

**“Going Dark” – The Simple Path to Exiting the U.S. Public Company Reporting System – Delisting and Deregistration under the U.S. Securities Exchange Act of 1934
by Ted Farris**

INTRODUCTION

There is a significant opportunity for some China-based companies with calendar year fiscal years that are unhappy with their U.S. stock exchange listings and the burdens of being a publicly reporting company in the United States to promptly delist and deregister their shares under the U.S. Securities Exchange Act of 1934 (the “*Exchange Act*”). This is because an automatic suspension of reporting obligations under Exchange Act Section 15(d) occurs when a calendar year company has less than 300 shareholders of record as of January 1, 2012.¹ As only record holders (and not beneficial owners) are generally counted under this provision, some companies may be able to exit the U.S. reporting system even though they have many hundreds of beneficial owners. This path to exiting the U.S. reporting system may be available even if a company does not have an alternative non-U.S. listing and is currently delinquent in its SEC filings. We believe that many China-based companies that may have compelling reasons to consider Exchange Act deregistration are not fully aware of this possibility.²

Many China-based issuers currently have compelling reasons to consider whether to voluntarily delist their securities from U.S. stock exchanges and exit the Securities and Exchange Commission (“SEC”) reporting system under the Exchange Act. Among the most common incentives for leaving the system are: (1) low trading volumes and share prices resulting from limited interest in the company’s shares, (2) the continuing management distractions and high costs that arise from U.S. disclosure and reporting rules, (3) cumbersome and expensive Sarbanes-Oxley governance and reporting requirements, (4) SEC investigations, U.S. regulatory and shareholder litigation and potential securities law liabilities, (5) the inability to raise further capital in

the United States, (6) the availability of a stock exchange listing outside the United States and alternative ways of raising capital overseas and in the private market.

This memorandum briefly summarizes the complicated steps necessary for a China-based issuer to delist and deregister under the Exchange Act for issuers that may wish to consider leaving the U.S. reporting system voluntarily. To effectively terminate its SEC reporting obligations, a China-based company potentially must deregister under any and all of three separate Exchange Act statutory provisions which may be applicable to them: Section 12(b) (for listed companies), Section 12(g) (for companies that have had more than 500 shareholders of record) and Section 15(d) (for companies that have filed a registration statement under the U.S. Securities Act of 1933). These statutes—each of which is a separate and distinct predicate for Exchange Act registration and reporting obligations³—apply to U.S. SEC reporting companies whether they are U.S. companies or foreign private issuers.⁴

Delisting from a U.S. Stock Exchange and Deregistration under Section 12(b) of the Exchange Act

The first step towards Exchange Act deregistration for a U.S.-listed issuer is to delist from any U.S. stock exchange on which its shares or ADRs may be traded. U.S.-listed issuers have an absolute right to delist their securities voluntarily and to deregister them under Section 12(b) of the Exchange Act by filing a Form 25 with the SEC. The issuer must give notice of its intention to file the Form 25 and issue a press release announcing that intention ten days prior to filing the Form 25. The delisting will become effective ten days after filing the Form 25. However, SEC reporting obligations are not suspended on the Form 25 filing date unless the company has no Section 12(g) or Section 15(d) obligations which would be revived on filing the Form 25. The actual termination of registration under Section 12(b) does not occur until 90 days after effectiveness of the delisting.⁵

Deregistration under Section 12(g)

Once a company has delisted and deregistered under Section 12(b) (even if it was never a listed company), it must also generally deregister under Section 12(g). Section 12(g) obligations (which are suspended while Section 12(b) obligations are in effect) are revived once Section 12(b) obligations are suspended by filing the Form 25.⁶ In order to deregister its shares under Section 12(g), the company must file a Form 15 pursuant to Rule 12g-4 based on its having less than 300 holders of record within the meaning of Rule 12g5-1 as of a current date.⁷ However, once the company's Section 12(g) registration is terminated, the company's reporting obligations under Exchange Act Section 15(d) would be revived if the company has ever filed a registration statement under the Securities Act of 1933. Those Section 15(d) obligations can also be suspended (usually on the same Form 15 filed to terminate Section 12(g) obligations under Rule 12g-4) as explained below.

Suspension of Reporting Obligations under Section 15(d)

Statutory suspension at beginning of fiscal year. A company's Section 15(d) obligations are automatically suspended by statute as of January 1, 2012, provided that the company had less than 300 holders of record on such date. Companies taking advantage of this automatic statutory suspension under Section 15(d) are required by Rule 15d-6 to file a notice on Form 15 informing the Securities and Exchange Commission ("SEC") of such suspension within 30 days.⁸ However, even if the company does not make that filing by January 31, 2012, that Form 15 filing is not a condition of the automatic reporting suspension set forth in Section 15(d).⁹ Therefore, we believe that a company can suspend its obligations under Section 15(d) by filing a Form 15 at the same time and on the same Form 15 that it files under Rule 12g-4 described above.¹⁰

Rule 12h-3 suspension during the fiscal year. There is another Exchange Act rule, Rule 12h-3, which allows a company to suspend its Section 15(d) obligations

based on its having less than 300 shareholders of record on any day other than the first day of its fiscal year, provided that it has less than 300 shareholders of record within the meaning of Rule 12g5-1, is current on all SEC filing obligations, and has not had a registration statement declared effective or updated pursuant to Section 10(a)(3) of the Securities Act. Such updating occurs automatically by means of the incorporation by reference of an annual report on Form 10-K into a company registration statement prior to filing the Form 15. Thus to be eligible to use Rule 12h-3 in 2012 a calendar year filer must not yet have filed its Form 10-K or Form 20-F for the year ended December 31, 2011 if it has any registration statements that would incorporate that filing by reference. If a company that is current on its SEC filings, did not have any registration statements declared effective in fiscal 2012 and has not yet filed its 2011 Form 10-K or Form 20-F, it would be eligible to suspend its Section 15(d) reporting obligations under Rule 12h-3 as well as under the statutory suspension set forth in Section 15(d). If a company does not meet these requirements, it can only use the automatic statutory suspension contained in Section 15(d) discussed above, unless it already has a primary non-U.S. trading market and meets the requirements of Rule 12h-6, discussed in Note 12 below.

Obligations in the 90 day period prior to effectiveness of deregistration. Obligations to file Form 10-Ks, 20-Fs, 10-Qs, 8-Ks and 6-Ks, as applicable to a particular issuer, are suspended immediately upon filing of the Form 15. However, other Exchange Act filing obligations continue during the 90 day period following the filing of the Form 15 (or Form 25 to deregister under Section 12(b)). Foreign private issuers that were previously registered under Section 12(b) or 12(g) will continue to be subject to Section 13(d) and Section 13(e) requirements, which includes the very onerous going private Rule (Rule 13e-3) during the 90 day period. U.S. issuers (or non-U.S. issuers that fail to qualify as foreign private issuers) will also continue to be subject to the proxy rules and Section 16 reporting and short swing profit requirements. Issuers that were reporting only under Section 15(d)—because they have had an effective

registration statement—would not be subject to these additional requirements during the 90 day period.

**Applicability of SEC Exchange Act Requirements During the
90 Day Period after Filing a Form 15 and/or Form 25
Suspending or Terminating Exchange Act Reporting**

	<u>Predicate for Registration</u>		
	<u>Section 12(b)</u>	<u>Section 12(g)</u>	<u>Section 15(d)</u>
<i>Foreign Private Issuers (FPIs)</i>			
Tender Offer Rules under Section 14(d)	Yes	Yes	No
Proxy Rules	No	No	No
Going Private Rules	Yes	Yes	No
Section 13(d)	Yes	Yes	No
Section 16	No	No	No
<i>U.S. and Other Non-FPI Issuers</i>			
Tender Offer Rules under Section 14(d)	Yes	Yes	No
Proxy Rules	Yes	Yes	No
Going Private Rules	Yes	Yes	No
Section 13(d)	Yes	Yes	No
Section 16	Yes	Yes	No

Board Considerations

In order to cease its Exchange Act reporting obligations, a company’s board of directors would generally need to conclude, in the exercise of its fiduciary obligations under the law of its jurisdiction of organization, that such termination would be in the best interests of the company and its shareholders. If the issuer is incorporated in Delaware, the business judgment rule would apply to this decision unless a board member had a particular conflict of interest or an affiliate transaction were involved with the decision (such as a purchase of minority shareholder interests) that might make a higher standard of review applicable. If there is an interested director transaction or other special circumstances affecting the independence of board members, a special

committee of independent directors is sometimes appointed to consider the question of deregistration and its fairness to, and effects upon, unaffiliated shareholders.

The decision to deregister involves balancing the costs and benefits of going dark to the company and its shareholders. The benefits to the company of terminating its reporting obligations would normally include significantly lower accounting, legal, insurance and compliance costs related to Exchange Act and Sarbanes-Oxley requirements and public disclosure obligations. The company should make an effort to estimate and document these savings. The company would normally also benefit through the reduced public scrutiny and disclosure requirements following deregistration and the time saved and the reduction of burdens and distractions on its management and staff.

A “dark” period could, if needed, also give a troubled company an opportunity to develop a revised operating plan to reinvigorate its business without the distractions and costs of being a public company. The company could also benefit from lower ongoing securities law liability risks, although Rule 10b-5 and other Federal and State antifraud statutes would still be applicable to U.S. domestic transactions in its shares.

Negative effects of a “going dark” decision, on the other hand, would include reduced visibility of the company to its public shareholders after it ceases public reporting. However, if the market for a company’s stock is already relatively illiquid and is trading at a low price per share, public shareholders may not be greatly injured or even surprised by a decision to deregister. Following filing of a Form 15, shares would typically trade in the over-the-counter market operated by OTC Markets Group, Inc. known as the “Pink OTC Market” and would have the abbreviation “PK” added to the trading symbol.

In computing the number of record holders for purposes of Rule 12g5-1, an issuer need not look through the holdings of brokers, dealers, banks or other nominees

to count the beneficial owners of its common shares. As a result, the company may have many hundreds of beneficial owners of its common stock while still having less than 300 holders of record for purposes of Rule 12g5-1.¹¹ To determine whether the company has less than 300 holders of record, the company should obtain a shareholder list (including for employees who hold shares or others who directly own share certificates) as of January 1, 2012 and as of a subsequent date (nearer the date on which it intends to file a Form 15) as well as DTC security position listings dated the same dates in order to count the total number of record holders shown in the manner required by Rule 12g5-1.

The impact of any decision to deregister on a company's minority shareholders must be carefully considered by the Board of Directors and/or a special committee. Public shareholders often view deregistration in a negative manner due to diminished available information about the company and the resulting potentially adverse impact on liquidity in the trading for the shares. However, the market for the company's common stock is often already extremely illiquid when a company is considering whether to "go dark".

A board of directors may also wish to consider whether it may be possible to mitigate the effect on the company's public shareholders of the deregistration process by having the board of directors establish a policy of continuing to regularly report unaudited earnings information (and perhaps annual audited information) in a manner similar to the company's past reporting practices for some further period. If desired this would help provide some additional liquidity to the company's shareholders while saving the expense of complying with full SEC, Sarbanes-Oxley governance requirements.

The company may also wish to consider providing an alternative market such as the Hong Kong stock exchange for its shareholders. Providing an alternative listing or relisting in connection with a U.S. reporting system exit can be a time consuming and expensive process (particularly where an overseas corporate structure may need to be

unwound), but provides a more attractive result for public shareholders. If a company which is a foreign private issuer is already listed outside the United States and the non-U.S. market is its primary trading market, the company may also wish to consider its eligibility to use Exchange Act Rule 12h-6 which can provide some dual listed foreign private issuers with an ability to exit the U.S. reporting system where a substantial majority of the company's trading volume is outside the United States and various other technical requirements are met.¹²

SUMMARY TIME SCHEDULE

The following sets forth a Summary Time Schedule for a voluntary Exchange Act deregistration where the company is not listed on any U.S. stock exchange and is not a foreign private issuer eligible to use Rule 12h-6.

Prior to going dark target date (for example, March 31):

1. Determine if the company has less than 300 holders of record under Rule 12g-5 as of January 1, 2012 and as of a current date.
2. Board to deliberate regarding proposal to deregister.
3. If a decision is made to proceed, issue an announcement.
4. Withdraw or terminate any/all Securities Act registration statements and deregister all unsold shares.
5. File Form 15 confirming the termination of registration and/or suspension of reporting under Rule 12g-4 and Rule 15d-6 or Rule 12h-3, as applicable.

If the company is listed on a U.S. stock exchange it must first delist before deregistering as described above. Delisting involves issuing an announcement at least 10 days before filing a Form 25 as well as the filing of a Form 25 at least 10 days before the Form 15 is filed. Delisting thus adds at least 20 days to the deregistration time schedule.

CONCLUSION

In conclusion, assuming it has less than 300 holders of record at January 1, 2012 and/or currently, a China based company that is a calendar year filer may have an opportunity now to exit the U.S. Exchange Act reporting system almost immediately and at minimal cost. This would allow the company to cease making filing SEC reports with respect to calendar year 2012 and would free it from future Exchange Act compliance obligations going forward¹³ which should result in substantial cost savings for the company in the future and also eliminate the management distractions and burdens of SEC compliance matters.

The Board should consider any proposal to delist and/or exit the U.S. reporting system in light of its fiduciary duties under applicable law. It is possible that minority shareholders of the company may object to the decision to exit the Exchange Act reporting system. If desired, an undertaking to continue public disclosure of operating results following a U.S. reporting system exit, although not required, could help reduce negative effects of the deregistration. Alternatively, the possibility of relisting in Hong Kong, on a Mainland stock exchange or elsewhere outside the United States could be considered.

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¹ The issuer must also previously or concurrently have delisted and deregistered under Section 12(b) and Section 12(g) of the Exchange Act, as applicable. But such deregistration need not have occurred prior to January 1, 2012, and such deregistration can typically be accomplished on the same basis as the Section 15(d) automatic suspension, namely having less than 300 shareholders of record.

² Many U.S.-trained lawyers are not familiar with the difficult and technical rules that govern deregistration under the Exchange Act.

³ Section 12(g) obligations are suspended while Section 12(b) obligations are in effect. Section 15(d) obligations are suspended while Section 12(g) obligations are in effect.

⁴ “Foreign private issuers” are defined in Exchange Act Rule 3b-4.

⁵ Exchange Act Rule 12d2-2.

⁶ Section 12(g) obligations are triggered by a company having more than 500 shareholders of record.

⁷ Deregistration is effective 90 days after filing the Form 15. The SEC has the option to reject a Form 15 during the 90 day period prior to effectiveness but almost never does so.

⁸ Rule 15d-6 provides that “If the duty of an issuer to file reports pursuant to section 15(d) of the Act as to any fiscal year is suspended as provided in section 15(d) of the Act, such issuer shall, within 30 days after the beginning of the first fiscal year, file a notice on Form 15 informing the Commission of such suspension unless Form 15 has already been filed pursuant to Rule 12h-3. If the suspension resulted from the issuer's merger into, or consolidation with, another issuer or issuers, the notice shall be filed by the successor issuer.”

⁹ See SEC compliance and disclosure interpretation No. 153.01. “[U]nder Rule 15d-6, if an issuer has fewer than 300 security holders of record at the beginning of the fiscal year, a Form 15 should be filed to notify the Commission of such suspension, but the suspension is granted by statute and is not contingent on filing the Form 15.”

¹⁰ Note that to take advantage of the statutory suspension under Section 15(d), a company must first deregister under both Section 12(b) and Section 12(g).

¹¹ Rule 12g5-1 reads as follows:

(a) For the purpose of determining whether an issuer is subject to the provisions of Sections 12(g) and 15(d) of the Act, securities shall be deemed to be “held of record” by each person who is identified as the owner of such securities on records of security holders maintained by or on behalf of the issuer, subject to the following: (1) In any case where the records of security holders have not been maintained in accordance with accepted practice, any additional person who would be identified as such an owner on such records if they had been maintained in accordance with accepted practice shall be included as a

holder of record; (2) Securities identified as held of record by a corporation, a partnership, a trust whether or not the trustees are named, or other organization shall be included as so held by one person; (3) Securities identified as held of record by one or more persons as trustees, executors, guardians, custodians or in other fiduciary capacities with respect to a single trust, estate or account shall be included as held of record by one person; (4) Securities held by two or more persons as co-owners shall be included as held by one person; (5) Each outstanding unregistered or bearer certificate shall be included as held of record by a separate person, except to the extent that the issuer can establish that, if such securities were registered, they would be held of record, under the provisions of this rule, by a lesser number of persons; and (6) Securities registered in substantially similar names where the issuer has reason to believe because of the address or other indications that such names represent the same person, may be included as held of record by one person.

(b) Notwithstanding paragraph (a) of this section: (1) Securities held, to the knowledge of the issuer, subject to a voting trust, deposit agreement or similar arrangement shall be included as held of record by the record holders of the voting trust certificates, certificates of deposit, receipts or similar evidences of interest in such securities; *provided however*, that the issuer may rely in good faith on such information as is received in response to its request from a non-affiliated issuer of the certificates or evidences of interest; (2) Whole or fractional securities issued by a savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution for the sole purpose of qualifying a borrower for membership in the issuer, and which are to be redeemed or repurchased by the issuer when the borrower's loan is terminated, shall not be included as held of record by any person; and (3) If the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the provisions of Section 12(g) or 15(d) of the Act, the beneficial owners of such securities shall be deemed to be the record owners thereof.

¹² Rule 12h-6 requires that (i) the issuer be current in all SEC filings, (ii) the issuer not have made a registered offering in the United States for the past 12 months, (iii) the company must have maintained a non-U.S. listing that constituted at least 55% of trading in a recent 12 month period, (iv) (A) the average daily trading volume ("ADTV") of the issuer's shares in the United States must be no more than 5% of worldwide ADTV, or (B) the company must have had less than 300 holders of record using a modified look through to beneficial owners that is stricter than the Rule 12g5-1 test, and (v) there is a 12 month further waiting period if the company did not meet the 5% ADTV test when it delisted. Most U.S. listed China-based companies would be unlikely to meet these requirements.

¹³ Delinquent filings from prior periods would still be required to be made.

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