

Corporate and Securities Update

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GOING DARK Considerations, Process and Timing

Given the economic conditions experienced globally over the last several years, the costs related to being a public company and the ever increasing regulatory requirements applicable to public companies, many small and mid-size public companies, as well as foreign private issuers, are considering ways to eliminate the costs and regulatory burdens of being a public company through the deregistration process. For example, recently Harbin Electric, a prominent, NASDAQ-traded Chinese company, announced its intention to no longer be a U.S. public company.

The deregistration process or "going dark" is the process by which a company that is subject to reporting to the Securities and Exchange Commission ("SEC"), pursuant to Section 12 of Securities Exchange Act of 1934 (the "1934 Act") deregisters from these requirements and becomes a private company. This deregistration would also involve delisting the company's securities from the exchange or OTCBB if the company's stock or other securities are publicly traded. "Going dark" is often confused with "going private." A "going private" transaction is a transaction where there is an exchange of cash for shares held by the company's existing shareholders and at the end of the exchange, the number of public shareholders is reduced to the point where the company can deregister. A "going private" transaction is typically initiated by a shareholder group, the management team or a private equity firm and is more complicated than just "going dark."

Although the "going dark" process can be very straight forward if you've been through it before, it can provide many traps for the unwary. As a result, it is critical that a company embarking down this road retain competent professionals to guide it through the deregistration process.

In order to deregister from the 1934 Act, a company must meet one of the following: (i) have less than 300 holders of record of its common stock; or (ii) less than 500 holders of record of its common stock and have less than \$10 million in assets in each of the last three fiscal years. Options are a separate class of securities for this purpose. A company that deregisters its registered securities suspends its obligations to file reports with the SEC under the 1934 Act and at the same time must delist such securities from listing on the exchange on which such securities are traded.

Before making a decision about "going dark," a company should engage in a cost-benefit analysis of remaining public versus deregistration. This analysis should include a re-examination of the reasons why the company went public in the first place and an examination of whether these reasons are still valid. For example, if a company takes advantage of its public company status by using its stock as an acquisition currency, accesses the capital markets, or otherwise believes the prestige of being public is important then "going dark" may not make good business sense. On the other hand, if a company is not raising funds in the capital markets or making acquisitions with its stock as currency, then the benefits to the company of "going dark" may outweigh the high costs and regulatory burdens of being public. Also, consideration has to be given to whether there is currently an active trading market for the company's stock and the liquidity that provides to shareholders and what will happen after delisting and deregistration.

Clearly, the most significant reason cited for "going dark" is the cost of being a public company. "Going dark" also reduces any liability of directors and officers going forward for violations of the Sarbanes-Oxley Act. In addition, deregistra-

tion reduces the burden on management of regulatory compliance and frees up management time to devote to running the company and think more strategically about long term goals without having to manage operations on a quarter by quarter basis due to market expectations. Also, the elimination of disclosure obligations eliminates the necessity of disclosing certain business information that could put the company at a competitive disadvantage. Further, if the exchange on which the company's stock is traded is not efficient, the market may not be a true indicator of value of the company. Deregistration provides additional flexibility on the corporate governance side since a company will no longer have to comply with all the corporate governance measures dictated by the exchanges and describe these policies in SEC disclosure documents. Finally, deregistration permits the company to maintain more control over its shareholder base.

The first step that a board contemplating "going dark" should do is set up a special committee independent directors to evaluate this issue and make a recommendation to the board. This special committee will frequently obtain investment banking advice. Typically, boards that go through a thorough and well thought out process are afforded the protection of the business judgment rule for their decision.

There are certain due diligence matters that a company which wishes to go dark must address. First, the company needs to determine if there are any existing registration statements that are still effective that need to be addressed in connection with the deregistration process, or the existence

of any registration obligations (i.e. registration rights owed to existing stockholders). With respect to outstanding debt or credit facilities, the company has to determine whether there are covenants in the indenture or the credit facility that would prevent the delisting or whether the delisting and deregistration would be an event of default under the credit agreement or indenture. A review of applicable state law and the company's article and bylaws issues is also necessary in connection with the deregistration process.

The deregistration process involves a number of steps:

- The company must file a Form 8-K following the board's decision to delist.
- The company must give notice to the exchange at least 10 days in advance of filing the Form 25 with the SEC of its intention to delist.
- At least 10 days prior to filing the Form 25, the company must issue a press release announcing its intention to deregister and delist and reasons for such delisting and post such press release on its website.
- The company must prepare and file a Form 25 with the SEC delisting the company's securities from the exchange and deregistering the stock under Section 12(b) of the 1934 Act. (The securities will be deemed delisted from the exchange 10 days after the Form 25 is filed.)
- The company may also have to file a Form 15 to terminate its obligations under Section 12(g) of the 1934 Act.

Questions

Any person who has a question regarding the issues raised in this *Corporate and Securities Update* may obtain additional guidance from a securities attorney in our Asia Group (www.blankrome.com).

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