Delisting of Companies

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Going Private: A Reasoned Response to Sarbanes-Oxley?

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This article critically examines the logic behind the going-private tendency of firms, almost as a studied response to the SOX Act. The "going private" and "opting out" decisions are studied in detail separately.

I. Introduction

The mounting financial, disclosure, and corporate governance costs of remaining public in today's regulatory environment, exacerbated by the Sarbanes-Oxley Act of 2002[1] ("Sarbanes-Oxley" or the "Act"), are causing many companies to question the value of being public[2]. Small and mid-sized issuers are most strongly considering the possibility of "going private"[3]. The goal? Avoiding the increasingly burdensome disclosure requirements, corporate governance dictates, and compliance costs of the federal securities laws, including Sarbanes-Oxley.

The broad vernacular of "going private", encompasses two events so dramatically different, that they should never be referred to under a common rubric. The conventional reference to a company "going private" is in regard to a major organic

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corporate transaction. Common structures are Leveraged Buy-outs ("LBOs") or Management Buy-outs ("MBOs"). A "going private" deal typically dramatically alters the control, capitalization, and ownership composition of a public company. The second reference is to a "delisting" or "deregistration" process pursuant to which a public company makes a transition to being a non-reporting company. The Securities and Exchange Commission (the "SEC" or the "Commission") permits an issuer to voluntarily "opt-out" of the public company reporting system because, its small shareholder base no longer justifies imposing public company obligations and SEC rules upon it. In the typical delisting event, there are no balance sheet, capitalization, or ownership changes prompting the deregistration process. Due to a quirk in the securities laws that focuses on "holders of record" rather than "beneficial owners", many companies are eligible to deregister based on their limited number of holders of record. Due to the Act, more and more companies have the motivation to do so.

Custom is to loosely refer to both circumstances as a company "going private"[4]. This article, however, will refer to the organic transactions (MBOs and LBOs) as "going private", and deregistering securities of an issuer from the Securities Exchange Act of 1934 (the "Exchange Act") as an "opt-out" transaction.

Going private transactions traditionally involved public companies with undervalued stock. Although popular conceit is that, the public marketplaces are "efficient", certain kinds of companies and industries (frequently small and mid-cap issuers) become public "orphans" following their IPO. The common characteristics of corporate orphans is that they have minimal public float, minimal or no "promotion" from an investment bank that provides regular coverage and institutional commentary, the trading volume is sparse, and institutional investors are rare[5]. As a consequence, the bid and ask price frequently has a significant "spread" and the stock price often does not reflect the highest value of the business. Conventional wisdom is impaired. The company's intrinsic value as a private company exceeds its market capitalization as a public company.

Although stunningly different in purpose and substantive corporate consequences, both going private and opting out are complex processes generally not justified solely by the desire to avoid regulatory burdens. Each requires rigorous

adherence to applicable state corporate law, federal securities law, and the rules of relevant self-regulatory organizations (i.e., national securities exchanges). There are significant board, management, disclosure, and fiduciary obligations to identify, address, and satisfy, and structural alternatives and consequences to review. This article examines "going private" and "opting out" separately.

II. Preliminary Considerations: Why Go Private?

Going private or opting out are major steps that cannot be taken lightly, easily, or quickly[6]. Both processes involve scrutiny from numerous corporate stakeholders, including stockholders, lenders, creditors, employees, and the marketplace in general. There are significant risks associated with both courses of action. In evaluating the merits of withdrawing from the public market, a company's board of directors must exercise reasonable business judgement, consider all relevant factors, and create a process permitting the company and its board to satisfy their common law and statutory fiduciary duties, particularly the duty of loyalty and the duty of care. These duties stem from extensive case law developed when directors' actions in approving a "going private" transaction have been challenged in court, generally by its stockholders[7].

The duty of loyalty provides that in making decisions "the best interest of the corporation and (its) stockholders takes precedence over any interest possessed by a Director"[8]. A condition precedent for satisfying the duty of loyalty is that, the interests of each director be identified. This disclosure obligation is paramount in a going private transaction. Members of the board or management are frequently on several sides of a proposed transaction. Employees' change of control provisions may be triggered (i.e., golden, silver, or bronze parachutes). Other existing and already disclosed related-party transactions sometimes undergo modification in negotiating a merger purchase price. Common examples are leases of physical assets between the company and affiliates of its controlling stockholders. The failure of a director to fully advise the Board of a potential conflict will generally negate protection for both the director who fails to make the disclosure, as well as the ability of other directors to rely on otherwise protective law. Without acknowledgement of all the facts (and an appreciation of the conflicts), a fully informed board decision is not possible.

The duty of care requires directors to perform their duties with the care that an ordinarily prudent person in a like position would use under similar circumstances. In most situations corporate directors and officers are protected by the "business judgement rule." Essentially, the business judgement rule allows for a non-interested director, exercising reasonable care and good faith judgement, to be protected from liability[9]. In going private transactions involving controlling stockholders, however, certain corporate directors and officers are not protected by the business judgement rule because, they are not "independent" of the controlling stockholder[10].

Although becoming a private company has financial cost and liabilities, there are also significant benefits. Private companies are not subject to most requirements of the federal securities laws, particularly disclosure and reporting requirements under the Exchange Act. Sarbanes-Oxley has imposed additional costs upon public issuers with no obvious offsetting benefit to any individual issuer[11]. By contrast, what is easily visible is that companies who regain private status, will immediately have lower ongoing legal, accounting, D&O insurance, and investor relations expenses[12].

From a loftier perspective, the US securities marketplace often rewards public companies more for short-term quarterly results than long-term value creation and performance. The focus of private companies and their owners and management tends to be longer-term. There is no quarterly pressure to meet "street" expectations every 90 days. Operating decisions and strategic planning for private companies reflect the luxury of time[13]. Stockholders of private companies generally realize the value of their investment only at the time the private company sells or goes public. Private companies also have virtually no obligation[14] to publicly distribute financial and other strategic information which can be used by its competitors[15].

The major market declines of 2001 and 2002 reduced the trading price of public companies on a very broad basis. With tighter capital markets, and sharply decreased analytical coverage of smaller issuers, many small-cap and mid-cap companies are no longer enjoying the anticipated benefits of being public. Companies with no need for additional equity are struggling to remember why they went public in the first place. Public companies trading at a low price-to-earnings

multiple no longer have economic motivation to use their stock as currency to fund acquisitions or raise equity. Given the current economic and regulatory environment, there are diminished benefits to remaining public and potentially significant rewards from becoming private, whether by going private or by opting out.

III. Traditional Going Private Transactions.

A. Structure and Mechanics

Historically, "going private" transactions were normally structured in one of the following four ways: (1) a cash out merger (i.e., a Management Buyout (MBO) or Leveraged Buyout (LBO)[16]); (2) a tender offer; (3) a reverse stock split, whereby minority stockholders are left with only fractional shares, which are subsequently purchased for cash by the issuer; or (4) a sale of all (or substantially all) of a company's assets to a newly-formed private company owned by some (or all) of the company's management team, followed by the public company's dissolution and distribution of the net sales proceeds to its stockholders[17]. In deciding how to structure the transaction, tax consequences, logistical and timing issues, and state law considerations each impact the analysis.

A critical issue meaningfully impacting structure is whether the acquirer wants to present public stockholders with a meaningful vote on a proposed transaction. A stockholder vote creates the protection afforded to good and open corporate governance process, but simultaneously risks the possibility of an injunction challenge[18]. On one hand, a public parent corporation seeking to take a company private, can use a tender offer to unilaterally effect a merger with its subsidiary by board resolution of the parent company, without holding a stockholder meeting or soliciting proxies from the acquisition group[19]. In what is sometimes referred to as a "two-step" going private transaction, a parent corporation seeking to take a company private initiates a voluntary tender offer to acquire a large percentage (e.g., 90%) of the target's stock. The acquirer is then able to implement a merger without having to obtain a stockholder vote[20]. A negotiated MBO, LBO, or reverse stock split, by contrast, generally requires proxy solicitations and stockholder approval of either: (1) the merger, or (2) an amendment to the company's Certificate of Incorporation or corporate charter[21].

The availability of appraisal rights to dissenting stockholders may also be an important factor in developing structure[22]. Dissenting stockholders in a merger transaction are generally entitled to appraisal rights under applicable state law provided that, they timely follow state corporate procedures, i.e., they vote against the merger (or abstain) and notify the corporation within the statutorily specified time period[23]. However, the appraisal remedy is generally available only in the case of a statutory merger. A cash-out of minority stockholders through a reverse stock split or asset sale would generally not be accompanied by appraisal rights[24]. Appraisal rights do not exist in the case of stockholders tendering their shares in a tender offer[25].

Finally, state anti-takeover statutes prohibiting or limiting related-party transactions (the essence of an MBO) may significantly impact the structure (i.e., process and timing) of going private transactions[26]. For example, Section 203 of the Delaware General Corporation Law prohibits in most cases a Delaware corporation from effecting a "business combination"[27] with an "interested stockholder" (i.e., a stockholder holding more than 15% of the corporation's outstanding voting stock) for three years after the stockholder becomes interested[28].

B. Standard of Review

Going private transactions have frequently triggered litigation. Stockholders routinely question the adequacy of the price and the validity of the process. Less commonly, minority stockholders have objected to a proposed transaction because, they seek to remain stockholders of the corporation[29]. When considering a going private transaction, the company's board must understand its duties, be sensitive to the possibility of litigation, and consider how the transaction and process may be scrutinized by the SEC, by its stockholders, and (potentially) the judiciary.

Because of the virtually inevitable conflicts of interest (i.e., management is involved as owners and/or management of both the selling entity and the buying entity), and the corporate gravity of the event[30], going private transactions are generally subject to an enhanced level of legal scrutiny. This is particularly true when an MBO or other form of going private transaction involves a dominant (or controlling) stockholder. The public company's board often includes directors appointed by senior management or owners of the acquirer. Among the concerns

are that, the personal loyalty of such directors to the controlling stockholder may impair the independence of their judgement, making it difficult to exercise their fiduciary obligation to all stockholders. In those circumstances courts have applied an enhanced level of scrutiny based upon an "inherent coercion" that exists when a controlling stockholder announces its desire to buy the minority's shares[31].

The level of judicial review may depend as much on the structure as the substance of the transaction. Under Delaware case law[32], negotiated mergers are evaluated under the "entire fairness" standard of review[33]. This is regarded as the most exacting standard of review used by Delaware courts. The scrutiny examines every aspect of the transaction to ensure that it meets the standard of "entire fairness" particularly "fair dealing" and "fair price"[34].

By contrast, Delaware courts have not applied the entire fairness standard in the case of a going private transaction structured as a "non-coercive" tender offer[35]. Coercion is generally understood to mean that a wrongful threat has been made that has the effect of forcing stockholders to tender at a price other than what they would otherwise tender[36]. In the recent *In re Pure Resources* decision, the Delaware Court of Chancery held that an acquisition tender offer by a non-controlling shareholder is non-coercive when: (1) it is subject to a non-waivable "majority of the minority condition", where a majority of the shares not owned or controlled by the controlling shareholder are tendered, (2) the controlling shareholder promises to promptly consummate a short-form merger at the same price if it obtains more than 90% of the stock, and (3) the controlling shareholder has made no retributive threats[37]. The cumulative impact of these three factors is to "minimize the distorting influence of the tendering process on voluntary choice"[38] and render the "entire fairness" standard unnecessary. The short-form merger typically following such tender offers is also not subject to the "entire fairness" standard of review[39].

Delaware's two-pronged approach has been criticized for developing different legal standards for transactions generating essentially the same substantive result[40]. This disparate treatment is rationalized by noting that the controlling directors and stockholders in tender offers no longer stand on both sides of the transaction,

and no longer have any control over the decision to sell, thereby minimizing the inherent conflicts[41]. Regardless of one's view, the different approaches taken by Delaware courts can have a significant impact on structure, often leaving the "two step" tender offer/short-form merger as the preferred method of acquisition[42].

C. The Role of a Special Committee

Given the enhanced level of scrutiny accompanying going private transactions, it is imperative that the issuer and its board, employ proper processes to ensure that the transaction is reviewed and approved by independent parties. The proponent of a going private deal (e.g., management or the large stockholder looking to effect the transaction) carries the burden of proving the transaction's fairness. Approval by an independent committee of directors (or an informed "majority of the minority" of the stockholders), however, generally shifts the burden to the challenging stockholder to prove that the transaction was unfair[43].

A well-conceived going private transaction involves appointing a Special Committee of directors, wholly-independent of the sponsor as early as possible in the going private transaction. The scope and authority of the committee needs to be clearly delineated. They should be specifically authorized to review the acquiror's proposal, negotiate transaction terms, and either recommend the proposal to the entire board or consider all possible alternatives, including a limited auction or full auction of the company[44]. To maximize the special committee's independence, and to protect the issuer, the purchaser, and the Board itself, the special committee should retain its own independent, legal and financial advisors, at the company's expense[45].

The special committee's most important obligation is to reach an appropriate, substantively based, determination of the merits of the transaction and its alternatives. The bedrock issue is whether consummating a deal benefits all stockholders. Courts are best able to evaluate (i.e., challenge) the process, rather than the substance, of a committee's negotiations and deliberations and decisions. Viewed from a litigation perspective, longer meetings are preferable to shorter meetings, and more meetings are preferable to fewer meetings. Length (at least on the surface) appears to demonstrate diligence[46].

Special committees should seek all relevant operating, financial, and analytical information affecting their decision. Long and numerous special committee meetings establish a protective corporate environment. When these meetings and analysis are well-documented, directors can demonstrate that they possessed all necessary information, and that full disclosure had been made to them and subsequently to the stockholders. Viewpoints expressed by committee members at meetings (especially statements made early in the process) should be thoroughly considered so as to be consistent with the public disclosures ultimately made with respect to the transaction[47].

Regardless of how the board or committee chooses to proceed, courts evaluate a special committee's discharge of their fiduciary obligations by analysing whether it followed appropriate processes. Directors must focus on substance and process. Their deliberations should reflect care and thoroughness, including reading and evaluating all relevant information, data, analyses, projections, and agreements. Transaction compensation or benefits to insiders should be exhaustively scrutinized because of the inherent conflicts.

Informed Board determinations require knowledge about a company's value (i.e., current value compared to projected value) and its realistic alternatives[48]. These are frequently based on management-prepared projections. Projections inherently have limited value since both the company and the world continuously change, rendering reasonable hypotheses wrong. The probability that projected operational results will be fully or partially achieved must be evaluated. Boards commonly review alternative projections based on different assumptions about operating performance. The bases for the difference in hypotheses should be carefully delineated and will be disclosed in a Merger Proxy statement. Information about value can be provided, in part, by the Company's investment banker through a financial analysis and ultimately the issuance of a fairness opinion.

The essence of applicable state law is usually that a special committee's obligation is to make an "informed" decision as to how to respond to a proposed majority buyout. This is only possible if the committee understands the proposed transaction (including price, terms, and conditions), has fully evaluated the company's available alternatives, and has created an evaluation and sales process that maximizes stockholder value.

D. Disclosure Issues

SEC Rule 13e-3 and accompanying Schedule 13E-3 requires certain disclosures in the case of any transaction "engaged in"[49] by an issuer with an affiliate having the effect of a class of equity securities not continuing to be listed on a securities exchange. For these purposes, an affiliate is defined as a person or entity that "directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer"[50]. The company is required to provide detailed disclosure about the background of the transaction, the reasons for the transaction, and the reasons why other alternatives were not pursued[51]. Preparing the chronology for the "Background" section of the Merger/Proxy statement is challenging. It is not uncommon for going private transactions or opt-out events to have been informally discussed (sometimes for years) before a significant catalyst occurs that transforms idle conversation into concrete action. How far back does the securities lawyer go? What rises to the level of materiality? How do the company and its counsel verify the accuracy and completeness of such disclosures?

In addition, disclosure is required as to: (1) whether or not the transaction is "fair"; (2) whether the approval of a majority of the minority stockholders is required; (3) whether an independent special committee approved the transaction; (4) whether a majority of independent directors approved the transaction; (5) whether a "fairness opinion" was rendered from an outside party, and, if so, (6) the material factors upon which the fairness opinion was reached[52]. Fairness opinions are usually limited to whether the going private transaction is fair "from a financial perspective".

In the tender offer context, SEC Rules 14d-9 and 14e-2 require target companies to disclose material information in an accurate and complete fashion, including whether or not the company is supporting the offer. The target board is not required to take any position with respect to the offer, but any position taken must be accompanied by a statement of the reasons for its position.

IV. Opt-Out Transactions: Delisting and Deregistration

Compared to going private transactions, opt-out transactions (simply deregistering and delisting a company's securities) are considerably less expensive and time-consuming.

The opt-out process does, however, involve an understanding of the complex interplay between several different sections of the SEC rules, as well as knowledge of the procedures and policies of the applicable national securities exchange. Opting-out is severely statutorily limited since the condition precedent is that each class of security of the issuer have fewer than 300 "holders of record".

A. When is Registration Required?

Understanding the mechanics of an opt-out transaction requires an understanding of why a particular class of securities was originally registered. The steps necessary to opt-out vary depending on which section of the securities laws the securities are registered under. Section 12(b) of the Exchange Act requires securities listed on a national securities exchange to be registered with the SEC[53]. Section 12(g)(1) of the Exchange Act read together with Exchange Act Rule 12(g) requires every issuer with assets exceeding $10,000,000 and over 500 holders of record of any class of equity securities to register that class with the Commission[54]. Pursuant to Section 12(g) (2) of the Exchange Act, however, this duty to register does not apply to any issuer with a security listed and registered on a national securities exchange[55]. In addition to the foregoing, an issuer must register each public offering of securities (i.e., a traditional initial public offering) pursuant to Section 5 of the Securities Act of 1933 (the "Securities Act")[56].

By contrast, to traditional underwritten initial public offerings, the genesis of Section 12(g) registration was to prevent companies from "creeping" public offerings. Concern was expressed that a series of "separate" private offerings (each exempt from SEC registration) could be conducted resulting in hundreds of shareholders owning non-registered stock. This scenario has an undesirable regulatory results since a private company would have numerous stockholders without the liquidity and disclosure protections afforded to stockholders of similarly-sized public-companies[57]. Section 12(g) is frequently incorrectly characterized as requiring SEC registration when a company has 500 or more stockholders, rather than the extremely precise definition that requires registration of the security only when an issuer has an individual class of securities held by 500 or more holders of record.

It isn't always clear how to calculate the members of a "class". As an example, many relatively mature venture-backed companies issue successive rounds of convertible preferred stock. Each series has a separate designation (Series A, Series B and so on), frequently convertible (under some circumstances) into the same class of equity securities (i.e., common stock). Is each series a separate class of securities? If so, Section 12(g) is not applicable until the holders of record for any individual series exceeds 500. Alternatively, the issuer could calculate the number of stockholders for a class by reference to the holders of all the common stock plus, the holders of all the preferred stock on an "as converted" basis. Approached in this manner, Section 12(g) would be triggered as soon as the company had 500 stockholders of record.

Section 12(g)(5) of the Exchange Act defines "class" to include "all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges"[58]. Based on this definition, some academic commentators believe that each series (if convertible) should be viewed as one "class" of securities[59]. The view, however, is not universal; particularly among practitioners. Each series of stock frequently has significant differences. Series are negotiated and sold separately. Consequently, their contractual protection, corporate governance rights (such as Board seats or observation rights), and dividend and liquidation preferences and priorities may have significantly different (even competing) rights and privileges until converted. In the absence of definitive case law or SEC comments, this calculation remains an open and important interpretive question in the private equity community.

Under Exchange Act Rule 12g5-1, the number of "holders of record" of a class of a company's stock includes each person who is identified as the owner of such securities on records of security holders maintained by or on behalf of the issuer[60]. Securities identified as held of record by pre-existing entities (such as a corporation, partnership, or trust) are counted as being held of record by one person. Legal title governs and there is no "look through" to the number of beneficial owners[61]. Accordingly, for the purposes of calculating the number of holders of record, the beneficial investors holding shares of stock in "street name" are generally disregarded[62]. For many public companies the vast majority of shares

are held of record by a handful of institutional depositories, investment banks, and other professional intermediaries[63].

B. Duty to File Periodic Reports

A company with securities registered under Section 12 (whether under 12(b) or 12(g) of the Exchange Act) is required to file "periodic reports" such as 10-Ks and 10-Qs with the SEC[64]. Companies with effective registration statements under the Securities Act are also required to file periodic reports pursuant to Section 15(d) of the Exchange Act[65]. Section 15(d) filing duties are automatically suspended so long as any issue of securities of the issuer is registered under Section 12 of the Exchange Act.

C. Delisting

The first step in many opt-out transactions is to de-list a registrant's securities from the applicable securities exchange, thereby eliminating the registration requirements of Section 12(b). An issuer can usually voluntarily request that its stock be removed from a national securities exchange by submitting a written request stating the reasons for its decision to delist and following the other rules of the applicable exchange[66]. Exchange Act Rules 12d2-2(d) and (e) permit a company to file an application to withdraw a class of securities from listing and registration on the exchange in accordance with the rules of the exchange[67]. Appropriate notice must be published by the Commission in the Federal Register. Following a specified notice and comment period, the SEC may issue an order permitting the delisting[68].

D. Mechanics of Deregistration

Following delisting and deregistration under Section 12(b), a class of securities automatically becomes registered under 12(g), unless it meets certain exceptions, such as having fewer than 300 holders of record. To terminate registration of a class of securities registered under Section 12(g), a company must file a Form 15 with the SEC certifying that either:

a. the number of holders of record of the class of the company's securities sought to be deregistered is less than 300; or

b. the number of holders of record of the class of the company's securities sought to be deregistered is less than 500 and the company's total assets have not exceeded $10 million on the last day of each of the company's three most recent fiscal years[69].

Upon filing Form 15, a company's registration under Section 12(g) of the Exchange Act is suspended. The suspension is effective 90 days (or such shorter period as may be determined by the SEC) after filing[70]. The issuer's obligation to file periodic reports under Section 13(a) of the Exchange Act, however, is suspended immediately upon filing the form 15.[71] It is worth noting that this filing duty would be revived if the class of securities again became held by more than 500 holders of record[72].

Although terminating a company's registration under Section 12 of the Exchange Act would also terminate its duty to file periodic reports under Section 13(a), a company with effective registration statements under the Securities Act remains obligated to file the periodic reports under Section 15(d) of the Exchange Act[73]. Different rules govern termination of the obligation to file periodic reports under Section 15(d). The requirement to file periodic reports under Section 15(d) is automatically suspended for any fiscal year (other than the fiscal year the registration statement became effective), if, at the beginning of the fiscal year, the securities of such class are held of record by fewer than 300 persons[74].

Pursuant to Exchange Act Rule 12h-3(a), the 15(d) duty to file periodic reports with respect to an "eligible class of securities" is immediately suspended upon filing a Form 15 certifying that the issuer has filed all periodic reports for its most recent three fiscal years and the current portion of the current fiscal year[75]. An "eligible class of securities" includes any class of securities held of record by: (1) fewer than 300 persons, or (2) fewer than 500 persons, where the total assets of the issuer have not exceeded $10 million on the last day of each of the company's three most recent fiscal years[76]. The suspension from the reporting obligations of Section 15(d) is available only while the securities remain "eligible" for suspension[77]. Accordingly, unlike the result for deregistration from Section 12(g), the duty to file periodic reports would be revived if the class of securities again became held by more than 300 holders of record.

The suspension is not available under Rule 12(h) for a fiscal year in which the registration statement applicable to the securities either: (1) becomes effective under the Securities Act, or (2) is required to be updated pursuant to Section 10(a)(3) of the Securities Act[78]. Accordingly, this suspension would appear to be unavailable to certain securities registered under the Securities Act. Examples would include securities relating to stock option plans registered on Form S-8, which are typically updated annually pursuant to the Securities Act as part of the issuer's 10-K. In a series of no-action letters, however, the Commission has consistently concluded that, Rule 12h-3 is not intended to apply to a registration statement on Form S-8, even if it is required to be periodically updated[79]. Unfortunately this conclusion has apparently not yet been reached with, for other registration statements, that are also periodically and routinely updated, such as a "shelf" registration on Form S-3, which means that an issuer will need to terminate the registration statements prior to the fiscal year in which it intends to file its Form 15.[80]

E. "Holders of Record:" An Outdated Concept

When Exchange Act Rule 12g5-1 was enacted almost 40 years ago in 1965, the beneficial owners of a company's stock were routinely listed on the corporate books as the holders of record. The Age of Computers had not yet developed and electronic data storage had not yet become the norm. Corporate recordkeeping was generally accomplished using paper ledgers and actual physical transfers of stock certificates[81]. The reasonable regulatory assumption was that 300 holders of record would be approximately equal to 300 beneficial owners[82].

Paper has since become obsolete and virtually replaced by electronic data storage. Investors now deposit their stock certificates in an account maintained by a securities broker that in turn holds securities in an account maintained by a securities depository[83]. A nominee of the securities depository (often referred to as "CEDE & Co.") serves as a global "holder of record" representing all of the shares held for the account of the various brokerage firms. They in turn maintain accounts for their investors. The result is that most beneficial owners of stock are no longer the "holders of record". Beneficial owners are represented almost entirely on corporate record books as "CEDE & Co."[84]

The original statutory intent was symmetrical. Companies whose shareholder base had grown to significant levels through a series of private offerings, had to register such securities and enter the SEC disclosure and reporting system through 12(g). Falling corporate stars whose stockholder base had dwindled had the right (but not the obligation) to exit the public system pursuant to 12(d). Asymmetry has been created because a 2004 beneficial holder of a company's stock is substantially the same as a 1965 "holder of record". Some surprisingly large public companies, with a significant number of investors holding stock in street name, are nonetheless eligible for deregistration because technically they have fewer than 300 stockholders of record[85].

Given the costs, pressures, and burdens of the present regulatory and economic environment, it is not surprising that many issuers are using the delisting procedures set forth in Rule 12(g) and elsewhere to opt-out of public company reporting obligations.

V. Post-transaction Considerations

Restoring a company's private status generally reduces most burdens associated with the regulatory requirements of the federal securities laws and the Act in particular. A private company nonetheless retains certain disclosure, governance, and other obligations under state law. State law and/or the company's charter documents generally require the company to hold annual stockholder meetings[86] and make certain limited disclosures to stockholders[87]. Some state corporation laws require annual disclosure of specified financial or other information to stockholders[88]. In jurisdictions like Delaware, however, a private company's disclosure obligations are limited[89].

Companies that opt-out of SEC registration may still have a significant number of individual unaffiliated stockholders even after returning to private status. Through mid-June 2004, approximately 240 companies made form 15 filings with the SEC indicating they were deregistering common stock. More than seventy indicated that they had at least 200 holders of record and 17 more indicated they had at least 50 holders of record[90]. Even though companies have completed an opt-out (or a going private) transaction, the continued ownership by numerous shareholders means that a company may nonetheless have to follow certain public

company procedures to meet its governance objectives. For example, a recently-private company with a significant number of stockholders may still need to mail out proxy solicitations to ensure that it has sufficient shareholder votes to meet its governance objectives, such as electing directors.

VI. Exiting The Public System: Why So Rare?

Despite the attention surrounding the advantages of going private, the benefits of opt-out transactions, and an apparent increase in the expressed desire to "go private", remarkably few companies have actually done so. According to one study, only 79 of the roughly 10,000 public companies in the United States attempted to truly go private in 2003.[91] Despite some alluring incentives to go private or opt-out (particularly for smaller to mid-sized issuers) there are countervailing reasons not to do so as well.

Perhaps most importantly, unless the proponents of a going private transaction own a controlling share of the equity securities, the "going private" announcement signals the market that the company is for sale. The board's obligations under Delaware case law to maximize stockholder value in a change-in-control circumstance may be triggered, and corporate auction processes may be required[92]. Other bidders (perhaps unwelcome) are invited to participate in the process. The outcome, and corporate control, is uncertain[93]. This can be uncomfortable for management, particularly if they aren't the sponsor and don't have employment agreements with change of control provisions. Corporate directors may find themselves in a difficult and awkward fiduciary position[94]. Also, being "in play" can be time-consuming for the Board and management, create an unstable operating environment, disconcert a company's customers, employees, and business partners, and create an opportunity for competitors to seek key employees or accounts.

Despite the increased burdens there remain not insubstantial benefits to being public. Public companies are generally able to raise capital or finance acquisitions more easily than private companies due to the liquid nature of their stock and the size of the aftermarket trading universe in their securities. There is a widely-shared perception that public companies are more "prestigious", and that their capital bases and access to capital provide greater staying power and financial substance than their private company competitors. This perception facilitates

public companies' abilities to attract customers, business partners, employees, and directors. Returning to private company status can have a long-term, adverse impact on all of the foregoing and is sometimes viewed by a company's board, management, or employees as a failure[95].

At the practical level, there are substantial transaction costs and litigation risks associated with going private. Such transactions routinely take as long as six months to complete, and are subject to significant legal and regulatory requirements[96]. The deals are sophisticated and complex. Generally, a going private transaction involves: (1) company counsel, (2) counsel for the sponsor, (3) counsel for the independent committee, (4) an investment banker for the committee to advise and give a "fairness opinion" and usually to "shop" the deal, and (5) often an investment banker for the sponsor. The SEC routinely reviews and comments on the disclosure documents. Moreover,. both going private and opt-out transactions can result in unhappy stockholders[97] with a concomitant risk of class action securities litigation. Depending upon the structure employed, the transaction may also be subject to significant judicial scrutiny.

Purely deal-driven economic factors may also be involved. Following the economic downtown in 2001 and 2002, and the sharp increase in troubled loans during those years, the debt markets have become more conservative. Lenders have drastically altered debt-to-equity ratios. Going private transactions routinely require much higher equity levels than was common throughout the 1990s. Accordingly, a going private transaction structured as an LBO or MBO may not easily be able to achieve the requisite level of debt or equity financing necessary to fund a transaction[98].

Finally, a key consideration driving going private transactions (i.e., avoiding costs associated with Sarbanes-Oxley) may not fully exist now, or in the near future. The financial reporting and corporate governance procedures by the Act are increasingly viewed (and required) by lenders, investors, and potential business partners as standard operating procedure. Many private companies are "voluntarily" complying with all (or a portion) of the corporate governance and financial statement requirements of the Act to satisfy their stakeholders. Going private transactions involve sophisticated financial institutions as suppliers of both debt

and equity. A reasonable assumption is that even after an MBO or LBO, the company may nonetheless continue to bear a portion of Sarbanes-Oxley's costs to satisfy their capital sources.

VII. Conclusion

Many financial intermediaries and legal advisors are encouraging their clients to consider exiting the public system to reduce regulatory, economic, and other burdens. In today's economic and legal climate, a company's board may well have a fiduciary obligation to consider all of the foregoing. Neither opting-out nor going private, however, is a universal panacea. In addition to the time, expense, and scrutiny incurred, even companies successfully completing a transaction may effectively remain subject to significant regulatory and governance obligations regardless of whether they are public or private. Upon reasoned reflection, therefore, it is not surprising that so few transactions returning public issuers to private status have actually occurred.

(This article is dedicated to the memory of our partner, James J Bartolozzi (1954-2003). He was a quintessentially urbane securities litigator who delighted in unraveling complex securities matters, and defending (or pursuing) them in a relentless, effective, and courteous manner.

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The authors thank their partners and colleagues, Irv Berliner, whose experience in going private transactions, editorial skills, and rigorous questions helped the authors immeasurably, and Dominic DiPuccio, who provided insightful and invaluable substantive advice.)

Endnotes

1 P L 197-204, 116 Stat. 745 (codified at various sections of 11, 15, 18, 28, and 29 U S C).

2 See Marc Morgenstern and Peter Nealis, *Sarbanes-Oxley-Impact on Mid-Cap Issuers* (paper presented at the Practising Law Institute Advanced Securities Workshop on August 12, 2004).

3 Some empirical data suggests that the frequency of going-private transactions has increased following the passage of Sarbanes-Oxley. See Grant Thornton LLP, Post Sarbanes-

Oxley: Number of Public Companies Going Private Increases 30 Percent, available at *http://www.grantthornton.com* (December 15, 2003) (noting a 30% increase in going private transactions during the 16 months immediately following enactment of the Act compared to the 16 months immediately preceding enactment); David A Stockton *et al.*, Going Private: the Best Option?, *National Law Journal* (June 23-30, 2003) (citing a study by FactSet Mergerstat indicating that going private deals as a percentage of mergers and acquisition transactions increased by approximately 23.7% from 2001 to 2002); see also Stephen Pounds, *Software Firm Grabs the Bootstraps*, PALM BEACH POST (December 29, 2003) (noting that 95 US companies went private during the 12-month period ending in July, 2003, compared to 75 US companies for the previous 12-month period); but see Gregory R Samuel and Sally A Schreiber, *Going Private Transactions*, 40-SPG TEX. J. BUS. LAW 85, 88 (2004) (observing that the number of going private transactions decreased from 2002 to 2003). "Pretty much everything is making you scratch your head and ask, 'Why am I a public company?'" *Pounds, supra* (quoting Marc Morgenstern).

4 See Paul Castor and Christy Lomenzo Parker, *"Going Private:" Business and Procedural Considerations in Seeking Relief from Reporting and Corporate Governance Requirements*", at 7 (March, 2003) (Rutan & Rucker, LLP publication) (copy on file with the authors); Gregory R Samuel and Sally A Schreiber, *Going Private Transactions*, 40 SPG TEX J BUS L 85, 89 (Spring 2004).

5 The industry joke is that the market is so illiquid that trading is by "appointment only".

6 The company and its counsel and financial advisors should engage in preliminary due diligence to determine whether going private or opting out is feasible. The company's ability to deregister its stock depends in most cases upon the number of holders of record of its stock. See Section IV – "Opt-out Transactions: Delisting and Deregistration", infra. Accordingly, the company should review its record stockholder list to determine the exact number of holders of record. The company should also review all of its own relevant documents including its existing contractual commitments, credit agreement, stock option plan, certificate of incorporation, and bylaws to determine whether there are any restrictions upon its ability to go private; *See* David Alan Miller and Marci J Frankenthaler, *Delisting/Deregistration of Securities under the Securities Exchange Act of 1934*, 17 NO. 10 INSIGHTS 7, 8 (2003).

7 To date, however, there appears to be no reported litigation by stockholders challenging the opting out process. But see The Nelson Law Firm, LLC, *Petition for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities* (July 3, 2003) (hereinafter, the "Nelson Petition") (citing 24 examples of issuers that they feel deregistered their securities under "circumstances suggesting manipulation of the capital markets").

8 *Cede & Co. v. Technicolor, Inc.*, 634 A. 2d 345, 361 (Del. Supr. 1993).

9 Under the business judgement rule, the decision of a board resulting from an informed opinion, based on *good process and full disclosure*, will generally not be examined by the courts. *See Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

10 See Part III.B *infra*.

11 See Morgenstern and Nealis, Sarbanes-Oxley Impact on Mid-Cap Issues, supra.

12 See Bruce E Cunningham, *Going Private* (June 2003) *available at http://www.gtlaw.com* (last visited June 26, 2004)). Notwithstanding the foregoing, companies considering going private should be aware that many lenders, business partners, and private equity investors are demanding Sarbanes-Oxley "type" compliance as standard operating procedure and the basis for corporate governance process and financial statement disclosure and format, regardless of whether a company is public or private. *See Morgenstern and Nealis, Sarbanes-Oxley-Impact on Mid-Cap Issuers, supra* (paper presented at the Practising Law Institute Advanced Securities Workshop on August 12, 2004); *see also* Anne Field, *Some Private Companies Embrace Tough Times*, The New York Times, Late Edition (July 15, 2004) (quoting Marc Morgenstern).

13 See Cunningham, supra ("Private companies enjoy the freedom to make more aggressive business manoeuvers.").

14 See Part V, *infra*.

15 The definition of materiality (a concept embedded throughout the Exchange Act's disclosure requirements) by its nature requires smaller issuers to disclose more information about smaller contracts than their larger competitors. The consequences that may arise from a $1,000,000 transaction (or the impact of a $1,000,000 effect under an off-balance sheet arrangement) for a mid-cap company may be material while even dozens of such transactions for their larger competitors may not be material. The inevitable consequence is that smaller companies are forced to disclose significant amounts of sensitive information that can be of genuine assistance to their larger competitors and exacerbate the intrinsic size, scale, and resource competitive handicaps of mid-cap companies. *See* Marc Morgenstern, *MD&A 2003: The Off-Balance Sheet Rules (A Mid-Cap Perspective)*, 35th Annual PLI Institute on Securities Regulation (2003) (available at 1395 PLI/Corp. 87); Marc Morgenstern, *Off-Balance Sheet Disclosures in MD&A*, the review of securities and commodities regulation (January, 2004).

16 In an MBO, management of a public company generally takes a company private by buying the company's outstanding shares not owned by management. In an LBO, a significant percentage (e.g., 70%) of the purchase price is borrowed.

17 See Samuel & Schreiber, supra, at 89.

18 See 5 SECURITIES LAW TECHNIQUES, *State Law on Going Private* § 68.02[1][a] ("Removing proxy solicitation disclosures from any pivotal role in the merger may insulate the transaction from an injunction challenge alleging that its approval was based on misleading disclosure.").

19 See Paul S Bird, *Developments in Spin-Offs, Sales of Divisions and Going Private Transactions*, 1279 PLI/Corp. 427 (2001) (Presentation at 33rd Annual Institute on Securities Regulation).

20 See, e.g., Delaware General Corporation Law § 253.

21 See Delaware General Corporation Law §§ 242(b); 251(c); Although generally not a statutory requirement, many mergers require the approval of a majority of the "disinterested shares," *i.e.*, the shares held by parties other than the acquiror. This additional requirement is based, in part, on case law holding that transactions involving a conflict of interest may be permitted if a fair and neutral body approves it. See Oberly v. Kirby, 592 Ad 445 (1991); see also Kahn v. Lynch Communications System, Inc. 638 A.2d 1110 (Del. 1994).

22 5 SECURITIES LAW TECHNIQUES, *State Law on Going Private* § 68.02(3)(a) "The appraisal remedy has become more popular and has taken on renewed significance in planning going-private transactions".

23 Id. at § 68.02(3)(6) (discussing basic requirements for perfecting an appraisal).

24 Id. ("Under Delaware law, absent special charter provisions, appraisal rights are available only in statutory mergers").

25 See *Bird, supra*, 1279 PLI/Corp. 427 ("From the point of view of the buyer, there are other reasons to prefer a first-step tender offer. The company's stockholders will not have any appraisal rights with respect to shares that they tender although they would have appraisal rights with respect to the second-step cash-out merger".)

26 See *Samuel and Schreiber, supra*, at 99.

27 The term "business combination" is defined in the Delaware statute to include any merger or consolidation of the target corporation with the interested stockholder. See Delaware General Corporation Law § 203(c)(2).

28 See Delaware General Corporation Law § 203(c)(5).

29 See *Singer v. Magnavox*, 380 A.2d 969, 980 (Del. 1977) *overruled on other grounds Weinberger v. VOP, Inc.*, 457 A.2d 701 (1983); See also *Samuel & Schreiber, supra*, at 100 ("In a number of cases, stockholders who wished to remain stockholders of a corporation have sued in an attempt to do so").

30 The sale of a business is often considered to be the most important and complex transaction of a company's life. *Cf.* Marc Morgenstern, *Philosophy of Acquisitions, Corporate Counsel's Quarterly* (January, 1992).

31 See, e.g., *In re Pure Resources, Inc.*, 808 A.2d 421, 436 (Del. Ct. Chancery 2002) (observing the "inherent coercion" that exists when a controlling stockholder announces its desire to buy the minority shares). Courts have also justified the enhanced level of scrutiny applied to going private transactions based upon the fiduciary duties that a majority stockholder owes to the minority stockholders. See *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1115 (Del. 1994) (applying a strict standard of review to ensure "that all parties to the transaction have fulfilled their fiduciary duties to the corporation and all its stockholders").

32 The majority of public companies are incorporated in Delaware, and most other jurisdictions use Delaware law for guidance in developing or interpreting local law. See *Cunningham, supra.*

33 See generally, e.g., *Kahn v. Lynch Communications Systems, Inc., supra*, 638 A.2d 1110.

34 Although all aspects of the transaction must be evaluated as a whole, the entire fairness standard usually encompasses two separate components: fair dealing and fair price. "Fair dealing" depends upon whether the controlling stockholder and the company's board of directors employed proper process in initiating, negotiating, and consummating the transaction. *Id.* at 1115 [citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (1983)] (emphasis added). "Fair price" looks to the economic fairness of the transaction, including the adequacy of the consideration paid for the shares. *Id.*

35 See *Solomon v. Pathe Communications Corp.*, 672 A.2d 35, 39 (Del. 1996).

36 See *In re Pure Resources, supra*, at 438. The adequacy of the price offered by the majority stockholder does not play a factor in this analysis. Id.

37 Id. at 445. The *In re Pure Resources* court also observed that there may be other "non-coercive" approaches, such as a tender offer accompanied by a separate questionnaire that asked the stockholders whether they wished the offer to proceed. The majority of the minority would have to answer in the affirmative for the offer to proceed. The stockholders would then tender their shares while remaining free to express an undistorted choice on the adequacy of the offer. Id. at 445, n. 45.

38 Id.

39 See generally *Glassman v. Unocal Exploration Corporation*, 777 A.2d 242 (Del. 2000). *Glassman* held that absent fraud or disclosure violations, a short-form merger could only be contested in an appraisal proceeding that focused upon the adequacy of the price paid.

40 See Thomas M. McElroy, Note, *In re Pure Resources: Providing Certainty to Attorneys Structuring Going Private Transactions, Or Not?*, 39 *Wake Forest Law Review* 539, 541

(Summer, 2004) ("The problem with these divergent policy approaches is that two transactions with substantially similar economic effects and similar risks to minority stockholders are treated as categorically different"). The *In Pure Resources* court called into doubt the disparate standards of review for negotiated mergers and tender offers. See *In re Pure Resources, Inc. Stockholders Litigation, supra*, 808 A.2d at 443 ("I admit being troubled by the imbalance in Delaware law exposed by the *Solomon/Lynch* lines of cases"). However, in that decision, the court declined to extend the "entire fairness" standard to tender offers. *Id.* Instead, the court enjoined the offer because it found coercion and disclosure violations. *Id.*

41 See *McElroy, supra*, at 544.

42 See, e.g., Douglas R Wright, *Going Private Transactions: The New Roadmap*, available at *http://www/faegre.com* (last visited June 23, 2004) ("controlling stockholders and their investment bankers would be well advised to adhere closely to the road map provided by (Delaware law) in structuring going private transactions").

43 See *Kahn, supra*, 638 A.2d at 1117; *In re JCC Holding Co., Inc.*, 843 A.2d 713 (2003). Despite endorsing a burden-shifting analysis when a majority of the minority approve a going private transaction, the JCC Holdings Co., Inc. court held further that minority stockholders who voted for the merger or accepted merger consideration were not barred by the doctrine of acquiescence from challenging the fairness of the merger. *Id.* at 843 A.2d 713. (emphasis added).

44 See Bird, *supra*, 1279 PLI/Corp 427. In appointing a special committee, the board should consider adopting a resolution stating that the appointment of the special committee is not to be construed as a determination that the company is "for sale", but that the committee was formed to consider whether the company should be for sale and to consider the appropriate price for any such sale by reviewing proposed offers. See Arthur M Borden, Going Private (1982) § 8.03(2). Securities counsel must insure that the intent of the board is captured. Depending on the board's precise determination and commitment, immediate public disclosure may be appropriate. Counsel must also analyse disclosure obligations arising from existing stock buy-back programs.

45 See *Bird, supra*, 1279 PLI/Corp 427.

46 At the extreme example of what not to do is the famous case dealing with Director liability caused by failure to make informed decisions, *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). Public company directors approved a merger only two hours after hearing about it for the first time. Not surprisingly, this was held to be a failure to fulfill their duty of care. Even if the Van Gorkom board's decision to approve the merger on the terms provided was objectively the "correct" determination, the board made itself vulnerable to potential liability by creating

a record that exhibited inadequate process. In a two-hour timeframe, the board could not have reviewed and correctly analysed the pertinent information. The process was so hasty that it seemed improbable that prudent analysis and judgement could have been exercised. Under those circumstances, board decisions may be challenged and directors may bear personal liability. In early 2003, the Delaware Chancery Court refused to dismiss litigation against the directors of The Walt Disney Company alleging breach of fiduciary duties in connection with both the employment and termination of employment of a new president. The Court noted that in approving the new president's five year, multi-million dollar contract, the Board was furnished an incomplete summary of the agreement, no compensation consultant or other expert was retained, and more time was spent discussing the $250,000 finder's fee paid to a director than was spent on the contract itself. In denying the motion to dismiss, the court noted that the complaint suggested that the Disney directors "failed to exercise any business judgement and failed to make any good faith attempt to fulfill their fiduciary duties". *In re The Walt Disney Company Derivative Litigation*, 825 A. 2d, 275, 278 (Del. Chancery Ct., May 28, 2003).

47 See *Borden*, GOING PRIVATE, *supra* at §13.02 ("In this matter, it is better to think before one speaks.").

48 See *In re Pure Resources*, *supra*, at 441 (observing that target boards are "well-positioned" to "understand the value of the target company, to compensate for the disaggregated nature of stockholders by acting as a negotiating and auctioning proxy for them, and as a bulwark against structural coercion,"); see also Borden, GOING PRIVATE, *supra*, at §8.03[2](4) (noting that independent committees faced with a proposed going private transaction should give very serious consideration to attempting to negotiate a higher price).

49 An open question appears to be when an issuer "engages" in a going private transaction. The SEC indicates that, in the case of a tender offer, the target company engages in the transaction if it recommends in favor of the transaction (as opposed to recommending against the transaction or remaining neutral). See Mimble Charles Cannon, *Augmenting the Duties of Directors to Protect Minority Stockholders in the Context of Going Private Transactions*, 2003 COLUM. BUS. L. REV. 191, 251 (2003) (citing SEC Manual of publicly-available telephone interpretations.)

50 See SEC Rule 13e-3(a)(1).

51 SEC Schedule 13E-3, Item 7.

52 SEC Schedule 13E-3, Items 8 and 9.

53 See 15 USC § 781(b).

54 See 15 USC § 781(g). Issuers without securities listed on a national securities exchange and not meeting the stockholder and asset requirement of Section 12(g) can nonetheless voluntarily register their securities under Section 12(g)(1).

55 Id.

56 See 15 U.S.C. § 77e(c).

57 See 4 SECURITIES LAWS TECHNIQUES § 49.03(2), *Registration of Over-the Counter Securities* ("Issuers seeking to avoid the full range of disclosures required by the Exchange Act could do so simply by not listing any of their securities on a national exchange and relying exclusively on the over-the counter market for trading").

58 15 USC § 781(g).

59 For purposes of determining whether a holder is a 10% beneficial owner under Section 16 of the Exchange Act, the 2nd Circuit Court of Appeals held that the relevant inquiry was not the percentage held as a separate series, but the percentage held of underlying common shares, based on the assumption that the series was convertible into common stock. See *Chemical Fund, Inc. v. Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967).

60 See Exchange Act Rule 12g5-1.

61 Id. Calculating the number of investors represented by an entity arises in many contexts under the securities statutes. In the private placement context, see Marc Morgenstern, *Corporations, Partnerships and Trusts as Purchasers Under Regulation D, Real Estate Securities Journal*, Volume 7, Issue 2 (1986).

62 See The Nelson Petition (petition on behalf of institutional investors to enact a "Beneficial Owner's Rule" requiring beneficial owners of stock in street name to be included as holders of record). Rule 12g5-1 does provide that if a company knows or has reason to know that the form of holding securities of record is used primarily to circumvent the Exchange Act, then the beneficial owners of those securities are deemed the record owners of those securities. See Exchange Act Rule 12g5-1. (emphasis added).

63 See The Nelson Petition ("Instead, beneficial owners are represented almost entirely on the corporate books by 'CEDE & Co.' ... and other nominee names serving similar functions").

64 See Exchange Act Section 13(a), 15 U S C § 78m(a).

65 See Exchange Act Section 15(d), 15 U S C § 78o(d).

66 See *Castor & Parker*, *supra*, at 5 ("Generally, a listed company that wishes to voluntarily delist must contact Nasdaq *via* written letter and state the reason for its decision to delist").

67 The delisting application must comply with the requirements set forth in Rule 12d2-2(e).

68 See Exchange Act Rule 12d2-2(d).

69 See Exchange Act § 12(g); Exchange Act Rule 12g-4.

70 See Exchange Act Rule 12g-4(a).

71 See Exchange Act Rule 12g-4(b).

72 Id.

73 See Exchange Act Rule 12g5-1(b).

74 See Exchange Act § 15(d), 15 U.S.C. § 78(o).

75 See Exchange Act Rule 12h-3(a). The issuer must be current in its periodic reports "without regard to Rule 12b-25", meaning that the issuer may not rely on the filing extension granted by SEC Rule 12b-25 to avoid filing a periodic report immediately prior to filing the Form 15. See SEC Release No. 34-20263, Proposed Suspension of Periodic Reporting Obligation (October 5, 1983).

76 See Exchange Act Rule 12h-3(b).

77 See Exchange Act Rule 12h-3(a).

78 See Exchange Act Rule 12h-3(c).

79 See, e.g., Vinson & Elkins (January 4, 1985); see also Friedman, Billings, Ramsey Group Inc. (March 25, 2003) ("We note that the Staff has previously stated that Rule 12h-3(c) is not intended to apply to normal course updating of registration statements on Form S-8 pursuant to Section 10(a)(3) of the Securities Act").

80 In several no-action letters, the SEC has permitted issuers, under limited circumstances, to suspend their reporting requirements during the first fiscal year in which a Securities Act registration statement relating to the class of securities became effective, despite the literal language of Rule 12h-3. This no-action position has typically been taken only when there were just a few or no stockholders. See, e.g., Alamo Rent-A-Car, Inc. (February 4, 1997); Collins & Aikman Products Co. (September 8, 1994); Ferrelgas, Inc. (August 19, 1994); Mtech Corp. (August 31, 1988).

81 See The Nelson Petition (citing Hazen and Markman, 23 Broker-dealer Operations under Securities and Commodities Law, "*Broker-Dealers—The Regulatory Era; The 60's-the Go-Go Years*" § 2.14 (2002)).

82 Although the original version of Rule 12g5-1 would have required that each account held in street name be counted as a holder of record, this requirement was dropped following numerous comments from securities brokerage houses claiming that Rule 12g5-1 as originally drafted was overly burdensome. See The Nelson Petition.

83 Id.

84 Id.

85 Of 24 opt-out transactions identified by the Nelson Petition, 17 had over 1,000 estimated beneficial owners. Id.

86 See D G C L § 211(b). Although Delaware law explicitly permits written actions to be taken by stockholders in lieu of a meeting, Delaware case law holds that an election of directors by written consent in lieu of a meeting that is not unanimous does *not* satisfy the requirement that a Delaware corporation hold an annual meeting of stockholders. See *Hoschett v. TSI International Software, Ltd.*, 683 A.2d 43, 46 (1996) ("I conclude absent unanimous consent that the mandatory language of Section 211(b) places on TSI the legal obligation to convene a meeting of stockholders to elect directors pursuant to the constitutional documents of the firm").

87 See generally Donald E Pease, *Delaware's Disclosure Rule: The "Complete Candor" Standard, its Application, and Why Sue in Delaware*, 14 DEL J CORP. L. 445, 481 (1989).

88 See, e.g., O R C § 1701.38.

89 The only disclosure explicitly called for by the D G C L is that stockholders be given written notice of any annual or special stockholder's meeting specifying: (a) the place, date, and hour of such meeting; (b) the means of remote communication, if any, by which stockholders and proxy holders may be deemed to be present in person and vote at such meeting; and (c) in the case of a special meeting, the purpose for such meeting. See D G C L § 222(a); *Stroud v. Grace*, 606 A.2d 75, 86 (1992) (holding that in the absence of a proxy solicitation, a company "is under no duty to disclose anything beyond the requirements of Section 242(b)(1) of the General Corporation Law").

90 See also note 85 *supra*.

91 See *Samuel and Schreiber, supra*, at 88; *see also Cunningham, supra* (reporting that 57 companies had filed Schedule 13E-35 with the SEC to go private in 2003 as of June, 2003).

92 The classic Delaware cases examining these issues are *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985), *Unocal, Inc. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), and *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). While the three cases are not wholly consistent, the essence of these cases is that the board's substantive obligation is to make an "informed" decision.

93 In evaluating a potential going private transaction, the special committee must have the ability to deal with a higher bidder, generally through agreeing to a "break-up" fee with the original purchaser and requiring a "fiduciary out" provision in the definitive Merger Agreement. Conceptually these are designed to permit a company to enter into a definitive Merger Agreement but still retain the ability to accept a subsequent better offer that would more fully maximize stockholder value.

94 Delaware General Corporation Law provides no requirement for target boards or special committees to review or approve tender offers made to their stockholders, and does not provide for any explicit authority to block such offers. See *In re Pure Resources, supra*, at 439. Nevertheless, a Delaware target corporation's board or special committee retains a fundamental duty to protect the corporation from harm reasonably perceived irrespective of its source. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (emphasis added).

95 See *Samuel and Schreiber, supra*, at 88 (listing "(p)ride and the perception (that) withdrawal from the public markets would be seen as failure as a reason why companies do not go private").

96 See *Cunningham, supra* ("A going private transaction can take as long as six months to complete and must clear numerous legal and regulatory hurdless").

97 With respect to opt-out transactions, see the Nelson Petition for a discussion of the "harsh result" to the beneficial stockholders of deregistration, particularly the illiquid market that results and the lack of ongoing financial information.

98 Id. ("These conservative lending practices have forced LBO funds to increase their equity contributions (as a percentage of transaction value) from approximately twenty-three percent in 1996 to more than 40 percent in the fourth quarter of 2002").