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U.S. Dodd-Frank Act's Application to Non-U.S. Issuers That are Not Financial Institutions

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Act**"). While the crux of the Act regulates financial institutions and U.S. companies, it will also impact, albeit to a lesser extent, foreign private issuers that are not financial companies. This memorandum summarizes the provisions of the Act most likely to be of interest to foreign private issuers that are not financial institutions. For a summary of the Act generally, please see our previous memorandums: *Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010* (July 21, 2010) and *Dodd-Frank Wall Street Reform and Consumer Protection Act, Preliminary Assessment of Provisions Effective Immediately or Very Soon After Enactment* (July 21, 2010).

Implementation of the Act

Before we delve into the applicable provisions in the Act, we note that, while certain provisions in the Act are effective immediately, the U.S. Congress has largely designed the bill to become effective in stages through the adoption of a series of rules. U.S. regulatory agencies, such as the U.S. Securities and Exchange Commission (the "**SEC**"), are entering an intense period of rulemaking over the next 6 to 18 months. Because the Act contains certain ambiguities, this rulemaking process will significantly shape the regulatory framework that is ultimately put in place under the Act and should be monitored closely. The Staff of the SEC has already expressed interest in receiving comments from and/or meeting with market participants throughout this rulemaking process. We expect to actively participate in this process and comment on behalf of our clients. We encourage you to contact us to discuss your views.

Whistleblower Protection and Rewards

Section 922 of the Act requires the SEC to compensate certain whistleblowers[1] who provide original information about violations of the U.S. federal securities laws. In particular, the SEC must pay eligible whistleblowers 10% to 30% of the amount of any sanctions, including disgorgement, collected in any proceeding in which the SEC levies sanctions in excess of $1 million. This is an expansion of the SEC's current authority under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), which caps such compensation at 10% of collected penalties, and restricts whistleblower compensation to the insider trading context.

Section 922 also provides whistleblowers with an express private right of action against employers who retaliate against them. Any actions by a whistleblower may be brought in U.S. federal court and remedies include, among others, reinstatement, double back pay with interest, as well as litigation costs and reasonable attorneys' fees.

In addition, Section 929A of the Act, which is effective immediately, expands the existing Sarbanes-Oxley whistleblower protections to include employees of consolidated subsidiaries of publicly traded companies. In the past, certain courts have not extended the whistleblower provisions of the Sarbanes-Oxley Act to subsidiary employees which has allowed publicly-traded parent corporations that employ most of their

[1] The Act, however, prohibits payment of awards to persons who were employed by "an appropriate regulatory agency," the Department of Justice, a self-regulatory organization, the Public Company Accounting Oversight Board, or a law enforcement organization, or a person who has been convicted of a crime related to the whistleblower's complaint.

employees at the subsidiary level to avoid liability under the Sarbanes-Oxley whistleblower provisions. In light of the Act's expansion of the Sarbanes-Oxley whistleblower protections to publicly traded company subsidiaries, companies should consider implementing whistleblower policies and procedures at the subsidiary level.

Beneficial Ownership Reporting Provisions

Section 929R amends Section 13 of the Exchange Act to authorize the SEC to shorten the 10-day period in which greater than 5% beneficial owners must initially report their ownership of a company's equity securities to the SEC on Form 13D and to no longer require these reports to be sent to the company or the national securities exchange on which the securities are traded.

Section 766 of the Act amends Section 13 of the Exchange Act to include within its beneficial ownership reporting requirements a market participant who becomes or is deemed to become a beneficial owner of a security upon the purchase or sale of a "security-based swap" that the SEC may define by rule. Section 766 also amends Section 13 of the Exchange Act to preclude security-based swap agreements[2] from being deemed as beneficial ownership positions in the underlying securities unless the SEC, by rule, determines after consultation with the prudential regulators and the Treasury, that (1) the purchase or sale of the security-based swap provides incidents of ownership comparable to direct ownership of the equity security, and (2) it is necessary to achieve the purposes of Section 13 of the Exchange Act that the purchase or sale of the security-based swaps be deemed the acquisition of beneficial ownership of the equity security.

Credit Rating Agency Reforms

The Act, in reaction to criticism for the failure of credit rating agencies to accurately reflect the ratings of complex structures, imposes new governance and compliance requirements, penalties and liability on nationally recognized statistical rating organizations ("**NRSROs**") which are expected to impact how NRSROs conduct their business and their relationship with their customers. The Act, among other things, 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.

The Act also nullifies Rule 436(g) under the Securities Act of 1933, as amended (the "**Securities Act**"), which had provided an exemption for credit ratings provided by NRSROs from being considered part of a registration statement prepared or certified by a person (considered an expert) within the meaning of Sections 7 and 11 of the Securities Act. As a result, in order to include an NRSRO credit rating in a registration statement (other than certain disclosure-related information), an issuer of securities is now required to file the NRSRO's consent along with the registration statement. NRSROs that consent to the inclusion of a rating in a registration statement will be exposed to liability as experts under Section 11 of the Securities Act for material misstatements or omissions with respect to such included ratings. The need to obtain consents from NRSROs may complicate the timing of offerings and may result in an increase in Rule 144A transactions. For more information on the use of ratings in registration statements and the related consent requirement, see Davis Polk's memorandum: *Guidance on Use of Credit Ratings in Securities Offerings Following Dodd-Frank* (July 21, 2010).

[2] A "security-based swap agreement" is defined as a swap agreement of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

Sarbanes-Oxley Act Internal Controls Exemption for Non-Accelerated Filers

Section 989G exempts non-accelerated filers or smaller company issuers (*i.e.*, generally reporting companies with a worldwide market capitalization of less than $75 million) from the requirement to provide an auditor attestation report on internal controls pursuant to Section 404(b) of the Sarbanes-Oxley Act. It also directs the SEC to conduct a study to determine how to reduce the burden of complying with 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.

Corporate Governance Reforms

Many of the corporate governance reforms contained in the Act amend the U.S. proxy rules or the executive compensation disclosures required in proxy statements by Item 402 of Regulation S-K (for example, say-on-pay, proxy access and new executive compensation disclosures) and are not expected to apply to foreign private issuers. Similar regulations, however, are under consideration by national regulatory agencies in countries around the world so it will be important to monitor how the United States implements these new rules as they may influence the outcomes in other countries.

The following corporate governance reforms, however, are subject to further definition by SEC rulemaking and could apply to foreign private issuers. While not certain, the SEC may ultimately exempt foreign private issuers from some or all of these requirements as they have done with other compensation-related disclosures in the past.

Independent Compensation Committee. Section 952 of the Act calls for the SEC to issue rules directing the national securities exchanges to require all members of a listed company's compensation committee to be independent, taking into account advisory or other fees and affiliate status and any other factors that are established by the SEC. *This requirement does not apply to foreign private issuers 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.

Executive Compensation and Clawback. Section 954 of the Act provides that the SEC must direct national securities exchanges to adopt 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. The amount to be clawed back is the amount in excess of what would have been paid under the restated results.

New Disclosures by Mining and Other Extraction Issuers

Reporting Requirements Regarding Coal or Other Mine Safety. Section 1503 of the Act requires operators of coal or other mines who are SEC registrants to provide disclosure in their Form 20-F about their violations of health or safety standards.

Disclosure of Payments by Resource Extraction Issuers. Section 1504 of the Act requires the SEC to enact rules by April 17, 2011 requiring resource extraction issuers (defined as companies that engage in the commercial development of oil, natural gas, or minerals) that are SEC registrants to issue an annual report disclosing any payments made by the issuer to a foreign government or the U.S. federal government, for the purpose of commercial development of those resources.

Conflict Minerals. Section 1502 of the Act requires the SEC to enact rules by April 17, 2011 requiring issuers to disclose whether certain minerals necessary for production or in their products originated in the Democratic Republic of the Congo.

For more on these requirements see the Davis Polk memorandum: *Spotlight on New Disclosure Requirements for Mining and Natural Resource Companies in Dodd-Frank Act* (July 23, 2010).

Securities Law Enforcement

Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Law. Section 929P(b) of the Act extends the jurisdictional reach of the antifraud provisions of the U.S. federal securities laws, but only with respect to actions by the United States or the SEC. In these actions, jurisdiction would include "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" as well as "conduct occurring outside the United States that has a foreseeable substantial effect within the United States." Because the Section is limited to actions by the U.S. Government or the SEC, it does not impact the recent U.S. Supreme Court decision in the *Morrison* case relating to a private civil action by a non-U.S. investor who purchased securities of a non-U.S. issuer on a non-U.S. exchange. In *Morrison*, the U.S. Supreme Court held that the anti-fraud provisions of the U.S. federal securities laws apply only in connection with a purchase or sale of a security listed on a U.S. stock exchange, and the purchase or sale of any other security in the United States. For more on the Morrison case see the Davis Polk memorandum: *Update: U.S. Supreme Court Limits Extraterritorial Application of U.S. Securities Laws - Morrison v. National Australia Bank* (June 28, 2010).

Section 929Y of the Act directs the SEC to study whether the U.S. courts' extraterritorial jurisdiction should be extended to private rights of action under the antifraud provisions of the U.S. federal securities law (which could ultimately lead to the adoption of additional regulation to overturn *Morrison*).

Aiding and Abetting Protection. Sections 929M, 929N and 929O of the Act amend the U.S. federal securities laws to explicitly provide the SEC authority to bring enforcement actions against secondary actors that "knowingly or recklessly" provide substantial assistance to another person in violating the U.S. federal securities laws. Previously, the federal securities laws did not explicitly provide for SEC enforcement actions based on "reckless" conduct.

"Control Person" Liability. Section 929P9(c) of the Act clarifies Section 20(a) of the Exchange Act so as to allow the SEC to impose joint and several liability on control persons—those found to "directly or indirectly control" a violator—unless they acted in "good faith" and did not "directly or indirectly induce" the violation of the securities laws.

Expansion of Audit Information to be Produced and Exchanged with Foreign Counterparts. Section 929J of the Act provides that a foreign public accounting firm must, if requested, produce its audit work papers to the SEC and the Public Company Accounting Oversight Board (the "**PCAOB**") if it "issues an audit report, performs audit work, conducts interim reviews, or performs material services upon which a registered public accounting firm relies." This Section provides that any registered public accounting firm that relies on the work of a foreign public accounting firm in issuing an audit or interim review must produce the foreign firm's audit work papers, if asked, and secure the agreement of the foreign firm that it will cooperate as a condition of such reliance. The impact of this provision remains to be seen—to date, local authorities in certain European countries, China and Hong Kong have asserted that the reporting requirements of the PCAOB violate local privacy rules and have prevented the PCAOB from inspecting the audit work papers of PCAOB-registered firms in these jurisdictions.

Section 981 of the Act amends the Sarbanes-Oxley Act to provide for the sharing of information with foreign auditor oversight authorities without waiving confidentiality or privilege. The Act requires the foreign authority to give a description of the applicable information systems and controls that it has in place, as well as the laws and regulations of the foreign authority that are relevant to information access.

Sharing Privileged Information with Other Authorities. Section 929K of the Act allows the SEC and domestic and foreign securities authorities and law enforcement authorities to share information without waiving any privilege applicable to that information. The Act, however, prevents the SEC from being compelled to disclose privileged information obtained from a foreign securities authority or law enforcement authority, if the foreign authority represented to the SEC in good faith that the information is privileged.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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