



This article was originally published in *PLI Current: The Journal of PLI Press*, Vol. 4, No. 3 (2020), <https://plus.pli.edu>. Not for resale.

# PLI Current

The Journal of PLI Press

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Vol. 4, No. 3, 2020

## Current Developments to the Process of Delisting and Deregistration of Securities from U.S. Exchanges

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*This article discusses delisting and deregistration of securities registered with the U.S. Securities and Exchange Commission (SEC) and listed on the New York Stock Exchange (NYSE) or the National Association of Securities Dealers Automated Quotations exchange (Nasdaq), and the associated suspension or termination of U.S. public company reporting and compliance obligations.*

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## Introduction

On May 20, 2020, the U.S. Senate unanimously passed S. 945, the Holding Foreign Companies Accountable Act (HFCAA).<sup>1</sup> The HFCAA, an amendment to the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), prohibits foreign issuers from listing and trading their securities on any U.S. securities exchange or through any other method regulated by the SEC if authorities in the foreign issuer's home jurisdiction prohibit the Public Company Accounting Oversight Board (PCAOB) from inspecting the issuer's registered public accounting firm. In doing so, the HFCAA aims to protect U.S. investors and increase the reliability of financial statements by ensuring that the PCAOB can inspect the audit practices of U.S.-listed issuers. This prohibition has significant ramifications since, according to the SEC, 224 U.S.-listed companies, with a combined market capitalization of over \$1.8 trillion, are located in countries where there are currently obstacles to PCAOB inspections required by the HFCAA.<sup>2</sup>

The HFCAA is driving significant interest in delisting and deregistration alternatives among non-U.S. issuers listed on the major U.S. securities exchanges. Even before the introduction of the HFCAA, many non-U.S. issuers, particularly from China and other jurisdictions in Asia, pursued going private transactions or delisting and deregistration processes following their U.S. initial public offerings (IPOs). This move by non-U.S. issuers was driven by a number of factors, including significant SEC reporting and compliance expenses, which especially affected those companies required to comply with the auditor attestation requirements in the assessment of their internal control over financial reporting under Section 404(b) of Sarbanes-Oxley. Although the Jumpstart Our Business Startups Act of 2012 (the JOBS Act)<sup>3</sup> provided a five-year ramp-up period for 404(b) compliance, and the SEC's March 12, 2020 changes to filer

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<sup>1</sup> Holding Foreign Companies Accountable Act, H.R. 7000, 116th Cong. (2020).

<sup>2</sup> Public Statement, U.S. Sec & Exch. Comm'n, Statement on the Vital Role of Audit Quality and Reg. Access to Audit and Other Information Internationally—Discussion of Current Info. Access Challenges with Respect to U.S.-listed Co.'s with Significant Operations in China, n. 9 (Dec. 7, 2018), <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other>.

<sup>3</sup> Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (Apr. 5, 2012).

definitions<sup>4</sup> significantly increased the number of issuers that qualify as smaller reporting companies that are exempt from 404(b) compliance, which helped reduce compliance burdens for qualifying issuers, the reality is that, for many companies, after their major capital raisings in the United States are completed, the compliance costs and regulatory burdens of being a U.S. public company can outweigh the benefits of maintaining a U.S. listing, especially when these companies also have the option of listing in other jurisdictions with lower compliance and regulatory burdens.

The dynamics identified above have combined with the additional operational challenges and significant market volatility caused by COVID 19. Together, these forces have created an environment in which foreign issuers affected by the HFCAA and U.S. public companies dealing with excessive operating costs may want to pursue delisting and deregistration alternatives. There are various steps and intricacies involved in the delisting and deregistration process, which are discussed below.

## **Delisting and Deregistration Process**

The delisting and deregistration procedure is often referred to in the securities industry as “going dark,” which is the process of voluntarily delisting a public company’s shares from one of the major securities exchanges and subsequently deregistering under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), thereby suspending or terminating public company reporting obligations under the Exchange Act. There are many benefits of delisting and deregistration that issuers can experience if they choose to “go dark.” Issuers can substantially lower the costs associated with compliance and reporting activities, as well as the significant management time required to continually maintain such compliance. Without continuous reporting obligations, key aspects of the business, including major product

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<sup>4</sup> On March 12, 2020, the SEC adopted amendments to the accelerated and large accelerated filer definitions. As a result, an issuer that is eligible to be a smaller reporting company (SRC) with less than \$100 million in annual revenue will no longer be required to obtain an audit of its internal control over financial reporting under 404(b). An issuer that has less than \$100 million in revenue is only required to have 404(b) certification if it meets the large accelerated filer definition (public float of \$700 million or more). As a result, many companies, particularly in life sciences and other growth company sectors, will qualify and will no longer have to comply with 404(b) requirements. *See* SEC, Final Rule, Release No. 34-88365, <https://www.sec.gov/rules/final/2020/34-88365.pdf>.

and strategic initiatives, can be implemented confidentially away from the public spotlight. Delisting or deregistering can also simplify corporate governance requirements and allow more flexibility to conduct various transactions. These benefits should be weighed against the costs of delisting and deregistration including: (i) failing to maintain compliance with the delisting or deregistration requirements causing a reinstatement of SEC reporting obligations; (ii) reduction in the trading market for the issuer's securities resulting in a potential drop in liquidity and/or share price; (iii) negative impact on shareholder confidence in the issuer; or (iv) potential shareholder litigation.

### ***Once the Decision to Delist and Deregister Is Made, How Does an Issuer Go About Achieving This?***

When analyzing the options to “go dark,” it is important to understand the difference between a going private transaction and delisting and deregistration. The term “going private” refers to transactions (or a series of transactions) whereby a controlling shareholder, significant shareholder or other affiliated persons decreases the number of shareholders of a public company, generally by cashing out its public shareholders. These transactions allow the issuer to terminate its public company status and related reporting and compliance obligations under the Exchange Act and Sarbanes-Oxley. As these transactions require significant capital and time commitments, as well as compliance with tender offer rules and regulations, delisting and deregistering under the Exchange Act is, in many cases, the more pragmatic option for issuers.

Delisting and deregistration are related but separate processes, and both need to be undertaken in order for an issuer to suspend or terminate its reporting and compliance obligations as a U.S.-listed issuer. Delisting is withdrawing or striking a class of securities from listing on a U.S. national securities exchange, such as the NYSE or Nasdaq. Deregistration is withdrawing a class of securities from registration under the U.S. Securities Act of 1933, as amended (the “Securities Act”) and terminating and/or suspending reporting obligations under the Exchange Act.

To properly understand the delisting and deregistration process, it is important to understand how Exchange Act reporting obligations are triggered in the first place. An issuer becomes subject to Exchange Act reporting requirements if it has a class of securities registered under Section 12 or 15(d) of the Exchange Act. This can occur in several different ways, including: (i) by listing a class of securities on a national securities exchange (Section 12(b)), which captures issuers that have conducted IPOs in the United States on the NYSE or Nasdaq; (ii) by meeting certain statutory

thresholds with respect to total assets and the number of shareholders (Section 12(g)); or (iii) by having an effective registration statement under the Securities Act (Section 15(d)).

Issuers seeking to delist and deregister must follow a process that results in both delisting and suspension or termination of the issuer's public reporting obligations under the Exchange Act. In contrast to going private transactions, open-market purchases or public tender offers, both delisting and deregistration can be effected without a shareholder vote, fairness opinion, or cashing out the public company shareholders.

An issuer is not subject to Exchange Act reporting obligations under more than one section at a time. For example, an issuer's reporting obligations under Section 12(b), by virtue of being listed on the NYSE or Nasdaq, suspend any other reporting obligations under another provision of the Exchange Act, such as Section 12(g) or Section 15(d). However, if the Section 12(b) registration is terminated, any other previously suspended reporting obligations under the Exchange Act (i.e., under Section 12(g) or Section 15(d)) are revived. As such, issuers will need to ensure that they suspend or terminate reporting obligations under these other provisions as well.

## **Delisting and Deregistration—Section 12(b)**

To delist from the NYSE, Rule 806.02 of the NYSE Listed Company Manual<sup>5</sup> requires that an issuer comply with the following procedures:

- Give written notice to the NYSE of the intent to withdraw a class of securities from listing and/or registration;
- Publish a press release providing notice of the delisting and the intention and reasons for withdrawal. The notice must also be posted on the issuer's website until the completion of the delisting process. The press release with notification must be made at least ten (10) days before filing a Form 25 with the SEC;
- Provide the NYSE with board resolutions authorizing the delisting;

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<sup>5</sup> NYSE, Listed Company Manual § 806.02, [https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS\\_TAL\\_5667%23teid-175](https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-175).

- File a Form 8-K (or 6-K if the issuer is a foreign private issuer (FPI)) announcing the delisting; and
- File Form 25 with the SEC.

To delist from Nasdaq, Rule 5840(j) of the Nasdaq Manual<sup>6</sup> requires that an issuer comply with the following procedures:

- Give written notice to Nasdaq of the intent to withdraw a class of securities from listing and/or registration at least ten (10) days before filing a Form 25 with the SEC;
- Publish a press release providing notice of the delisting and the intention and reasons for withdrawal. The notice must also be posted on the issuer's website until the completion of the delisting process. The press release with notification must be made at least ten (10) days before filing a Form 25 with the SEC;
- File a Form 8-K (or 6-K if the issuer is an FPI) announcing the delisting; and
- File Form 25 with the SEC.

Once Form 25 is filed with the SEC, the delisting occurs automatically after ten (10) days, and, in most cases, the issuer's securities will stop trading on the related securities exchange. At this point, the issuer's Section 13(a) reporting obligations will be suspended, making it no longer necessary for the issuer to file annual reports on Form 10-K<sup>7</sup> or Form 20-F<sup>8</sup>, or quarterly or interim reports on Form 10-Q<sup>9</sup> or 6-K<sup>10</sup>. However, it is important to note that Section 14(a), Section 16 and Section 13(d) are still applicable to issuers and beneficial owners during the suspension period, which continues for another eighty (80) days (a total of ninety (90) days from the date Form 25 was filed). This process operates automatically through the passage of time, and the SEC rarely intervenes during this time period, though there is a "safety valve" allowing

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<sup>6</sup> Nasdaq Stock Market Rule 5840(j),

[https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5000#nasdaq-rule\\_5800](https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5000#nasdaq-rule_5800).

<sup>7</sup> <https://www.sec.gov/files/form10-k.pdf>.

<sup>8</sup> <https://www.sec.gov/files/form20-f.pdf>.

<sup>9</sup> <https://www.sec.gov/files/form10-q.pdf>.

<sup>10</sup> <https://www.sec.gov/files/form6-k.pdf>.

the SEC to intervene in limited circumstances if it deems necessary. Issuers, may, however, still be required to file periodic reports during this ninety (90) day period if the issuer must register under Section 12(g) of the Exchange Act or report under Section 15(d) of the Exchange Act (both outlined below). The Form 25 filing also serves to withdraw the class of securities from registration, which becomes effective ninety (90) days after its filing. Once effective, the issuer's reporting obligations under Section 12(b) of the Exchange Act are terminated.

### **Deregistration—Exchange Act Section 12(g)**

Once an issuer's Exchange Act reporting obligations under Section 12(b) are terminated, as outlined above, the issuer's Section 12(g) reporting obligations may be revived if (i) the class of securities to be deregistered was listed on Nasdaq prior to August 2006, or (ii) there are more than 300 shareholders of record of the class of securities to be deregistered. If there are fewer than 300 shareholders of record, Section 12(g) deregistration is effective by operation of law. Otherwise, to terminate any revived reporting obligations under Section 12(b), the issuer must file a Form 15<sup>11</sup> with the SEC.

While the processes for delisting and deregistration are intertwined, the delisting process must occur prior to deregistration. Therefore, the issuer can only file Form 15 after Form 25 is effective, meaning that the earliest Form 15 can be filed is ten (10) days after Form 25 is filed. Form 15 is effective ninety (90) days after filing unless the SEC allows for earlier effectiveness. In contrast to Form 25, the filing of Form 15 immediately suspends the issuer's periodic and other reporting obligations under Section 13(a) of the Exchange Act.

### **Deregistration—Exchange Act Section 15(d)**

After terminating an issuer's Exchange Act reporting obligations under Section 12(b), it is possible to also revive the issuer's Section 15(d) reporting obligations if the issuer has an effective registration statement on file with the SEC. Once an issuer is registered pursuant to Section 15(d), the issuer's reporting requirement can never be terminated, but its obligations can be suspended for eligible classes of securities (FPIs can, in certain circumstances discussed below, terminate reporting requirements).

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<sup>11</sup> <https://www.sec.gov/files/form15.pdf>.

Section 15(d) reporting obligations are suspended automatically if (i) an issuer has a class of securities registered under Section 12 or (ii) there are fewer than 300 shareholders of record of the class of securities subject to registration on the first day of any fiscal year (other than the year in which the subject registration statement became effective). If an issuer's Section 15(d) reporting obligations are suspended, but the issuer later does not meet the record holder and asset eligibility thresholds for suspension on the first day of a subsequent fiscal year, the issuer's reporting obligations under Section 15(d) will be revived. Therefore, issuers that delist and deregister must monitor the number of record holders on an annual basis to ensure they meet the suspension requirements of Section 15(d). The exception to this requirement is an issuer that is an FPI meeting the requirements to file a Form 15F outlined below, in which case Form 15F operates to terminate, rather than suspend, these reporting obligations.

Rule 12h-3 of the Exchange Act permits issuers to voluntarily suspend Section 15(d) reporting obligations if they file a Form 15 with the SEC and meet the following conditions: (i) must be current in Exchange Act reporting requirements for the last three fiscal years and the portion of the current fiscal year prior to filing Form 15, and (ii) the registered class has (a) fewer than 300 shareholders of record, or (b) as of the end of the issuer's last fiscal year, fewer than 500 shareholders of record and assets less than US\$10 million. Even issuers with thousands of beneficial owners may have less than 300 shareholders of record since they are only required to count the number of registered holders on the shareholder list and, if depositaries are listed, the number of holders for whom the depository holds securities, which is typically a more limited number than the actual number of beneficial owners. For most U.S. issuers, it is possible to count the registered holders and add the number of participants listed in the security position listing of the Depository Trust Company (DTC). For purposes of determining whether an issuer has less than 300 holders of record, there is no requirement to further "look through" DTC participants to the ultimate beneficial owners. Accordingly, many issuers may meet the shareholders of record threshold to delist.

Rule 12h-3 of the Exchange Act is not available to an issuer if it had a registration statement relating to the shares go "effective in the fiscal year for which the issuer seeks to suspend reporting, or has had a registration statement...updated by Section 10(a)(3) of the Securities Act during the fiscal year for which the issuer seeks to suspend



reporting.”<sup>12</sup> Furthermore, issuers cannot rely on the fewer than 500 record holders and US\$10 million in assets rule if a Securities Act registration statement went effective or required a Section 10(a)(3) update during the two succeeding fiscal years.<sup>13</sup> Issuers with shelf or other Securities Act registration statements (typically on Form S-3 or F-3) are considered to have had a registration statement “updated” during the year because the annual report filing is a Section 10(a)(3) update to those registration statements. This is due to the fact that the annual report is automatically incorporated by reference.<sup>14</sup>

## **Typical Delisting and Deregistration Timeline**

### ***Before Commencing the Process***

The board of directors of the issuer should approve resolutions authorizing the issuer to proceed with delisting and deregistration. For FPIs, these resolutions should follow their home country board (and any relevant committee) approval process.

Domestic filers must file a current report on Form 8-K under Item 3.01(d) upon any definitive action taken to delist, which means that these issuers must do so within four business days of the board decision.<sup>15</sup> FPIs must comply with home country rules and furnish any required disclosure on a Form 6-K.

### **Day -10**

File written notice of intent to file a Form 25 with the securities exchange (this is done under Rule 12d2-2(c)(2)(ii) when initiated by the issuer).

Issue a press release and file an 8-K/6-K (FPI) announcing the delisting/deregistration and explaining the rationale.

### **Day 0**

File Form 25 with the SEC.

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<sup>12</sup> SEC, Staff Legal Bulletin No. 18 (Mar. 15, 2010),

<https://www.sec.gov/interps/legal/cfs1b18.htm>.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*, n. 5.

<sup>15</sup> SEC, Final Rule, Release Nos. 33-8400; 34-49424, <https://www.sec.gov/rules/final/33-8400.htm>.

### **Day 3-5**

Issuers should withdraw any filed registration statements under which no securities have been sold and file post-effective amendments to any outstanding registration statements under the Securities Act. Issuers should build into the timeline this three to five (3-5) day period before filing the Form 15 listed below for any post-effective amendments terminating any registration statements on Form S-1/S-3 or F-1/F-3 to be declared effective by the SEC.

### **Day 10**

File Form 15 with the SEC and issue press release announcing deregistration.

At this point, the issuer will be delisted from the securities exchange and Section 12(b) registration is suspended.

### **Day 90**

Form 25 is effective, thereby terminating Section 12(b) registration.

Section 12(g) registration is revived but is suspended by the Form 15 filing.

### **Day 100**

Form 15 is effective, thereby terminating Section 12(g) registration. Section 15(d) registration is suspended on effectiveness of Form 15.

## **Special Deregistration Rules for Foreign Private Issuers—Exchange Act Rule 12h-6**

In March 2007, the SEC adopted Rule 12h-6 which allows FPIs to terminate their reporting obligations under Section 15(d) of the Exchange Act or deregister a class of securities under Section 12(g) thereunder if they satisfy the following three conditions: (i) the FPI must have had reporting obligations under the Exchange Act for 12 months and filed or furnished all reports during this period, including the filing of at least one annual report; (ii) the class of securities of the FPI sought to be deregistered, must not have been sold, subject to certain exceptions, through a registered public offering in the twelve (12) months leading up to the sought deregistration; and (iii) the FPI must have maintained a listing of the class of securities sought to be deregistered on an exchange in the FPI's primary trading market for at least the twelve (12) months

preceding the deregistration filing.<sup>16</sup> In the period leading up to the adoption of Rule 12h-6, there were many dual-listed FPIs that had accessed the U.S. capital markets through a listing of American Depositary Receipts (ADRs) on the NYSE or Nasdaq, and after its passage, this rule helped many issuers delist and deregister. Since the non-U.S. issuer would still be listed on a non-U.S. Exchange, the issuer would need to consider the requirements of that exchange compared to the U.S. exchange requirements. At the moment, dual or multiple listings, particularly in certain sectors like technology, life sciences and other growth sectors, are not as common, and the ability of issuers listed solely on the NYSE or Nasdaq to take advantage of Rule 12h-6 is more limited; however, as implementation of the HFCAA may take time, and enforcement of delisting may run up to three years based on the current drafting of the HFCAA, there can be planning opportunities to list on other exchanges around the world which could lead to situations where Rule 12h-6 would be helpful.

If the above three conditions are met, Rule 12h-6 provides two methods to be eligible to terminate reporting obligations under the Exchange Act: the Counting Method and the Average Daily Trading Volume (ADTV) Threshold Method. The Counting Method allows an FPI to terminate its reporting obligations in relation to the FPI's securities if, on a date within 120 days before filing for deregistration, the FPI has either (i) less than 300 record holders on a worldwide basis, or (ii) less than 300 record holders who reside in the United States.<sup>17</sup> To judge whether an FPI meets the Counting Method, an FPI can look through "the amount of securities represented by accounts of customers [who reside] in the United States to brokers, dealers, banks and other nominees located in (i) the United States; (ii) the [FPI's] jurisdiction of incorporation, legal organization or establishment; and (iii) the [FPI's] primary trading market," if different than the market listed in the preceding item (ii).<sup>18</sup> Furthermore, if an issuer aggregates the trading volume in two foreign jurisdictions for the purpose

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<sup>16</sup> SEC, Final Rule, Release No. 34-55540, <https://www.sec.gov/rules/final/2007/34-55540.pdf>; *see also* SEC Press Release No. 2007-55, SEC, SEC Posts Text of Rules Facilitating Foreign Private Issuer Deregistration Under the Exchange Act (Mar. 27, 2007), <https://www.sec.gov/news/press/2007/2007-55.htm#:~:text=New%20Exchange%20Act%20Rule%2012h,interest%20for%20that%20class%20of.>

<sup>17</sup> 17 C.F.R. § 240.12h-6(c)(2).

<sup>18</sup> 17 C.F.R. § 240.12H-6(e)(1)(i).

of determining its primary trading market, it will have to look through both of the foreign jurisdictions when looking through accounts to meet the threshold of 300 record holders.<sup>19</sup>

The ADTV Threshold Method sets out an ADTV test that an FPI must meet in order to deregister its equity securities, pursuant to which the ADTV of an issuer's class of securities must be five percent or less of that class of securities ADTV "on a worldwide basis for the same period."<sup>20</sup> There are two constraints on issuers that limit their ability to use the ADTV test method to deregister securities. First, an issuer cannot terminate its reporting obligations using Rule 12h-6 if (i) an issuer has terminated an ADR facility for a class of securities in the past twelve (12) months, and (ii) the ADTV of that class of securities in the United States is greater than five percent of the ADTV on a worldwide basis.<sup>21</sup> Second, an issuer cannot terminate its reporting obligations using Rule 12h-6, if, within the past 12 months, the issuer delisted a class of securities from a U.S. national securities exchange or inter-dealer quotation system and the ADTV of that class of securities in the U.S. was greater than five percent of the issuer's worldwide ADTV at the time of such delisting.<sup>22</sup>

FPIs seeking to take advantage of Rule 12h-6 must file a Form 15F to deregister a class of securities under the Exchange Act. If the issuer meets all the conditions in Rule 12h-6 outlined above to terminate registration of a class of securities under the Exchange Act, and the FPI has no classes of securities with reporting obligations aside from the class for which deregistration is sought, the FPI is eligible to file Form 15F. Once Form 15F is filed, reporting obligations under the Exchange Act are immediately terminated.

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<sup>19</sup> 17 C.F.R. § 240.12h-6(e)(1)(ii).

<sup>20</sup> 17 C.F.R. § 240.12h-6(a)(4)(i).

<sup>21</sup> SEC, Final Rule, Release No. 34-55540, <https://www.sec.gov/rules/final/2007/34-55540.pdf>.

<sup>22</sup> *Id.*

## **Considerations for Issuers with American Depositary Shares (ADSs)**

Issuers with ADSs listed on one of the major US securities exchanges have a choice with respect to their ADS programs following delisting and deregistration. These issuers can either terminate the ADS program or transition to a Level I ADS program.

All of the major depositary bank deposit agreements provide for a process whereby the issuer can instruct the depositary to terminate the depositary receipt facility. Holders of ADSs will be asked to surrender their ADSs for cancellation. At this juncture, issuers can instruct the depositary to: (i) deliver underlying shares to holders; (ii) sell the underlying shares in the market and deliver cash to holders; or (iii) move the underlying shares to a different depositary receipt custody account type and issue another type of depositary receipt (i.e. GDR, HDR, JDR).

For FPIs that want to pursue a delisting but still have shares/ADSs traded in the over-the-counter market (OTC), in addition to the delisting and deregistration steps outlined above, the following additional steps need to be taken:

- Coordinate a new ticker symbol for OTC with Financial Industry Regulatory Authority, Inc. (FINRA) which will be assigned once the Form 25 is effective;
- Amend deposit agreement to reflect change in issuer's reporting status;
- File F-6 amendment with SEC (automatically effective);
- Depositary bank will distribute delisting notice to ADS holders including new OTC ticker symbol; and
- Following deregistration, to the extent applicable, for FPIs that are listed in at least one other market, post information on website required to maintain Rule 12g3-2(b) exemption.

## **Registration Rights, Shareholder Agreements and Debt Instruments**

Prior to undertaking a delisting and deregistration exercise, it is important for issuers to review any registration rights or shareholder agreements and the terms of any outstanding debt instruments. Following delisting and deregistration, an issuer may no longer be able to comply with any existing obligations to register privately placed shares. Also, certain debt instruments may have covenants requiring maintenance of a

listing and any failure to do so may cause an event of default under the terms of the debt instrument and potentially lead to acceleration or other adverse consequences.

## **Specific Considerations for U.S.-Listed Chinese Issuers**

Statements made by the HFCAA’s sponsors and the text of the HFCAA itself indicate that the HFCAA was aimed at U.S.-listed Chinese issuers.<sup>23</sup> The HFCAA puts these issuers in a difficult position, and compliance may be impossible, especially because various Chinese regulations effectively prohibit the inspection of public accounting firms based in China by foreign regulators, including the PCAOB.

While most Chinese firms that list on U.S. exchanges do so through the Cayman Islands or other offshore entities due to Chinese foreign investment and various regulations, the financial statements included in these IPO registration statements are audited by People’s Republic of China (PRC) based auditors. Accordingly, Cayman Islands/Chinese issuers that list on the NYSE or NASDAQ—an exchange that includes many high-profile Chinese internet and technology companies, as well as Chinese issuers from other growth sectors—are directly impacted by the HFCAA.

The HFCAA also requires issuers to submit to the SEC documentation that establishes that the issuer is not owned or controlled by a governmental entity in the foreign jurisdiction where the issuer’s accounting firm has a foreign office, which may prove very difficult for U.S.-listed Chinese issuers.

Issuers identified by the SEC must allow the PCAOB to inspect or investigate the issuer’s registered public accounting firm. If the issuer fails to allow the PCAOB to conduct an inspection for three consecutive years, the SEC will prohibit the issuer from being traded on a U.S. securities exchange or through any other method regulated by the SEC, including over-the-counter trading of securities. The trading prohibition may be removed by the SEC if the issuer certifies it has retained a registered public accounting firm that the PCAOB has inspected to the satisfaction of the SEC. If the issuer fails to comply again, trading will be suspended for a minimum of five years.

In the current draft of the legislation, a U.S.-listed Chinese issuer effectively would have up to three years before non-compliance would compel a delisting. However, it is

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<sup>23</sup> Press Release, John Kennedy United States Senator for Louisiana (May 20, 2020), <https://www.kennedy.senate.gov/public/2020/5/senate-passes-kennedy-and-van-hollen-s-bill-to-kick-deceitful-chinese-companies-off-u-s-exchanges>.

important to determine a course of action now to ensure enough time to execute a plan with respect to an issuer's U.S. public equity and ongoing U.S. regulatory and compliance obligations.

As counsel to a U.S.-listed Chinese issuer, prior to advising a delisting and deregistration exercise, it may be prudent to consider a secondary listing in another jurisdiction closer to home, such as Hong Kong. A mechanism for exchanging ADRs listed in the United States with ordinary shares listed in Hong Kong should also be considered and would likely be favored by shareholders. At a minimum, this would give the U.S. public equity a "second home" and optionality for shareholders to "move exchanges." It also would provide a clear equity liquidity framework in the event of a U.S. delisting and could lower the risk and cost of any "take private" transaction with respect to the U.S.-listed equity securities.

Over the last few years, a number of prominent Chinese companies that conducted IPOs on Nasdaq or the NYSE have engaged in going private transactions and completed their delisting and deregistration as part of that process. While this process can take a number of forms, the end result is that the promoter/group proposing the transaction acquires all or most of the outstanding shares/ADSs, and the selling shareholders typically receive cash for their shares.

One important consideration for this type of going private transaction is that Rule 13e-3 under the Exchange Act governs such transactions and imposes significant disclosure requirements on a U.S. public company going private. Among other items, there will be a proxy statement or tender offer document which must be filed with the SEC with detailed disclosure requirements, including, among other items, disclosure about the following:

- The purpose of the transaction;
- Alternatives considered and reasons for their rejection;
- Reasons for the structure of the transaction and for undertaking it at this time;
- Reasons the issuer believes the transaction is fair;
- A discussion of the analysis underlying a financial advisor's fairness opinion;

- Any firm offers made by any third party for the company during the past two years; and
- Extensive financial information.<sup>24</sup>

Notwithstanding these disclosure requirements, a number of high profile U.S.-listed Chinese companies pursued the full 13e-3 process, which they often followed by a primary listing in another market, typically in Asia.

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<sup>24</sup> See 17 C.F.R. § 240.13e-3.