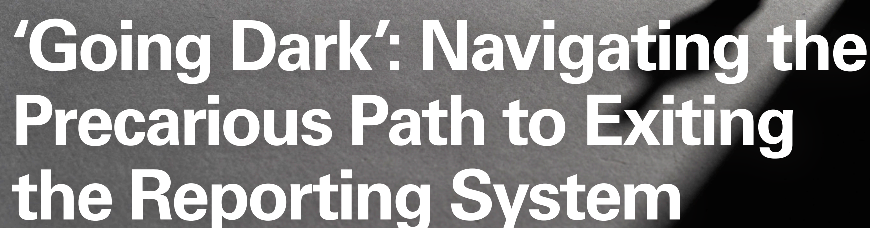
'Going Dark': Navigating the Precarious Path to Exiting the Reporting System



- Companies with sharply declining stock prices may find it beneficial to voluntarily exit the reporting system to reduce costs and eliminate compliance burdens.
- To reap the full rewards of "going dark," a company should consider terminating or suspending its reporting obligations in addition to delisting.
- Some of the possible detriments and risks associated with going dark are not obvious, such as possible impacts on contracts and financings.

During periods of market turmoil and declining stock prices, companies may be tempted or pressured to delist and deregister their shares. This process is often referred to as "going dark." Given the poor performance of companies that have recently entered the public markets and a dearth of favorable financing options, we anticipate that more companies will experience difficulty maintaining compliance with stock exchange minimum bid price and market capitalization requirements. Other companies may consider voluntarily going dark due to the costs and burdens of complying with exchange listing rules and the burdens of being a public company.

Voluntary Exchange Delistings

Public company boards often begin to consider the possibility of going dark when faced with challenges related to exchange listing standards or upon receipt of a delisting or non-compliance notice.

Sometimes it is possible to implement a plan to cure the non-compliance. If a notice is triggered by a company's share price falling below the minimum bid price requirement, the company may consider a reverse stock split that decreases the number of issued shares by a specified ratio without affecting the total market capitalization.

Other paths to avoid an involuntary delisting include signaling to the market that a company is interested in finding a buyer or engaging in other strategic transactions. Of course, companies in this position should also be considering changes to business operations that would facilitate long-term growth prospects or other ways to execute current strategy to organically regain compliance.

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Despite these efforts, companies sometimes conclude it is neither desirable nor feasible to maintain a listing. Reducing compliance costs and stepping out of the public eye may provide some breathing room to focus on fixing or growing the business.

It should be noted that some investors have come to expect companies to comply with the exchange-imposed governance and disclosure requirements even if a company delists, and auditors will likely require an independent audit committee.

Deregistration

It rarely makes sense to delist but maintain registration of a class of securities. Most companies faced with a delisting will also seek to deregister applicable classes of securities so they do not need to file periodic reports or otherwise comply with the requirements of the Securities Exchange Act of 1934 (Exchange Act). Deregistration is more complex than delisting, however, and requires a detailed analysis of how to efficiently terminate or suspend a company's reporting obligations.

Generally, a domestic U.S. company will need to have fewer than 300 stockholders of record in order to terminate or suspend its reporting obligations. (For these purposes, shares held in street name by a broker-dealer are held of record only by the broker-dealer, but for commercial depositories like the Depository Trust Company, each of the depository's accounts holding a company's shares will count as a distinct record holder.)

If a company has more than 300 stockholders, it may consider implementing a reverse stock split or tender offer in an effort to cash out stockholders with smaller holdings. But these are complex maneuvers that often require consideration of the board's fiduciary duties and may trigger more demanding "going private" disclosures under the Securities and Exchange Commission's rules. They may also require complex valuation and solvency determinations.

Bear in mind that some contractual agreements — in particular, debt financing arrangements — may require a company to make ongoing disclosures to the market.

Pros and Cons

Boards must understand the pros and cons associated with voluntarily going dark, regardless of the motivation, and we have found that boards are not always aware of all the disadvantages of going dark beyond the obvious reduction of liquidity. For example, a delisting or deregistration can trigger defaults under a company's debt financing agreements — exacerbating what may already be a precarious financial position. Before deciding to step out of the public eye, boards must weigh any perceived benefits against the complexity and risks of exiting the reporting system.

Potential Benefits of Going Dark	Potential Downsides and Pitfalls of Going Dark
Costs reduced by elimination of Exchange Act reporting. The burdens of being a public company are significant. Assuming a company is eligible to terminate its reporting obligations, it can achieve substantial cost savings	**Reduced liquidity and potential decrease in share price.** The initial announcement of the delisting is likely to result in a large decline in trading prices. Trading volumes and analyst coverage will decrease significantly after delisting and will be eliminated upon deregistration.
No need to comply with exchange governance and disclosure requirements. National exchanges impose disclosure and governance standards beyond those required by the federal securities laws, including additional independence requirements for audit and compensation committee members and various stockholder approval requirements.	**Reduced utility of the company's equity.** The securities of an unlisted company are less useful as currency for acquisitions and as a vehicle to raise equity capital, and they will be less attractive as equity-based compensation for employees.
Elimination of annual listing fees. A delisted company will not pay annual listing fees.	**Third-party approvals and consents may be required.** Some contracts and instruments may require that a company (or its parent guarantor) maintain its status as a listed and reporting company. Going dark may result in the company paying consent fees, or trigger default events or the acceleration of debt, which could offset any savings from a reduced compliance burden.
Ongoing trading (for a limited time). Upon delisting from a national securities exchange, the stock of a company that continues to file periodic reports with the SEC may continue to trade "over the counter" on decentralized markets, such as OTC Markets Group, providing continued (albeit reduced) liquidity for stockholders. Upon deregistration, however, much of this trading will likely cease.	**Significant compliance costs and expenses may remain.** A company that delists but does not deregister or is unable to deregister promptly will continue to bear the burdens complying with Exchange Act reporting requirements, including the need to produce annual and periodic reports, obtain Sarbanes-Oxley certifications from officers and directors, and hold annual stockholder meetings.
Enhanced focus. Removing public scrutiny and compliance-related distractions may result in management having more time to focus on growing the business.	**Potential for stockholder litigation.** Stockholders may bring litigation against the board of directors based on the decreased liquidity and decline in share price resulting from a delisting. A voluntary delisting that is not coupled with deregistering (and the associated cost savings) may result in increased stockholder skepticism.
	Deregistration takes time. While delisting is often a streamlined process, deregistration is more technical and is not immediate. Companies seeking to deregister will generally need to wait until 90 days after effectiveness of the delisting. There may also be circumstances where a company must continue filing Exchange Act reports for a longer period.
	Reputational damage. Going dark may negatively affect how a company is perceived by the market, its customers or lenders.

Things To Bear in Mind

For an imminent delisting by an exchange, or where a company decides voluntarily to delist and deregister, boards should:

- Be cognizant of requirements to keep stockholders informed.
- Communicate with other stakeholders about the company's plans.
- Assess the impact of delisting on commercial contracts, debt agreements, leases and employee equity plans.
- Review the company's equity and debt financing agreements to understand whether and how delisting or deregistration would trigger defaults or other issues under various covenants (*e.g.*, registration rights), and any related consequences.
- Consider, in consultation with counsel, whether and when the company may terminate or suspend its reporting obligations under the Exchange Act.

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