any interim reports that include financial statements; (iii) press releases; and (iv) all communications and documents distributed directly to security holders. For certain other types of documents it is possible to provide an English summary of the document instead of a full translation.

- Exchange Act Reporting Condition. The issuer must not have any reporting obligation under the Exchange Act. If a foreign issuer lists any of its securities on a U.S. securities exchange or publicly offers any securities in the U.S., this will create an Exchange Act reporting obligation and render it ineligible for the Rule 12g3-2(b) exemption. Additionally, if a foreign issuer incurs a reporting obligation with respect to any class of securities, it will be precluded from relying on the Rule 12g3-2(b) exemption for all other classes of securities, not just the securities that created the reporting obligation. Thus if a foreign issuer lists or publicly offers debt securities in the U.S., it will be unable to use the Rule 12g3-2(b) exemption for any securities including both debt and equity, unless it subsequently terminates the registration of such securities under the Exchange Act.

Ongoing Compliance Under Rule 12g3-2(b)

Once a foreign issuer establishes the Rule 12g3-2(b) exemption, it must continue to meet the above conditions in order to maintain its exempt status. Just as the foreign issuer is responsible for deciding whether it meets the initial eligibility criteria, it must also monitor compliance with Rule 12g3-2(b) on an ongoing basis in order to ensure that it remains eligible. This includes continued publication of the required home country disclosure documents promptly after such documents become public, and ensuring that the issuer's primary foreign trading market satisfies the 55% average daily trading volume condition for each fiscal year in which the exemption is claimed. If a foreign issuer fails to meet these conditions, it may become subject to the registration and reporting requirements of the Exchange Act.

In terms of maintaining compliance, we note that the publication requirement is entirely within the foreign issuer's control and, accordingly, the risk of noncompliance with this condition should be quite low. On the other hand, the issuer does not have complete control over the foreign listing condition, which is a function of relative U.S. and offshore trading activity. However given that both unsponsored and Level 1 sponsored ADRs can only trade in the over-the-counter markets in the U.S., we believe there is a very low probability of U.S. trading reaching a level that would cause trading volumes in the home market to fall below the required 55% threshold.

Impact of Rule Changes on Unsponsored ADR Programs

Under U.S. law, depositary banks have the ability to create unsponsored ADRs representing securities of a foreign issuer without the issuer's participation or consent. As a precondition to the establishment of an unsponsored ADR program, the foreign issuer must qualify for a Rule 12g3-2(b) exemption. Prior to the October 10, 2008 amendments to Rule 12g3-2(b), foreign issuers had to furnish copies of their home country disclosure documents to the SEC in order to establish and maintain an exemption under Rule 12g3-2(b). Therefore a degree of cooperation from the issuer was ordinarily required for a depositary to establish and operate an unsponsored ADR program. Under the amended rules, however, the relevant disclosure documents are no longer furnished to the SEC (they must instead must be made available on a public website or through a publicly available electronic information delivery system) and, consequently, cooperation between the depositary and issuer is not required.

As a result, depositaries can create an unsponsored ADR program for any foreign issuer that publicly posts the applicable disclosure information. Since many foreign issuers voluntarily provide English-language versions of their home country documents on their investor relations web pages, an unprecedented number of unsponsored ADR programs were established on and after the effectiveness of the amendments to Rule 12g3-2(b). Under the new rules, a depositary can file a registration statement to register unsponsored ADRs so long as it has a reasonable good faith belief, after exercising reasonable diligence, that that a foreign issuer electronically publishes information in English in accordance with Rule 12g3-2(b). Therefore U.S. depositary banks can create unsponsored ADR programs without notifying the issuer or seeking issuer cooperation.

Impact of Rule Changes on Sponsored ADR Programs

Just as the amendments to Rule 12g3-2(b) have made it easier for depositaries to establish unsponsored ADR programs, it has also become easier and less expensive for foreign issuers to create sponsored Level 1 ADR programs. Issuers no longer need to go through the time consuming and often costly process of submitting a written application to the SEC in order to qualify for an exemption under Rule 12g3-2(b). In addition, it has become easier to remain in compliance with the Rule. The ability to post the required home country disclosure documents on a website instead of mailing paper copies to the SEC reduces both the cost and administrative burden of compliance. The electronic disclosure requirement is also an improvement from an investor relations standpoint. Previously the documents submitted under Rule 12g3-2(b) were difficult to access, as they were only available in paper form through the SEC's public reference room, whereas now investors can obtain such documents instantly and at no cost through the Internet. This increases transparency and should enhance foreign issuers' abilities to promote their ADR programs to U.S. investors.

Comparison of Unsponsored and Level 1 Sponsored ADR Programs

From a foreign issuer's perspective, there is no difference between an unsponsored ADR program and Level 1 sponsored program in terms of ongoing legal and regulatory compliance. In either case the issuer must meet the conditions of Rule 12g3-2(b) and, as long as it does so, no additional U.S. disclosure or regulatory requirements will apply. The criteria for maintaining a Rule 12g3-2(b) exemption are identical irrespective of whether an unsponsored or Level 1 sponsored ADR program exists with respect to an issuer's securities.

Unsponsored Programs. The key difference between unsponsored and sponsored ADR programs relates to the foreign issuer's degree of participation in the ADR program and foreign issuer's ability to control the terms of the program. In unsponsored ADR programs the foreign issuer has no involvement in the establishment or operation of the program, and the depositary alone determines the rights afforded to ADR holders. As a result, holders of unsponsored ADRs normally do not have the right to vote or participate in foreign issuer transactions. With a sponsored ADR program, an issuer can decide what rights, if any, it wishes holders of ADRs to have.

In an unsponsored program the depositary unilaterally files with the SEC a registration statement on Form F-6 to register the ADRs under the U.S. Securities Act of 1933, as amended,[1] (the "Securities Act") whereas the foreign issuer and depositary are both required to sign the Form F-6 filed by the depositary for a sponsored ADR program. In either case, the Form F-6 filing involves minimal disclosure and very few substantive requirements. In fact the only disclosure required under Form F-6 is to attach the form of deposit agreement to be entered into between the foreign issuer, the depositary and all holders of the ADRs issued thereunder (the "deposit agreement") for a sponsored ADR program or a copy of the form of ADR certificate for an unsponsored ADR program.

An additional difference between unsponsored and sponsored ADR programs is the fact that multiple unsponsored programs can co-exist for the same issuer. This can lead to inconsistent treatment of ADR holders and investor confusion. For example, the fees charged to holders can differ among depositaries, and net dividend payments received by ADR holders can vary depending on the exchange rates used by each depositary to convert funds into U.S. dollars and the timing of such conversions.

Level 1 Sponsored Programs. In a sponsored ADR program the foreign issuer is involved in the establishment of the ADR program and the determination of the terms and conditions thereof. The foreign issuer and the depositary must negotiate and enter into the deposit agreement which governs the structure and operation of the ADR program. This gives the issuer the opportunity to influence all aspects of the ADR program, including the rights of ADR holders, and to include provisions limiting the risk of both the foreign issuer and the depositary. Moreover given the fact that a sponsored ADR program involves only a single depositary, there is no possibility of multiple programs and inconsistent terms.

The most basic form of ADR program is known as a “Level 1” program, which is utilized by foreign issuers that have no interest in raising capital in the United States and do not seek to have their securities traded on a stock exchange in the U.S. (e.g. the NYSE or Nasdaq). A "Level 1" ADR program is the easiest, least risky and least costly form of ADR program to implement. Level 1 ADRs are not listed on a U.S. securities exchange and trade exclusively in the over-the-counter markets, usually the “Pink Sheets” electronic quotation system. The shares used to create the Level 1 ADRs are those currently trading in the local markets for the foreign issuer's securities.

[1] The Securities Act governs the offering and sale of securities. All offers and sales must either be registered under the Securities Act or qualify for an exemption from registration. ADRs are considered a separate security from the underlying shares and are separately registered on Form F-6.

Level 1 ADR programs are eligible for the Rule 12g3-2(b) exemption and, provided the foreign issuer meets the applicable requirements of the Rule, Exchange Act disclosure and reporting obligations will not apply to such foreign issuer. All disclosure will be governed by home country requirements, including financial reporting. Therefore the issuer has no obligation to reconcile its financial statements to US GAAP. In addition, Level 1 ADR programs are not subject to the stringent requirements of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act").

Additionally, in a sponsored ADR program the depositary is generally entitled to receive financial contributions and/or reimbursements from the depositary. Such contributions and/or reimbursements can be used to offset both the initial costs of establishing the program and the ongoing expenses associated therewith, including investor relations activities conducted to promote the ADR program in the U.S.

By sponsoring an ADR program, a foreign issuer also creates a platform through which it can communicate with, and expand its base of, U.S. investors. In a sponsored ADR program, the issuer generally has access to the depositary's ADR register which identifies all registered ADR holders. Although many investors may not be listed on the ADR register because they hold ADRs through a broker or other intermediary, there are a number of methods that a depositary can be required to use in an effort to identify such investors (known as beneficial owners) for the foreign issuer. In addition, the depositary can be required to provide the foreign issuer on an ongoing basis with numerous reports related to the ADR program, the issuer's ownership levels in the United States, comparisons of the issuer to its peers trading in the United States and other reports that the issuer might request or require. This gives the foreign issuer the ability to analyze its U.S. shareholder base and conduct targeted investor relations activities. Such possibilities do not exist in an unsponsored program, as the foreign issuer has no means of identifying holders and it would be very time consuming and expensive for the foreign issuer to generate such reports. A sponsored ADR program also gives an issuer the opportunity to expand its U.S. shareholder base by marketing the program to potential new investors.

For your reference, attached hereto as Exhibit A is a table summarizing the key differences between Level 1 sponsored and unsponsored ADR programs.

Risk Comparison Between Unsponsored and Level 1 Sponsored Programs

With regard to litigation risk, both unsponsored and sponsored ADR programs expose foreign issuers to the possibility of class-action lawsuits in the U.S. ADRs are securities issued under U.S. law to investors primarily located in the United States. This is the

case whether a program is sponsored or unsponsored, and therefore the risk of litigation can exist in either context. Even without an ADR program, such risk could exist to the extent U.S. investors directly hold a foreign issuer's securities. Under any of these circumstances, a foreign issuer can be sued in the U.S. courts to the extent it has jurisdictional contacts within the U.S. Provided jurisdiction exists, the issuer is subject to lawsuits for violations of the U.S. securities laws, such as the publication of materially inaccurate or misleading information. U.S. investors (including both ADR holders and shareholders directly holding ordinary shares) could initiate a cause of action against the issuer for such misstatements even if the information was not specifically intended for the U.S. market.

With respect to the level of risk created by an unsponsored ADR program, it is important to understand that if a foreign issuer has jurisdictional contacts in the U.S., including contacts unrelated to the ADR program, there may exist a basis to establish jurisdiction for a broad range of claims. For example, if a foreign issuer transacts extensive business in the U.S. or has U.S. based operations, the issuer may be subject to "general jurisdiction" which creates exposure to claims of any nature, including those based on violations of the U.S. securities laws. Where sufficient contacts exist, the foreign issuer is not in a position to argue lack of jurisdiction, and therefore the establishment of even an unsponsored ADR program can create increased risk due to the greater statistical likelihood of securities class action litigation.

It is possible that, in circumstances where a foreign issuer has no contacts with the United States other than the existence of an unsponsored ADR program, the issuer could theoretically assert lack of jurisdiction as a defense. Under these narrow facts, the U.S. courts may be unwilling to assert jurisdiction. The potential lack of jurisdiction, however, may not necessarily deter U.S. investors from initiating a lawsuit (frivolous or otherwise). Therefore the issuer may still have to deal with class action litigation and incur the costs of mounting a defense. In addition, the commencement of a class action lawsuit often creates a number of collateral risks and costs, including negative publicity, reputational risk and the potential for duplicative litigation in the foreign issuer's home country. Accordingly it is our view that any ADR program, whether sponsored or unsponsored, creates a number of risk factors that should be analyzed by the foreign issuer.

There is a significant difference between sponsored and unsponsored programs from the standpoint of risk exposure: the level of risk in a sponsored program can be minimized, and potentially reduced below that which exists in an unsponsored program, through the use of exculpatory provisions inserted into the deposit agreement that are designed to protect the foreign issuer. Since ADR holders are deemed to be parties to

the deposit agreement and are bound by its terms, their ability to assert claims against the issuer can be contractually limited under the deposit agreement. In contrast, the issuer has no legal relationship with ADR holders in an unsponsored program, and therefore no ability to control its risk with respect to such holders.

This White Paper is a summary presented for general informational purposes only. It is not a complete analysis of the matters discussed herein and should not be relied upon as legal advice.

For more information, please contact Scott A. Ziegler or George Boychuk of Depositary Management Corporation at (212) 319-4800.

Exhibit A

Comparison of Unsponsored and Level 1 Sponsored ADR Programs

	Unsponsored	Level 1 Sponsored
Trading Market	ADRs trade OTC; not listed in the U.S.	ADRs trade OTC; not listed in the U.S.
Registration of ADRs	Form F-6 filed unilaterally by depositary	Form F-6 filed jointly by issuer and depositary
Exchange Act Reporting	Not applicable, provided Rule 12g3-2(b) exemption is maintained	Not applicable, provided Rule 12g3-2(b) exemption is maintained
Disclosure	Post home country disclosure documents on website	Post home country disclosure documents on website
Financial Reporting	Governed by home country requirements; no reconciliation to US GAAP	Governed by home country requirements; no reconciliation to US GAAP
Sarbanes Oxley	Not applicable	Not applicable
Rights of Holders	Determined solely by depositary, typically no voting rights	Determined jointly by depositary and issuer; typically voting rights granted, Deposit Agreement entered into setting forth rights and limitations of holders of ADRs
Financial Contributions	Not applicable	Under standard market practice, depositary provides annual financial contributions to support the program
Marketing/ Investor Relations	Not applicable	Issuer can communicate with ADR holders and promote the program