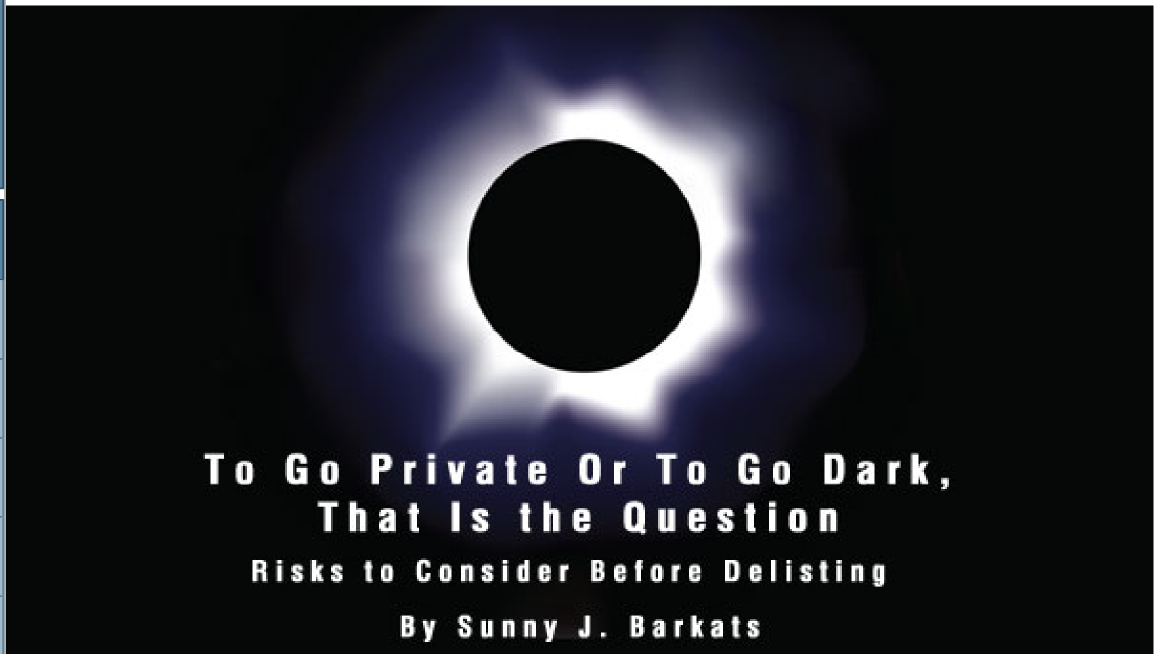

There are more than 15,000 publicly traded companies, many of which receive little benefit in being public. In recent times, the motivation for going public, even for venture capitalist backed entities, is often simply to provide liquidity and has little to do with maximizing value for the remaining shareholders.

In light of increasingly turbulent conditions facing publicly traded companies today, going private may be a rational option, even for companies that recently became public. In fact, the simple elimination of the growing regulatory costs imposed on public companies may be reason enough.

Small and mid-size issuers have been particularly vulnerable to the recession. The cost of being a listed company rose dramatically over the past few years, the passage of Sarbanes-Oxley meant greater liability risk for officers and directors, and compliance got more complex as SEC scrutiny grew stringent. To top it all, the market for Private Investment in Public Equity is stagnant, and no one expects a near-term return to reasonable deal terms providing small-cap issuers with sufficient capital.

For public companies, a "going private" or "going dark" transaction may allow them to focus on long-term strategy rather than quarterly results and save substantial capital needed to grow their business. With the market undervaluing many companies' shares due to systemic price dislocations, going private can provide liquidity for investors and allow company management to shift its focus and resources away from compliance and reporting activities and toward running the business and building long-term value.

Going Dark
Going dark and going private are sometimes confused with one another. Going dark is simpler; there is no actual transaction to complete, and the process is generally more time efficient and less costly than going private.

Going dark requires the filing of a simple form with the SEC to delist the company's shares from an exchange and can be affected when a company has fewer than 300 shareholders on record or less than 500 record shareholders and less than $10 million in assets at the end of its last three fiscal years (excluding beneficial shareholders in street names).

For companies listed on a national securities exchange such as NYSE, NYSE Alternext, or NASDAQ, going dark requires filing forms 15 and 25 to suspend its public status and reporting obligations. The company doesn't have to file a disclosure document with the SEC to go dark and doesn't have to describe the transaction to its shareholders.

Though the required forms and process are simple and inexpensive, a company must properly analyze all aspects of going dark to determine if doing so is appropriate and to ensure compliance with all SEC regulations. Furthermore, it is imperative to keep in mind that the company may be required to "turn the light back on."

This can happen for reasons outside of a company's control, like when a broker dealer that holds company stock in street name distributes that stock to the beneficial owners, thereby effectively increasing the number of record owners. Though delisting under form 25 will terminate registration under Section 12(b) of the Exchange Act, the company's SEC reporting obligations are not terminated because the shares still will be registered under Section 12(g).

To deregister under Section 12(g) and suspend reporting obligations, the issuer must still file form 15, certifying that it meets the 300/500 stockholder requirement. Deregistration under Section 12(g) is effective 90 days after filing form 15. If the SEC denies termination of registration under Section 12(g), the company will have 60 days to file all periodic reports that it would have been required to file had form 15 not been filed.

More important, companies going dark usually continue to trade after the date of deregistration in an OTC "Pink Sheets" market. Shareholders wishing to obtain information on a company after it has gone dark may request the books and records of the company by following applicable state law procedures.

Going Private
In contrast to going dark, a going private transaction requires an active "purchase" transaction to

bring the shareholders of record below the 300/500 shareholders level as defined in Rule 13e-3 of the Securities Exchange Act of 1934.

A going private transaction often involves a cash transaction to purchase the shareholders' shares in the company in order to reduce the shareholders base and enable the company to terminate its public status.

Going private can be accomplished either through a merger with a newly created entity owned by a control group; a tender offer by the newly formed entity; or a self tender offer by the company on its own shares with a reverse split. Going private requires complex filings with the SEC under Rule 13e-3, or, if accomplished by an issuer self-tender, Rule 13e-4. If the transaction is an issuer tender offer, the company will be required to file a Schedule 13E-3 or Schedule TO.

If the transaction involves a tender offer, or if the consideration is going to consist in whole or in part of securities of another issuer, disclosure under Regulation 14D, Regulation 14A, or Regulation 14C also will be required. Preparing the SEC filings and the necessity of SEC review means that a going-private transaction will generally take months to complete. This process is more costly and time-consuming than going dark. However, when it is completed, the company's shares are no longer publicly traded.

Regardless of whether a going dark or going private transaction is selected, the issuer is relieved of periodic reporting requirements, compliance with Sarbanes-Oxley, and compliance with the rules and regulations of the stock exchange on which its shares were listed. Each approach has its advantages and disadvantages.

Litigation Risks
Though there is no affirmative duty to ensure a market in a company's stock, a shareholder may argue that going dark is a breach of fiduciary duty because those shareholders assumed or expected the company's stock would have greater liquidity and that the company encouraged this assumption or expectation.

It is recommended that an issuer choosing to go dark consider issuing a press release, providing its stockholders with the opportunity to sell the company's shares through an exchange prior to their delisting. While shareholder approval is not required in a going dark transaction, deregistering will likely cause some shareholders to sell and lead to a marked decline in share price. This decline in share price increases the potential for litigation as disgruntled shareholders file claims relating to the deregistration.

Technically, the board of directors of the company going dark must authorize the going dark procedures and filing of form 15. Board approval must be given at a duly-called meeting or by unanimous written consent. In approving the decision to go dark, a board of directors must fulfill its fiduciary duties. Hence, the board of directors must believe in good faith that going dark is in the best interest of the company and its shareholders.

The board's decision is usually reviewed under the business judgment rule standard. A few cases indicate that a company's directors may breach their duties in pursuing such a plan if they do so for self-interested purposes.

In Hamilton v. Nozko, the court reasoned that corporate action, even where legally permissible, might be forbidden if it's taken for an unsuitable purpose. In the Hamilton case, the court noted that directors exercising business judgment could incidentally take steps that cause delisting and deregistration that might negatively impact the market for the company's securities.

The principal risk implication for going private transactions arises from the fact that there is an active plaintiff's bar that opposes most going private transactions, making litigation more likely to occur. When and if litigation ensues, the board will have to meet this higher standard in defending both its decision to go private and the method by which it did.

Going private transactions, however, are usually favored by shareholders and institutional investors because they require shareholder approval in certain circumstances (e.g., mergers and reverse splits) or affirmative actions by the shareholder to tender their shares (which they have the option to do or not do depending on the perceived fairness of the transaction). Though in some instances a going private transaction can save the company considerable time, money, and energy, it's likely to be an unpopular process with shareholders.

The most pressing legal issue confronting any proponent of a going private transaction is whether the proposed transaction will survive scrutiny under state law standards that govern going private transactions. For this reason, the directors should be concerned that their decision fully conforms to the constraints imposed upon them as fiduciaries under state law. Under Delaware law, management's decision to go private is evaluated under the business judgment rule, which sets up a strong presumption of the validity of board action.

Pursuant to the business judgment rule, a company's board of directors is clothed with the presumption of being motivated by a bona fide regard for the interests of the company. The presumption is that in making a business decision like whether to go private, the company's directors are not acting out of self-interest or engaging in self-dealing, but rather acting on an informed basis, in good faith, and in an honest belief that going private is in the company's best interest.

Go Dark or Private Cautiously
Readers should keep in mind that dissenting shareholders may sue a company for going private or going dark, and the cause of action upon which they can base their claims are diverse. Minority shareholders have, in many cases, filed a derivative action against a company's decision to go private. Shareholders often allege the intent to deceive, manipulate, or defraud shareholders.

But the burden of proof is on the plaintiff, and the standard is by a preponderance of the evidence. Therefore, it has been difficult for minority shareholders to obtain a judgment in their favor. It's not easy to prove a malicious intent to defraud shareholders, or to prove a coercive intent behind the company's decision to go dark or private, especially since there lies in today's market relatively obvious circumstantial economical reasons to conclude that it's in the best interest of many small-to-mid-cap issuers to become private. But a costly and time-consuming dispute may arise regardless.

I recommend that the decision to go dark or private be carefully considered; it's more complex than it seems, and it's important to retain proper legal and accounting professionals early on in the process. Primary among concerns should be a weighing of the benefits of remaining public against the benefits from going dark or going private. Important factors such as share price, company performance, public float, and the SEC costs of compliance should be weighed against the company's needs to have publicly traded stock as acquisition currency.

Sunny J. Barkats is a pioneer in the PIPE and APO markets and the partner responsible for building the securities/capital markets law practice group at internationally-known law firm Herzfeld & Rubin P.C. in New York. Email sbarkats@barkatslawgroup.com or call 646-287-9494 646-287-9494 for more information.

"To Go Private Or To Go Dark, That Is the Question"
Comments

Stan- CFO BB Company Says:

Wow- a lawyer who actually tries to simplify the complexities of this component of SEC law- how refreshing. Well researched, written, and informative.

Reply to this Comment | 2009-04-02 13:27:35

Jerry- CPA/PCAOB Says:

This article allows our clients to put in perspective the reality of the market and certain alternatives; I would like to elaborate this topic with Mr. Barkats. The role of auditors and lawyers in those transactions and the decision making process is crucial.

Reply to this Comment | 2009-04-07 07:45:23

Jack (CEO OTCBB) Says:

What are the steps that are required before filing a Form 13-E? Do we need to issue a press release or a shareholder proxy?

Reply to this Comment | 2009-04-13 11:13:43

Jerry Says:

Fantastic article. You are hired.

Reply to this Comment | 2009-04-14 15:36:57

Ayalon Says:

wow, great article.

Reply to this Comment | 2009-04-22 14:21:56

HairyKrishna Says:

Funny... there's an older article of EXACTLY the same name and subject matter written by other lawyers... http://files.ali-aba.org/thumbs/datastorage/lacidoirep/articles/TPL1002_Yadley_Blair_thumb.pdf

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