INSIGHTS

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DEPARTMENTS

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SECURITIES REGISTRATION

Delisting/Deregistration of Securities under the Securities Exchange Act of 1934

In the wake of the Sarbanes-Oxley Act of 2002 and the current economic climate, public companies are being forced to consider whether the benefits of being public outweigh the costs. An Exchange Act registered company with less than 300 record holders that wants to "go private" need not engage in a complex, time consuming and expensive "going private" transaction to avoid the costs of periodic reporting and compliance with Sarbanes-Oxley. Voluntary delisting and deregistration may provide a cost-efficient alternative to the burdens of being public while leaving open the opportunity to return to the Exchange Act reporting system in the future.

by David Alan Miller and Marci J. Frankenthaler

The current uncertain economic forecast in the capital markets and the stringent requirements imposed by the Sarbanes-Oxley Act of 2002 (SOX) have forced management of many public companies to evaluate whether they should remain public. The cost of maintaining registration is a major issue, because the legal, accounting, and other expenses associated with being a public company have increased dramatically. A company must weigh these costs against the benefits of public company status, such as better access to capital for expansion, repayment of debt and diversification of operations, enhanced corporate image and the availability of a broad range of incentives for management and employees.

Under the rules of the Securities and Exchange Commission (SEC), a company with a class of securities registered under the Securities Exchange Act of 1934 (Exchange Act) that has less than 300 record holders, or less than 500 record holders if the company's total assets have not exceeded $10 million as of the end of the company's three most recent fiscal years, may terminate the registration of (or deregister) any such class of securities. The common stock of many small cap companies often will fit in one of these two categories regardless of the number of beneficial owners of the stock because the vast majority of beneficial owners hold their stock in street name through a broker rather than "of record." These companies are able to deregister at any time, generally without stockholder approval, if their boards of directors find it to be in the company's best interest. Once a company deregisters, it is no longer required to file annual, quarterly or periodic reports with the SEC or to comply with SOX or the SEC rules implementing SOX.

For some companies, deregistration may be an alternative step to "going private." A going private transaction commonly takes the form of a tender offer, exchange offer, reverse stock split or merger, is organized by a company's controlling stockholder or management and financed by sophisticated third party financiers. The purpose of a going private transaction is to enable the company or the control group to acquire all or substantially all of the company's publicly-held shares in order to return the company to its pre-IPO, "closely held" status. Going private transactions are much more complicated, time consuming and expensive than deregistration because the company is required to comply with complex SEC regulations regarding going private transactions.

There are a number of requirements that a company must satisfy to be able to terminate the registration of its common stock and discontinue its obligation to file periodic reports with the SEC. Additionally, if the company's securities are listed on a stock exchange or Nasdaq, the company will have to request to have its securities removed from listing prior to deregistration. Delisting does not, however, lead to deregistration of the securities with the SEC. Unless the company also deregisters its securities, the company will continue to be subject to the SEC's reporting requirements. This article highlights the steps involved in delisting and deregistering a company's securities.

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Initial Considerations and Due Diligence

To determine whether deregistration is a feasible option, a company must:

Determine the number of holders of record of the class of securities to be deregistered. The company should obtain the record stockholder list from transfer agent to determine the exact number of holders of *record* of common stock.[1] A company must have: (1) fewer than 300 record holders or (2) fewer than 500 record holders and less than $10 million in assets at the end of each of the last three fiscal years to be eligible for deregistration under Sections 12(g) and 15(d) the Exchange Act.

Determine whether the company is registered under Section 12(b), 12(g) or 15(d) of the Exchange Act.[2] The steps to be taken to deregister vary depending on which section the company's securities are registered under the Exchange Act. A company whose securities are listed on a national securities exchange must register its securities pursuant to Section 12(b) of the Exchange Act. A company whose securities are quoted on the Nasdaq National Market, Nasdaq SmallCap Market or the OTC Bulletin Board must register its securities pursuant to Section 12(g) of the Exchange Act. In addition, companies that have more than 500 investors and $10 million in assets at calendar year end must register their securities under Section 12(g) of the Exchange Act. Section 15(d) of the Exchange Act creates reporting obligations for companies not registered under Section 12(b) or Section 12(g) but that have registered a distribution of securities under the Securities Act of 1933 (Securities Act).

Determine whether the company has filed a registration statement that has been declared effective during the fiscal year. Under Section 15(d) of the Exchange Act, a company will *not* be able to suspend its reporting obligations with respect to a class of equity securities during the fiscal year in which a registration statement to which this class of securities relates was declared effective.[3]

Determine whether the company has filed its annual and quarterly reports. A company will *not* be able to suspend its reporting obligations under Section 15(d) of the Exchange Act unless the company has filed all of its annual and quarterly reports for the shorter of its most recent three fiscal years and the portion of the current year preceding the date of the filing of the Form 15, or the period since the company became subject to the reporting obligation. Note that the company's quarterly and annual reports need not have been filed within the prescribed deadlines for such reports to satisfy this requirement—the company just needs to have filed all of its periodic reports.

Analyze whether deregistration is the right decision for the company. This is extremely important, especially because deregistration results in the company's inability to list its securities on an exchange, Nasdaq or the OTC Bulletin Board. The company must consider the negative aspects of being registered, including:

1. The significant legal, accounting and other expenses associated with being a public company; and
2. Less flexibility as a result of mandatory periodic disclosure.

The company must weigh these costs against the benefits of public company status, including:

- Raising capital in the public marketplace;
- Using public stock to consummate acquisitions;
- Enhanced corporate image and increased incentives for management and employees; and
- Liquidity of stock.

Review the company's existing contractual commitments. The company may have contractual obligations to continue to file SEC reports and/or to deliver audited financial statements, such as those typically contained in underwriting, registration rights or financing agreements. If so, the company will need the consent of these parties to deregister or it will be subject to a potential lawsuit upon breach of such agreements.

Review the company's stock option plans and agreements. Companies should be aware of the effect of deregistration on stock options granted to employees pursuant to any current employee stock option plan registered on Form S-8. If the company deregisters its stock, the company must find an exemption from

Securities Act registration requirements. Even if an exemption from registration is available, employees who exercise options no longer will receive freely tradable shares but instead will receive restricted shares. If no exemption is available, a company may not be able to issue shares to employees without registration under the Securities Act.

Review the company's certificate of incorporation and bylaws. Reviewing the company's certificate of incorporation and bylaws will ensure that there are no restrictions on terminating SEC reporting (although it is unlikely that either the certificate of incorporation or bylaws will contain any such restriction).

Review the laws of the company's state of incorporation. The laws of the company's state of incorporation must be reviewed to determine the company's continuing obligations to stockholders following deregistration under the Exchange Act, such as furnishing financial statements (including whether they need to be audited) and holding stockholder meetings. For example, under Delaware and New York law, a company that deregisters its securities under the Exchange Act is still required to hold annual stockholder meetings. However, the failure to hold an annual meeting does not affect the validity of any corporate action. Also, a formal proxy statement need not be distributed to stockholders, just a notice of the meeting. Although Delaware and New York law do not require a company to furnish its stockholders with annual financial statements, some states, such as Arizona, require companies to furnish annual financial statements to shareholders within a certain period of time after the end of each fiscal year.

Procedural Considerations

Once the company has determined to deregister its securities under the Exchange Act, the company must take the following steps:

Obtain Board Approval

The company must obtain approval of the board of directors to take all steps necessary to delist its securities from an exchange or Nasdaq, if necessary, and to deregister the company's securities under the Exchange Act. Stockholder approval is not required. The board of directors should consider the following when discussing whether to approve delisting and deregistration:

- The effects of deregistration on the company's ability to raise capital;
- The past, current, and future role of the public company vehicle in the company's expansion plans;
- Whether the company has taken advantage of its public company status—has being a public company enhanced its corporate image and increased incentives for management and employees?;
- The time and costs involved in preparing periodic reports and complying the SEC reporting requirements;
- The effects of public disclosure of information relating to the company's business and operations to competitors;
- The potential additional costs involved in complying with the SOX and the SEC rules promulgated thereunder, including recruiting independent directors to serve on audit committees and implementing enhanced disclosure controls and procedures and internal controls, among other things, relating to CEO/CFO personal certifications;
- The effects of loss of liquidity of securities on stockholders; and
- The procedures, timing and costs associated with delisting and deregistration.

Voluntarily Delist the Company's Securities from the Relevant Exchange or Nasdaq and File a Form 15

The steps a company will take following board approval to deregister depends on whether the company is registered under Section 12(b), Section 12(g), or Section 15(d) of the Exchange Act. When a company deregisters its securities in accordance with one of these three sections, it must analyze whether it is then registered by default under another section, and if it is, then it must deregister from that section as well.

Section 12(b) companies. Companies registered under Section 12(b) of the Exchange Act first must apply

to the exchange to remove the company from listing in accordance with the rules of the exchange. Each exchange has different delisting procedures. For example:

- New York Stock Exchange (NYSE) Rule 500 requires a company proposing to withdraw a security from listing to: (1) obtain approval of the audit committee and the board of directors, (2) publish a press release announcing the proposed delisting, and (3) send to at least 35 of its record shareholders with the largest positions in the security written notice alerting them to the proposed delisting. The notice must specify the earliest possible date of delisting, (which date may not be less than 20 or more than 60 business days after the later of the date the notice is sent or the press release is issued) and must include a statement that the company complied with items (1) and (2) above. The company contemporaneously must send a copy of the notice to the NYSE.[4]

- American Stock Exchange Rule 18 requires a company proposing to withdraw a security from listing to give written notice to the exchange of its intention to voluntarily withdraw its securities from listing and registration on the exchange, provided the company complies with all applicable state laws in effect in the state in which it is incorporated.

- The Boston Stock Exchange requires a company proposing to withdraw a security from listing to file with the exchange a certified copy of the board resolutions authorizing the delisting, along with a draft of the SEC withdrawal application. On receipt of the draft delisting application and board resolutions, the exchange will provide the company with a No Objection Letter. The company then must file the delisting application, certified board resolutions and No Objection Letter with the SEC.

- Pacific Stock Exchange Rule 5.4(b) requires a company proposing to withdraw a security from listing to submit a certified copy of a resolution adopted by the company's board of directors authorizing withdrawal from listing and registration, and a statement setting forth in detail the reasons for the proposed withdrawal and the facts in support of it.

Upon filing for voluntary delisting from the exchange, the company should issue a press release announcing the filing and the company's intention to deregister its securities under the Exchange Act once delisted. Some exchanges, like the NYSE, require a press release announcing a proposed delisting as a prerequisite to delisting.

If the exchange approves the company for delisting, it will issue a no-action/no comment/no objection letter notifying the company of its approval and instructing the company to submit an application to the SEC pursuant to Exchange Act Rule 12d2-2 to approve the exchange delisting. The company then will file the delisting application in triplicate with the SEC.[5] A copy of the application also must be sent to the applicable exchange.

Once the SEC's Division of Market Regulation receives the application, it is required to publish notice of its receipt of the application in the *Federal Register*. The notice also will solicit public comment for a period of approximately 21 calendar days. If no comments are received during the 21-day period, then the SEC will issue an order approving the application within two days following the expiration of the comment period.[6] Once the SEC issues the final order, the company is no longer registered under Section 12(b) of the Exchange Act and now must deregister under Sections 12(g) and/or 15(d) of the Exchange Act by filing a Form 15 with the SEC in accordance with the procedures described subsequently.

Section 12(g) companies. Unlike certain exchange-listed companies that are required to undergo a formal delisting process, companies whose securities are quoted on the Nasdaq National Market or SmallCap Market may voluntarily delist their securities upon written notice to Nasdaq.[7] The OTC Bulletin Board does not have any formal requirements regarding delisting.

Although not required by Nasdaq or OTC, a sufficient time prior to voluntarily delisting and filing a Form 15, a Nasdaq or OTC company may want to consider issuing a press release stating that the company intends to voluntarily delist its securities and file a Form 15. This would serve to:

- Give holders the opportunity to sell their shares while the company's securities are still listed and registered under the Exchange Act; and

- Alert market makers that immediately at delisting and filing Form 15, the company's securities will cease trading on Nasdaq or the OTC Bulletin Board, as the case may be, and may be eligible for quotation on the "pink sheets" (described below). Market makers then will have the opportunity to prepare a Form 211 package in advance of the filing of the Form 15.

The company would then file a Form 15 with the SEC certifying that:

- The number of record holders of the class of securities to be deregistered is less than 300; or

- The number of record holders of that class of securities is less than 500 and the registrant's total assets have not exceeded $10 million on the last day of each of the registrant's three most recent fiscal years.

Simultaneous with filing Form 15, the company would issue a press release announcing the delisting and the filing of Form 15.

At filing Form 15, a company's common stock immediately will cease to be quoted on Nasdaq or the OTC Bulletin Board, as the case may be, and may be eligible for quotation on the "pink sheets," an automated, real time electronic quotation service similar to the OTC Bulletin Board that is operated by Pink Sheets LLC, a privately owned company that provides broker/dealers, issuers, and investors with electronic and print products and information services designed to improve the transparency of the over-the-counter markets. The "pink sheets" is a source of competitive market maker quotations, historical prices and corporate information about over-the-counter issues and issuers.[8]

Immediately with filing Form 15, the company's duty to file any reports required under Section 13(a) of the Exchange Act is suspended. However, the SEC has up to 90 days from the Form 15 filing to deny the termination of registration under Section 12(g) if it finds that the facts do not support the certification. If the SEC does so, the company must file with the SEC, within 60 days of the denial, all reports that would have been required had Form 15 not been filed. If the SEC approves the termination of registration under Section 12(g) within such 90-day period, then the registration of the equity security will be terminated as of the date of SEC approval. Companies should be aware that Section 16 of the Exchange Act (governing short-swing profit liability and the filing of Forms 3, 4, and 5) remains applicable until the termination of registration becomes effective.

Section 15(d) companies. In addition to SEC filing obligations that arise under Section 12 of the Exchange Act, Section 15(d) independently requires that a company that has filed a registration statement that has been declared effective under the Securities Act file periodic reports with the SEC. When a company terminates its registration under Section 12 but has previously filed a Securities Act registration statement that was declared effective, the issuer's duty to file periodic reports may continue under Section 15(d). SEC Rule 12h-3 provides that any reporting obligations arising under Section 15(d) immediately are suspended at the issuer's filing of a Form 15. A company may terminate its registration under Section 12 and suspend its registration under Section 15(d) by filing one Form 15 and checking the appropriate boxes on the form to indicate termination and suspension of registration under these sections.

Post-Deregistration Considerations

A company that deregisters its securities under the Exchange Act will want to keep the following in mind:

1. The company must consider whether or not it wants to continue to furnish information to market makers in order to maintain quotation on the pink sheets;

2. The company will continue to be required to comply with the laws of the state of its incorporation with respect to the company's continuing obligations to stockholders, including holding annual meetings and furnishing financial statements, if applicable;

3. The company may want to continue to issue press releases about significant company events, although it is not required to do so; and

4. If the company desires to reenter the Exchange Act reporting system, it will need to file a Form 10 or similar form with the SEC. The SEC will review the Form 10 just as it would review a registration state-

ment and the company will be able to resume its reporting obligations upon the SEC's approval of Form 10.

Conclusion

Given the current economic climate and the potential additional costs involved in complying with the SOX and the SEC rules implementing SOX, companies that currently are publicly listed on an exchange, Nasdaq, or the OTC Bulletin Board and subject to SEC public reporting requirements are being forced to consider whether the current benefits of being public outweigh the costs. An Exchange Act registered company that has less than 300 record holders and wants to "go private" need not engage in a complex, time consuming, and expensive "going private" transaction in order to avoid the costs and expenses of periodic reporting. Voluntary delisting and deregistration under the Exchange Act may provide a cost-efficient alternative to the burdens of being public while leaving open the opportunity to return to the Exchange Act reporting system in the future.

NOTES

1. Exchange Act Rule 12g5-1 defines "held of record" for purposes of Sections 12(g) and 15(d) of the Exchange Act. It is the counting rule for determining whether a company has sufficient security holders to become or remain subject to Section 12(g) and to remain subject to Section 15(d). Institutional custodians, such as Cede & Co. and other commercial depositories, are not single holders of record for purposes of the Exchange Act's registration and periodic reporting provisions. Instead, each of the depository's accounts for which the securities are held is a single record holder. In contrast, securities held in street name by a broker-dealer are held of record under the rule only by the broker-dealer. The SEC originally proposed a version of the rule that would have looked through to the beneficial owners of the street-name securities, but adopted the rule in a form that does not produce this result. Release No. 33-7426 (September 15, 1964); *see also Division of Corporate Finance Manual of Publicly Available Telephone Interpretations*, July 1997, Section M, Interpretation No. 30.

2. Note that a class of securities never is considered registered under more than one section at a time. For example, if a Section 15(d) reporting company registers a class of securities under Section 12(b) or Section 12(g), its Section 15(d) reporting obligation is suspended while the class of securities is registered under Section 12.

3. Companies should be aware that this requirement also applies to Form S-8 registration statements for securities offered under employee benefit plans, which are declared effective on filing.

4. On August 20, 2003, the NYSE filed with the SEC a proposed rule change to repeal NYSE Rule 500 and amend Section 806 of the NYSE Listed Company Manual regarding the procedures for voluntary delisting. Amended Section 806 would require simply that a company furnish the NYSE with a certified board resolution evidencing board approval of the voluntary delisting. On September 10, 2003, the SEC published the proposed rule for comment in the *Federal Register*. Within 35 days of the date of publication (October 15, 2003) or within a longer period as the SEC may designate up to 90 days or as to which the NYSE consents, the SEC either will approve the proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved.

5. The application will include the documents originally submitted to the exchange along with the no-action/no comment/no objection letter issued to the company by the exchange. Mail the application to: Ms. Gail Fortson, Paralegal Specialist, Division of Market Regulation, Mail Stop 10-01, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, DC 20549-1001.

6. It should take approximately four weeks from the time the application is filed with the SEC until the issuance of the order.

7. Nasdaq Rule 4480(b) simply provides that a company may voluntarily terminate its designation on written notice to Nasdaq. Generally, a listed company that wishes to voluntarily delist must send a letter to Nasdaq stating the reason for the company's decision to delist. The company also must send to Nasdaq a copy of Form 15 as filed with the SEC. Nasdaq rules do not require stockholder approval for delisting.

8. Before an equity issue can be quoted on the pink sheets, a market maker first must determine if the company is eligible for an exemption under SEC Rule 15c2-11, based primarily on frequency of quotation. If there is no exemption available, a Form 211 must be completed and mailed with two copies of the required company information to NASD Regulation, Inc., OTC Compliance Unit, 9513 Key West Ave., Rockville, MD 20850. The OTC Compliance Unit will review the information contained in the Form 211 and contact applicants if additional information is necessary. A notification will be sent out when the application has been cleared.

For a company's common stock to continue to be quoted on the pink sheets, the market maker must have certain company information in its possession that is "reasonably current" (*i.e.*, the balance sheet is as of a date less than 16 months before publication or submission of a quotation, the statements of profit and loss and retained earnings are for the 12 months preceding the date of the balance sheet, and if the balance sheet is not as of a date less than six months before the publication or submission of a quotation, it must be accompanied by additional statements of profit and loss and retained earnings for the period from the date of the balance sheet to a date less than six months before the publication or submission of a quotation). Other information regarding the company (*i.e.*, name, address, outstanding shares, nature of business, products offered, names of officers and directors, etc.) will be considered "reasonably current" if it is as of a date within 12 months prior to the publication or submission of a quotation.