No Easy Exit: The Challenges For Non-U.S. Issuers Seeking to Delist

by Mark S. Bergman*

The enactment of the Sarbanes-Oxley Act and the SEC rulemaking that followed prompted a number of non-U.S. issuers listed in the United States to question the value of maintaining their listings. What these issuers have discovered is that, while terminating a listing or quotation is simple, getting out of the U.S. reporting system is no easy matter. This article explores the reasons for that conclusion.

Background

For some issuers, the costs of being a U.S. reporting company—likely to increase again this year as preparations are made to implement internal control processes ahead of the July 2005 deadline—appear to outweigh the benefits. For some, the acquisition prospects that prompted a U.S. listing have not materialized. For others, flowback to the home market—hastened by the willingness of U.S. fund managers to buy in the issuer's local market—has reduced the volume of trading in the U.S. market. At the same time, Rule 144A can facilitate access to the U.S. markets without SEC registration, potentially narrowing the advantages a U.S. listed company has over a non-U.S. listed company.

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Issuers accessing the U.S. public markets will generally list their securities on a U.S. stock exchange or Nasdaq—either listing the securities as a discrete action or in connection with a public offering. Both a listing and a public offering trigger SEC registration requirements, albeit under separate regimes. A public offering requires registration under the regime that governs public offerings (the Securities Act of 1933) and a listing requires registration under the regime that governs companies whose shares are listed or otherwise widely held (the Securities Exchange Act of 1934).

Although the NYSE and Nasdaq have approval processes (as a part of which issuers must establish that they meet the requisite listing standards and agree to be bound by ongoing obligations), the bulk of the work for companies listing or listing/offering securities will involve SEC registration. If the issuer conducts a public offering, the issuer will have filed a Form F-1 registration statement with the SEC under the Securities Act and will have filed a relatively short form (Form 8-A) to effect the registration under the Exchange Act. If the issuer only lists securities, it will have filed a Form 20-F registration statement under the Exchange Act. In either case, if the issuer offers/lists its shares in the United States in the form of American Depositary Shares ("ADSs"), it will also have filed a Form F-6 registration statement.

Termination of an NYSE Listing or Nasdaq Quotation

For the non-U.S. issuer seeking to terminate a listing on the NYSE or quotation on Nasdaq, there is a relatively straightforward process. All that is required is a letter requesting such a termination and, in the case of an NYSE listing, a certified copy of the board resolutions approving the delisting. Shareholder approval is not required.

When an NYSE listing or Nasdaq quotation is terminated, the issuer's ordinary shares (or ADSs) cease to trade in the United States. At this point, however, the issuer is still an SEC registrant, but more about that below.

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Termination of the ADR Program

If the issuer has ADSs trading in the United States and delists, there is no reason to maintain the issuer's ADR program. An ADR program generally may be terminated by termination of the applicable Deposit Agreement, which often will require at least 30 days' notice from the issuer. The depositary would then mail a notice of termination to all ADS holders, who would be expected to surrender their ADSs in exchange for the underlying ordinary shares.

It would not be uncommon for a depositary bank to be entitled to recoup the costs and expenses incurred by it in setting up an ADR program in the event of an early termination. Accordingly, the terminating issuer might have reimbursement obligations.

Termination of Exchange Act Registration

As a condition to having securities listed on the NYSE or quoted on Nasdaq, the issuer will have registered its underlying securities under Section 12 of the Exchange Act. As a result of this registration, the issuer became subject, among other things, to SEC reporting requirements. Although the registration was prompted by the issuer's desire for an NYSE listing/Nasdaq quotation (perhaps together with a concurrent capital raising), termination of the listing or quotation does not result in termination of the issuer's Exchange Act registration: Exchange Act registration is triggered not only by a listing or quotation, but also by the existence of a significant shareholder base.

Technically, a foreign private issuer that has 500 or more shareholders worldwide, and 300 or more shareholders resident in the United States, is required to register its shares under Section 12 of the Exchange Act, whether or not it also maintains a stock exchange listing or a quotation on Nasdaq.[1] A foreign private issuer may terminate its registration (and thereby immediately cease to file periodic reports with the SEC), only if it has fewer than 300 shareholders in the United States.

To complicate matters, issuers that conduct registered public offerings in the United States become subject to an independent SEC reporting requirement under Section 15(d). For issuers that are Section 12 registered, this separate reporting requirement is in effect suspended, as it is by and large duplicative of the Section 12 requirements. When a Section 12 issuer terminates its Section 12 registration, if it was also subject to this separate Section 15(d) obligation, that obligation resurfaces. Luckily, if the issuer can terminate its Section 12 registration, it can also once again suspend its Section 15(d) reporting obligations.

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The 300-shareholder limit raises two issues. The first is how to count the issuer's shareholders (of both ADSs and the underlying ordinary shares) in the United States. The issuer would need to have DTC in the United States, with respect to ADSs, and the local settlement system, with respect to ordinary shares, ascertain the number of holders of the issuer securities with U.S. addresses and also request the same of all brokers, dealers, banks, and nominees that are record holders of ordinary shares and ADSs regarding the number of separate accounts for which they each hold the issuer securities on behalf of persons resident in the United States.

The issuer may find that there are a significant number of U.S. persons holding ordinary shares through nominee accounts maintained with local or foreign banks and brokers. Furthermore, the issuer should anticipate that it may be difficult to obtain the required information.

If an issuer were able to establish that it has fewer than 300 holders of its securities resident in the United States, it could then terminate the registration of its ordinary shares under the Exchange Act. Termination of registration of a class of securities is effected by filing a Form 15 with the SEC under Rule 12g-4 of the Exchange Act. If the issuer would also face a potential 15(d) reporting obligation upon termination of its Section 12 registration, the Form 15 should also make reference to Rule 12h-3, which provides for suspension of the Section 15(d) obligation upon filing of a Form 15 and has the same test for eligibility as Rule 12g-4. The suspension of Section 15(d) reporting obligations is immediate if the issuer has timely filed its SEC reports for the shorter of the life of its reporting obligations and three fiscal years.

Provided the Form 15 is valid (i.e., there were fewer than 300 shareholders resident in the United States at the time), deregistration would follow within 90 days of filing, although the obligation to file reports is suspended right away. If the certification under Form 15 is subsequently withdrawn or denied, the issuer would be required to file within 60 days all required reports as if the Form 15 had not been filed.

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This raises the second issue: how to remain below the 300-shareholder threshold. This is important, as the suspension of the Section 15(d) reporting obligation following the filing of a Form 15 is only effective for as long the issuer maintains fewer than 300 shareholders resident in the United States. For companies that did not have a Section 15(d) reporting obligation because they never made a public offering in the United States, the 300-shareholder threshold becomes an issue as it would for any other issuer that triggers the 300-shareholder test. In either case, if the number of shareholders in the United States were to increase above 300, the issuer could once again find itself subject to the reporting requirements of the Exchange Act.

If an issuer could ensure that it had fewer than 300 U.S. resident shareholders for a continuous period of at least 18 months, it could seek an exemption under Rule 12g3-2(b). This exemption would permit the issuer to avoid any future Exchange Act reporting obligations that might otherwise arise by merely submitting copies of its local filings with the SEC when such submissions are made public locally. Rule 12g3-2(b) issuers are not required to make any certifications in respect of such filings under Sarbanes-Oxley and are not subject to any of the other provisions of Sarbanes-Oxley. However, the Rule 12g3-2(b) exemption is unavailable to any foreign private issuer that has had a reporting obligation during the preceding 18 months.

If an issuer cannot remain below the 300-person threshold for the entire 18-month period, the reporting obligation is in effect re-instituted (and a new 18-month period begins). For issuers subject to suspension, the obligation could be triggered in respect of the fiscal year at the beginning of which there are 300 or more holders resident in the United States. In this case, the issuer would file its annual report for the preceding year, and an issuer that never had a Section 15(d) reporting obligation could become subject to a new registration process. It is difficult to stay below the 300-shareholder threshold because there is no way to ensure that shares do not flow back into the United States.

Alternatives

Some foreign private issuers have considered conducting tender offers in the United States to reduce the number of shareholders, but transactions of this sort are problematic: It is difficult to conduct a tender offer only in the United States, and likely that arbitrageurs in the United States will elect to hold securities in contemplation of an upward swing in the stock price.

Other foreign private issuers whose shares are listed only in the United States have delisted through going-private transactions. Such an option would presumably not be available to an issuer whose ordinary shares are listed outside the United States and that wishes to remain public in its local market.

Issuers with high yield debt that was subject to a registered exchange offer are Section 15(d) issuers. Although they can terminate their SEC reporting obligations if, as is likely, they have fewer than 300 holders of the notes, the indenture under which the notes were issued will require continued reporting. Although these so-called "voluntary filers" will not be subject to the audit committee independence rules, they generally are subject to many of the other disclosure and disclosure-related rules and regulations applicable to reporting companies.

Consequences

Until such time as it is able to de-register its shares, an SEC registrant remains obligated to file its Form 20-F with, and submit reports on Form 6-K to, the SEC and remains subject to provisions of the Sarbanes-Oxley Act. Upon delisting, the rules that are tied to listed company status, such as the audit committee independence rules, cease to apply. If the issuer is able to demonstrate that it has fewer than 300 sharehold-

ers resident in the United States and it deregisters its shares, and remains capable of certifying as to that fact over a period of 18 months, it will then be eligible for the 12g3-2(b) exemption discussed above, whereby it submits only its home country reports to the SEC.

In sum, deregistration of a company's securities under Section 12 of the Exchange Act, while technically possible, could be challenging. With no reasonable way to prevent the flowback of ordinary shares into the United States following the filing of a Form 15 (even assuming a termination of a listing/quotation), it would be difficult for the issuer to ensure it maintains a shareholder base of fewer than 300 persons for the entire required 18-month period.

Recently a group of European trade organizations wrote the Chairman of the SEC on behalf of European issuers to raise these issues and to seek some accommodations to facilitate deregistration. As the deregistration process implicates fundamental provisions of the registration system, it is unclear whether the SEC will be willing to make any such accommodations. Thus far, informal statements from the SEC staff (including remarks by the director of the SEC's Division of Corporation Finance in early May) indicate that the staff is very much aware of the issue and suggest that some modifications may be forthcoming, but not immediately. W

Notes

1 There are two relevant provisions of Section 12: Section 12(b) is relevant if the issuer lists on the NYSE, while Section 12(g) is relevant if the issuer quotes its shares on Nasdaq or if it triggers the "widely held" thresholds.