Linklaters

U.S. Securities Law Briefing

De-listing, De-registration – Delayed? The SEC Proposes New *Procedures* for the De-listing and De-registration of Securities

Last week the U.S. Securities and Exchange Commission (the "SEC") proposed rule changes designed to streamline the *procedures* for removing from listing, and withdrawing from registration, securities registered under the U.S. Securities Exchange Act of 1934 (the "Exchange Act"). While the rule proposals would simplify the procedures for de-listing and de-registration of a class of securities registered under the Exchange Act, they do not address the substantive problems faced by issuers seeking to suspend or terminate their reporting obligations under the Exchange Act and to put an end to their obligations to comply with the many new compliance requirements made applicable to "issuers" (i.e., companies with Exchange Act-registered securities) by the U.S. Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act").

Attention has recently focused on the concerns of non-U.S. issuers that desire to terminate their U.S. listings and exit the U.S. markets. Those concerns arise most of all from obligations, imposed by the Sarbanes-Oxley Act, including mandatory CEO and CFO certification of disclosure and financial statements in annual reports on Form 20-F, mandatory management assessment and auditor attestation of internal controls, mandatory disclosure of off-balance sheet arrangements and aggregate contractual obligations, and mandatory "reporting up" by legal advisers involved with U.S. securities law matters, all of which are perceived outside the United States as highly intrusive, disproportionately expensive and administratively onerous. Increased home-market liquidity has also reduced many non-U.S. issuers' desires to maintain a listing in the United States. This Briefing considers not only the proposed new procedures for de-listing and de-registering securities, but also the consequences of the SEC's omission to address any part of the proposed rule changes to non-U.S. issuers' concerns regarding potentially never-ending U.S. reporting and compliance obligations despite de-listing and its accompanying de-registration.

Proposed New Procedures for De-listing and De-registering Securities

De-listing and De-registering under Section 12

Currently, in order voluntarily to de-list a class of securities and withdraw ("de-register") that class from registration under the Exchange Act, an issuer must (1) comply with the de-listing rules and requirements of the relevant exchange (often, for non-U.S. companies, the New York Stock Exchange); and (2) apply to the SEC to withdraw the class both from listing on the exchange and from registration under Section 12(b) of the Exchange Act. The SEC publishes the issuer's application for comment, and any interested person may submit to the SEC in writing facts and opinions bearing upon the application, including what terms should be imposed by the SEC for the protection of investors. The SEC may order a hearing on the matter and, in its final Order, can impose such terms as it believes necessary for the protection of investors. De-listing and de-registration can also be initiated by an exchange when an issuer's securities fall below the exchange's listing standards or based on certain corporate actions of the issuer (e.g., where the entire security class is matured, redeemed, retired or extinguished by operation of law).[1]

The exchange de-listing process differs from the procedures applicable to the de-listing of securities from the Nasdaq Stock Market ("Nasdaq"). Section 12(b) does not apply to issuers

[1] Current Rule 12d2-2 also provides for de-listing and de-registration initiated by the exchange or by the issuer in other circumstances which are deleted from the rule as proposed to be changed.

listed on Nasdaq because Nasdaq is not formally an “exchange” under U.S. law. As a result, issuers may voluntarily terminate their listings upon written notice to Nasdaq, and Nasdaq may terminate listings, pursuant to procedural rules of the National Association of Securities Dealers (“NASD”) that have been approved by the SEC. De-listing determinations by the NASD are reviewable upon appeal to the SEC.

Consequences of De-listing

If a class of an issuer’s securities is voluntarily or involuntarily de-listed under the rules of the relevant exchange (unless also listed elsewhere in the United States), those securities are concomitantly de-registered under Section 12(b) of the Exchange Act; if a class of an issuer’s securities is voluntarily or involuntarily de-listed from Nasdaq under NASD rules, registration status is not necessarily affected. In either instance, mandatory registration obligations still apply, under Section 12(g) of the Exchange Act, to issuers with relatively small amounts of assets (US$10 million) and relatively low numbers of securityholders of the class in question (500 worldwide including 300 or more holders resident in the United States), and mandatory reporting obligations continue, under Section 15(d) of the Exchange Act, for issuers who have had one or more registration statements declared effective under the U.S. Securities Act of 1933 (the “Securities Act”).

Proposed Rule Changes

The proposed rule changes serve the limited purpose of seeking to reduce the paperwork burden on exchanges and issuers and clarifying the de-listing process for members of the public seeking access to information on the registration and de-registration of a security.

Under the rules as proposed to be changed, exchanges and issuers would follow the rules of the applicable exchange regarding the de-listing of securities, after which the exchange or issuer would file a Form 25 with the SEC to remove the security from listing and withdraw it from registration under Section 12(b) of the Exchange Act. The changes being proposed would make the exchange de-listing procedures similar to the current procedures for de-listing securities from Nasdaq.

- Voluntary De-listing

  An issuer would withdraw its securities from exchange listing and concomitant registration by filing an application on Form 25 certifying: (1) that it has complied with the exchange’s rules for de-listing and any applicable corporate laws; (2) that it has submitted written notification of its intent to de-list its securities from the exchange 10 days prior to filing Form 25; and (3) that it has issued public notice of its intent to de-list via a press release and a web posting. The de-listing of the security would be effective 10 days after the Form 25 is filed with the SEC, and the withdrawal from registration would occur 90 days after filing of the Form 25. To preserve the SEC’s authority to protect the interests of investors, the SEC would be able to postpone effectiveness of a de-registration to determine whether the Form 25 is proper and whether any terms should be imposed for the protection of investors.

- Exchange-Initiated De-listing

  An exchange would be able to de-list a security by filing an application on Form 25, and the de-listing would be effective 10 days after the Form 25 is filed with the SEC. Withdrawal from registration would occur 90 days after the filing of the Form 25. An SEC Order would no longer be required for de-listing and de-registration; however, the rules of the exchange would have to provide: (1) notice to the issuer of the exchange’s decision to de-list its

securities; (2) an opportunity for appeal to the exchange's board of directors, or to a committee designated by the board; and (3) public notice of the exchange's final determination to de-list the security at least 10 days before the de-listing becomes effective. These requirements are largely consistent with the procedures the exchanges presently have in place.

– Corporate Actions

The proposed rule changes would retain the current requirement that an exchange file a Form 25 to strike a security from listing and registration following certain corporate actions: where the entire security class is matured, redeemed, retired, or extinguished by operation of law.

Form 25 and EDGAR

The proposed rule changes would expand the use of Form 25 to apply to de-listings whether initiated by the issuer or by an exchange, and would require that every Form 25 be filed electronically on EDGAR. In that manner the proposed rule changes would make information on de-listing and de-registration more readily accessible on the internet for the convenience of the investing public. The de-listing of a security would be effective 10 days, and removal of the security from registration under Section 12(b) would be effective 90 days, after the filing of the Form 25 with the SEC.

Substantive Issues Not Addressed in the Proposed Rule Changes

Despite the proposed simplification of the procedures for de-listing and concomitant de-registration under Section 12(b) of the Exchange Act, there are other mandatory registration obligations still applicable to most issuers of securities previously listed on an exchange, and continuing reporting obligations applicable to issuers that have had registration statements declared effective under the Securities Act. Specifically:

– Section 12(g) requires registration under the Exchange Act, regardless of whether the issuer has an exchange listing or Nasdaq quotation, if, in the case of a non-U.S. company, the company has US$10 million or more in assets on the last day of its most recent fiscal year and any class of its equity securities is held by 500 or more persons worldwide including 300 or more holders resident in the United States.

– A company which has had a registration statement declared effective under the Securities Act becomes a reporting company under Section 15(d) of the Exchange Act and continues in that status unless, at the beginning of any fiscal year, the registered class of securities covered by the relevant registration statement is held of record by fewer than 300 persons worldwide (or, in the case of a non-U.S. company, fewer than 300 holders resident in the United States).

These other obligations render it extremely difficult for non-U.S. issuers to terminate their annual and periodic reporting obligations under the Exchange Act and to put an end to their obligation to comply with the requirements under the Sarbanes-Oxley Act applicable to companies with Exchange Act-registered securities. Briefly:

– although Rule 12g3-2(b) (which principally requires a non-U.S. issuer to furnish to the SEC information made public in its home market or distributed to its shareholders in lieu of reports under the Exchange Act) provides a commonly-used means for non-U.S. companies that don't list their securities on a U.S. exchange or Nasdaq to avoid registration under Section 12(g), that Rule is not available for 18 months after an issuer has terminated its

Section 12(g) registration and is permanently unavailable for issuers that have reporting obligations under Section 15(d) even if those obligations are suspended (which encompasses all issuers that have made a registered public offering in the United States or filed a registration statement in connection with a business combination with a U.S. reporting company);

- a non-U.S. issuer can only de-register a class of securities otherwise required to be registered under Section 12(g) of the Exchange Act by certifying to the SEC that the class of securities is held by fewer than 300 U.S. resident holders;
- a non-U.S. issuer's reporting obligation under Section 15(d) of the Exchange Act can be suspended only if the relevant class of securities is held by fewer than 300 U.S. resident holders; and
- Rule 12g3-2(a) provides that a class of securities issued by a non-U.S. company is exempt from registration under Section 12(g) of the Exchange Act if the class is held by fewer than 300 U.S. resident holders at fiscal year end. (If a non-U.S. company subsequently exceeds this threshold on the last day of any fiscal year, it must once again register under Section 12(g), or its reporting obligation under Section 15(d) is reinstated, as the case may be.)

A non-U.S. company must "look through" record ownership by depositaries, similar institutional holders and financial intermediaries in order to determine that securities of the class are held by fewer than 300 U.S. resident holders. Unwillingness by and inhibitions on depositaries and intermediaries almost always frustrate issuers' efforts to complete this required "look through". In contrast, the worldwide securityholder threshold maybe an easier standard to satisfy in that it is based on record ownership of securities.[2]

Thus, to suspend or terminate their reporting obligations and to put an end to their required compliance with the plethora of Sarbanes-Oxley-imposed requirements, non-U.S. companies must clearly establish, after the extremely difficult "look through", that there are fewer than 300 U.S. resident holders of the class of securities sought to be de-registered. Further, non-U.S. companies that have ever made a U.S.-registered public offering cannot permanently free themselves of the burdens of Exchange Act reporting obligations but rather must perform the 300-U.S.-resident-holder analysis annually at the end of each fiscal year. Given the relative ease with which U.S. investors can access non-U.S. markets, remaining below this threshold is often outside of the control of the company seeking to deregister.

Non-U.S. Issuers Seeking De-listing and De-registration

As a consequence of the additional regulatory burdens imposed by the Sarbanes-Oxley Act, increased home-market liquidity and the economic downturn that has impacted markets around the globe, many non-U.S. companies registered with the SEC are pressing for substantive reform affecting de-listing and de-registration under the Exchange Act, to a far greater extent than is demonstrated in the presently proposed rule changes. This past winter a group of European industry groups, representing leading European companies, including more than 100 registered under the Exchange Act, wrote to the SEC with a series of proposals to ease the burden on non-U.S. issuers seeking to terminate their reporting and compliance obligations. The industry groups have asked for modifications which would: (1) allow an issuer satisfying certain disclosure standards two years after a U.S. public offering or listing, to terminate its reporting obligations and

[2] While a number of commentators have suggested that the staff eliminate the "look through" and use a record ownership test, senior SEC staff have indicated informally that they would be more likely to impose the "look through" requirement on U.S. domestic issuers than to relieve non-U.S. issuers of the requirement.

be permitted to utilize the Rule 12g3-2(b) exemption from Exchange Act registration so long as trading volume in the United States remains less than 5 percent of worldwide trading volume during the issuer's most recent fiscal year; and (2) revise Rule 12g3-2(b) so that companies do not become permanently ineligible to use it.

Perhaps even more importantly, SEC Director of Corporation Finance Alan Beller indicated, in a heralded speech in Berlin in late April, that the SEC is looking for a balanced way to address the non-U.S. issuers' concerns. The very fact that the staff of the SEC is considering these issues, even if (as Mr. Beller indicated) action by the SEC is unlikely to come soon, ought to be taken as encouraging by non-U.S. issuers and their financial and legal advisers.

While we at Linklaters are ever hopeful that the recent non-U.S. issuers' proposals and the Division Director's articulate reaction herald a dialogue between the Commission and non-U.S. issuers, it must be acknowledged that a host of external factors is likely to impact the seriousness and speed of SEC action on the non-U.S. issuers' requests. For the time being the SEC continues to demonstrate a willingness to address the concerns of non-U.S. issuers seeking *access* to the U.S. markets, and (as always) directs a good deal of attention to equal-treatment arguments advanced by domestic U.S. companies, but must be expected to proceed slowly on issues of *departure* from the U.S. markets where some, albeit small, number of U.S. investors is left to trade on markets overseas. In the climate of summer 2004, at the SEC concerns regarding investor protection will no doubt remain paramount.

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