CHAPTER 6

The Impact of Sarbanes-Oxley on IPOs and High Yield Debt Issuers

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INTRODUCTION

Most of the corporate governance, accounting and disclosure requirements established pursuant to the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "SOX") apply only to public companies.[1] These significant requirements are addressed in other chapters of this treatise in greater detail and include:

- CEO and CFO certifications of periodic reports and financial statements;
- Disclosure controls and procedures;
- Internal control over financial reporting; and
- Increased regulations affecting directors and officers.

In this chapter, we primarily focus on SOX's impact on first-time participants in the capital markets, namely companies considering initial public offerings ("IPOs") in the United States and issuers of non-investment grade ("high yield") debt securities in the United States. We also discuss the increased incidence of public companies "going dark" by deregistering under the Securities Exchange Act of 1934, as amended (the "Exchange Act") after the passage of Sarbanes-Oxley. We conclude with a discussion of the Securities and Exchange Commission's (the "SEC") recent changes to Rule 144 and the impact that a significantly liberalized private securities market could have for these issuers.

THE IMPACT OF SARBANES-OXLEY ON COMPANIES GOING PUBLIC

This section addresses the cost of SOX compliance that must be considered by a private company considering an IPO. It also discusses the impact

1. *See infra* note 109 and the accompanying text.

of these costs on the competitiveness of U.S. public equity markets in a global context.

Costs of Compliance

The costs of becoming a public company have always been significant, but SOX has greatly increased these burdens. For most private companies seeking to go public, SOX compliance entails additional personnel, outside consultants, and systems improvements. SOX also imposes significant new responsibilities on directors and officers and increases their exposure to personal civil and criminal liability, making it more costly for public companies to recruit and insure their directors and officers.[2]

The most significant time and cost component of SOX compliance has been implementing effective internal control over financial reporting ("ICFR") in compliance with Section 404 of SOX.[3] Designing and documenting ICFR involves extensive commitment of internal resources and, in our experience, almost always involves at least one additional outside accounting or consulting firm other than the company's auditor, which is not permitted to participate in designing the controls it will later audit.[4] Smaller companies face particular challenges in implementing effective ICFR given their generally more limited resources. For example, effective ICFR frequently requires that certain duties and responsibilities be segregated among different employees, which can be difficult for a private company that has historically operated with limited staff by delegating multiple oversight responsibilities to one individual.

A 2006 survey found that year-one Section 404 costs, including audit fees and internal implementation costs, averaged \$8.5 million for Fortune 1000 companies and \$1.2 million for smaller companies with a market capitalization of under \$700 million.[5] Measured as a percentage of revenue, these costs are disproportionately more burdensome for smaller companies: Section 404 costs represented 0.38% of revenue for smaller companies, compared to 0.11% for Fortune 1000 companies.[6] These costs generally decrease significantly by the second year following implementation, primarily due to improved efficiency as companies climb the learning curve in implementing and assessing ICFR.[7] However, companies that uncover material weak-

2. Eric Dash, *Executive Pay: A Special Report; For Directors, Great Expectations (and More Pay)*, N.Y. Times, Apr. 4, 2004, § 3, at 10.

3. Alix Nyber, *Sticker Shock: The True Cost of Sarbanes-Oxley Compliance*, CFO, Sept. 2003, at 51–62.

4. *See* The State of the Securities Industry: Hearing before the Senate Comm. on Banking, Housing, and Urban Affairs, 108th Cong., 1st Sess., Sept. 30, 2003 (Response to written questions of Senator Sarbanes from William H. Donaldson) (explaining the SEC's warning to accounting firms against having a vested interest in internal control systems being audited).

5. CRA International, *Sarbanes-Oxley Section 404 Costs and Implementation Issues: Spring 2006 Survey Update* (Apr. 17, 2006), at 7, 10 (available at http://polaris.umuc.edu/~kklose/website/Sox%20404.pdf).

6. *Id.*

7. *Id.*

nesses in their ICFR—10.0% of all U.S. public companies in 2005 and 8.8% in 2006[8]—continue to bear high costs. These companies saw audit and audit-related fees increase by 2.59% in the second year of SOX implementation, for a cumulative increase of 72.50% from pre-SOX audit fees.[9] Other costs, particularly the opportunity cost of management and employee time spent on SOX compliance itself, are more difficult to quantify.

In response to these trends, the SEC has worked to mitigate the challenge faced by newly public companies and smaller companies in meeting Section 404 requirements. The SEC established a transitional period for newly public companies, including foreign private issuers listing on a U.S. exchange for the first time, which defers the first required Section 404 reports until the second annual report after becoming public.[10] The SEC has also repeatedly delayed Section 404 compliance for small companies with a public float of under $75 million[11] and has further allowed such companies to use the Form S-3 short form for shelf offerings,[12] thus expanding their access to capital prior to Section 404 implementation.[13] Further, in July 2007, the SEC approved the Public Company Accounting Oversight Board's ("PCAOB") proposed Auditing Standard No. 5 ("AS 5"), which governs the way auditors evaluate a company's ICFR.[14] As explained by the

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8. Glass Lewis & Co., *The Materially Weak* (Feb. 27, 2007), at 1 (available at http://www.tc.pbs.org/nbr/pdf/GlassLewis-Materially.pdf). 2005 was the first year of Section 404 compliance for most U.S. public companies, and the number of U.S. companies reporting material weaknesses declined by 13% in the second year as investments in ICFR paid off. *Id.* at 6. Among S&P 500 companies in particular, only 11 reported material weaknesses in 2007, suggesting that the burdens of SOX have nonetheless paved the way for significant improvements in ICFR among large U.S. issuers. Jaclyn Jaeger, 2007 Material Weaknesses Plummet, *Compliance Week*, Aug. 3, 2008, *available at* http://www.complianceweek.com/article/4380/2007-material-weaknesses-plummet.

9. Glass Lewis & Co., *supra* note 8, at 29.

10. Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies, Release Nos. 33-8760, 34-54942, 71 Fed. Reg. 76,580 (Dec. 15, 2006) (available at http://www.sec.gov/rules/final/2006/33-8760.pdf).

11. As of this writing, the deadline had been moved to the first annual report for fiscal years ending on or after December 15, 2009. *See* Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers, Release Nos. 33-8934; 34-58028, 73 Fed. Reg. 38,094 (June 26, 2008), *available at* http://www.sec.gov/rules/final/2008/33-8934.pdf

12. Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3, Release No. 33-8878, 72 Fed. Reg. 73,534 (Dec. 19, 2007) (available at http://www.sec.gov/rules/final/2007/33-8878.pdf).

13. *See id.* at 72 Fed. Reg. 73,536-73,537 n.31 (discussing the SEC's decision to permit Form S-3 eligibility in advance of the Section 404 compliance deadline).

14. Order Approving Proposed Auditing Standard No. 5, An Audit of Internal Control over Financial Reporting that Is Integrated with an Audit of Financial Statements, a Related Independence Rule, and Conforming Amendments, Release No. 34-56152, 72 Fed. Reg. 42,141 (July 27, 2007) (available at http://www.sec.gov/rules/pcaob/2007/34-56152.pdf). AS 5 supersedes Auditing Standard No. 2, which previously provided guidance for auditors evaluating Section 404 compliance. Auditing Standard No. 5: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements, PCAOB 2007-02 (June 12, 2007) (available at http://www.pcaobus.org/Rules/Rules_of_the_Board/Auditing_Standard_5.pdf).

SEC, AS 5 is expected to make ICFR audits more flexible and scalable and significantly reduce the costs to smaller or less complex companies.[15]

Apart from cost issues, SOX may be influencing management behavior in other ways. One study suggests that SOX has had a chilling effect on risk-taking behavior such as research and development expenditures.[16] In addition, by postponing Section 404 compliance for companies with public float of under $75 million, the SEC may have created incentives for these small companies to stay small. Several studies indicate that a disproportionate number of issuers report a public float of just under $75 million, and that these firms are more likely to pursue corporate actions aimed at reducing their public float, presumably to take advantage of this accommodation.[17]

Effect of SOX on IPOs and the Competitiveness of the U.S. IPO Market

Since the passage of SOX, there has been growing concern that the cost of SOX compliance has adversely affected the U.S. IPO market, from the mainstream press[18] to academic literature[19] to government-commissioned reports.[20] The disproportionate burden of SOX on smaller companies sug-

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15. SEC Approves PCAOB Auditing Standard No. 5 Regarding Audits of Internal Control Over Financial Reporting; Adopts Definition of "Significant Deficiency," SEC Press Release 2007-144 (July 25, 2007) (available at http://www.sec.gov/news/press/2007/2007-144.htm). The PCAOB has also published preliminary staff guidance on how AS 5 should be applied to smaller and less-complex public companies. Preliminary Staff Views—An Audit of Internal Control That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies (Oct. 17, 2007) (available at http://www.pcaobus.org/Standards/Standards_and_Related_Rules/AS5/Guidance.pdf).

16. Leonce Bargeron, Kenneth Lehn & Chad Zutter, *Sarbanes-Oxley and Corporate Risk-Taking* (Mar. 6, 2008) (available at http://ssrn.com/abstract=1104063).

17. Peter Iliev, *The Effect of the Sarbanes-Oxley Act (Section 404)* (Dec. 25, 2007), at 10–12 (available at http://ssrn.com/abstract=983772); Feng Gao, Joanna Shuang Wu & Jerold Zimmerman, *Unintended Consequences of Scaling Securities Regulation: Evidence from the Sarbanes-Oxley Act* (Nov. 15, 2007) (available at http://ssrn.com/abstract=1014054).

18. *See, e.g., What's Wrong with Wall Street*, The Economist, Nov. 23, 2006, at 11; Erika Brown, *London Calling*, Forbes, May 8, 2006 (available at http://www.forbes.com/forbes/2006/0508/051.html).

19. *See, e.g.,* Luigi Zingales, *Is the U.S. Capital Market Losing Its Competitive Edge?*, ECGI—Finance Working Paper No. 192/2007 (Nov. 2007) (available at http://ssrn.com/abstract=1028701). *But see* Craig Doidge, George Andrew Karolyi, & Rene M. Stulz, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time*, Fisher College of Business Working Paper No. 2007-03-012 (July 2007) (available at http://ssrn.com/abstract=982193) (finding that U.S. exchanges continue to attract the same relative number of high-quality global IPOs, while foreign issuers that avoid listing in the United States tend to have weaker fundamentals and governance standards than those that typically pursue a U.S. IPO).

20. *See, e.g.,* Michael R. Bloomberg & Charles E. Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* (Jan. 22, 2007), at 97-100 (available at http://www.schumer.senate.gov/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf).

gests that some private companies that would otherwise go public have been deterred from doing so. In addition, there is evidence that foreign private issuers are increasingly choosing not to list their shares on a U.S. exchange to avoid being required to comply with SOX.

Given the costs of SOX compliance, particularly Section 404, there is little doubt that SOX has influenced the listing decisions of small companies in the United States. Companies with revenues of $25 million or less have made up a smaller share of the IPO market after SOX, from 53% of all IPOs in 2000 to an average of 29% a year from 2002 to 2007.[21] Venture capitalists now increasingly prefer mergers and acquisitions over IPOs as an exit strategy due to the perceived additional costs of SOX compliance.[22]

The sharp decline in the IPO market share of U.S. exchanges in recent years provides strong support for the negative impact of SOX. From 1996 to 2000, U.S. exchanges captured an average of 51.1% per year of all "cross-listed" IPOs by non-U.S. companies listing on an exchange not in their home country.[23] That number plummeted to 6.4% in 2002 and has averaged only 15.3% per year from 2003 to 2007.[24] Whereas U.S. exchanges represented over 33% of all listed companies worldwide in 1996, their share declined to under 15% by 2006.[25] Moreover, it is not just smaller companies that have been shying away from the United States. Of the 20 largest global IPOs in 1996, eight were listed on a U.S. exchange.[26] In 2006, only one of the top 20 global IPOs was listed on a U.S. exchange, and in 2007, none of the top 20 was listed in the United States.[27] Anecdotal reports of executives of foreign private issuers frequently suggests that SOX and U.S. regulation is a factor in their decision making.[28]

In addition to the loss of cross-listed foreign firms, some U.S.-domiciled companies have foregone U.S. exchanges altogether and instead list their IPOs only on a foreign exchange. During the IPO boom years of 1996 to 2001, only three U.S.-domiciled companies listed their IPOs solely on a foreign exchange, representing 0.1% of U.S. company IPOs during that period.[29] Beginning in 2002, however, an increasing number of U.S.

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21. Data from IPO Vital Signs (accessed Jan. 15, 2008).

22. U.S. Government Accountability Office, *Sarbanes Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Small Public Companies* (Apr. 2006), at 39 (available at http://www.gao.gov/new.items/d06361.pdf).

23. Committee on Capital Markets Regulation, *The Competitive Position of the U.S. Public Equity Market* (Dec. 4, 2007), at 11 (available at http://www.capmktsreg.org/research.html).

24. *Id.* at 12.

25. Statistics from the World Federation of Exchanges website (available at http://www.world-exchanges.org/statistics).

26. Committee on Capital Markets Regulation, *supra* note 23, at 14.

27. *Id.*

28. *See, e.g.,* Craig Karmin & Aaron Lucchetti, *New York Loses Edge in Snagging Foreign Listings*, Wall St. J., Jan. 26, 2006, at C1.

29. Committee on Capital Markets Regulation, *supra* note 23, at 17.

companies each year have chosen to list their IPOs solely on a foreign exchange, even as the total number of U.S. IPOs dwindled. From 2002 to 2006, 28 U.S. companies conducted foreign-only IPOs, representing 3.6% of U.S. company IPOs in that period.[30] In the first three quarters of 2007, 15 U.S. companies listed their IPOs solely on a foreign exchange, representing 9.2% of all U.S. company IPOs during that period.[31] Venture capitalists report that investment banks now frequently include overseas exchanges when pitching IPOs to startup companies in the United States.[32] These trends might be even more pronounced but for the limitations imposed on offshore equity financing by Regulation S under the Securities Act of 1933 (the "Securities Act"), which imposes strict "offering restrictions" on offshore sales of equity securities by U.S. issuers to prevent "flowback" into the U.S.[33] Among other restrictions, equity securities sold offshore by non-reporting U.S. issuers pursuant to Regulation S are considered "restricted securities" under Rule 144 and are also ineligible for resale in the United States or to U.S. persons for up to one year.[34]

London has been one of the biggest beneficiaries of perceived over-regulation in the United States. The London Stock Exchange's lightly regulated Alternative Investment Market ("AIM") has exploded in popularity among international companies since the passage of SOX, from two non-U.K. listings in 1995[35] to 340 international listings at the end of 2007.[36] In 2007, London exchanges attracted 86 IPOs from non-U.K companies and raised a total value of $28.9 billion, more than double the value raised by non-U.S. companies on the New York Stock Exchange ("NYSE") and NASDAQ combined.[37] Of the international companies listing in London in 2007, 19 were U.S.-based companies that listed their IPOs on AIM.[38]

30. *Id.*

31. *Id.*

32. *Europe Wins Another*, Wall St. J., Nov. 24, 2007, at A10.

33. Regulation S is a safe harbor for the sale of unregistered securities where such sale is made in an offshore transaction and no directed selling efforts are made in the U.S. and other offering restrictions are implemented. Securities Act Rules 901-905.

34. Restricted securities are subject to the resale restrictions of Rule 144 of the Securities Act. *See infra* note 98 and the accompanying text. Securities sold pursuant to Regulation S are also subject to a distribution compliance period, during which the securities may not be sold in the United States or to U.S. persons and during which U.S. issuers and their offshore underwriters must exercise extreme caution to avoid "directed selling efforts" in the U.S. Securities Act Rule 903. Effective February 15, 2008, the distribution compliance period is one year for non-reporting issuers and six months for reporting issuers that are in compliance with their reporting obligations. Revisions to Rules 144 and 145, Release No. 33-8869, 72 Fed. Reg. 71,545 (Dec. 6, 2007), at 71,559 (available at http://www.sec.gov/rules/final/2007/33-8869.pdf).

35. Doidge et al., *supra* note 19, at 4.

36. London Stock Exchange maintains global lead for international IPOs in 2007, London Stock Exchange Press Release, Dec. 28, 2007 (available at http://www.londonstock-exchange.com/NR/exeres/57062D09-FE5D-40F0-91F2-B3C3363FB9A1.htm).

37. *Id.*

38. *Id.*

A large measure of the success of London's AIM is almost certainly due to the minimal requirements for a company to list there.[39] However, AIM's success cannot be solely attributed to its listing criteria, since 50% of the U.S. IPOs on AIM in 2007 were large enough that they would have qualified for a listing on a U.S. exchange.[40] Moreover, as noted previously, securities offered on a foreign exchange are subject to Regulation S and subject to certain resale restrictions.[41] Thus, the growth in AIM's international listings suggests that both U.S. and non-U.S. issuers alike recognize significant value in avoiding SOX, even at the expense of being subject to other regulatory restrictions.

A further indicator of the impact of SOX is the growing evidence of foreign private issuers accessing the U.S. capital markets without listing on a U.S. exchange and thereby subjecting themselves to the Exchange Act and SOX. In a technique that has become commonplace, a foreign private issuer will list its IPO on a foreign exchange and still tap the large and liquid institutional market in the United States by accessing the Rule 144A market instead of the public market. Notably, even though the number of new foreign IPOs in the United States has decreased, the Rule 144A private market has continued to grow. In 1996, Rule 144A issues represented 34.4% of all new foreign issues in the United States by number of issues, and 28.9% by value.[42] From 2002 to 2007, however, Rule 144A issues comprised an average 80.4% of all new foreign issues by number per year, and 83.4% by value per year.[43] As we will discuss at the end of the chapter, the recent changes to Rule 144 are likely to encourage more issuers, both domestic and foreign, to execute the U.S. tranche of their global IPO in the Rule 144A market.

To be sure, the passage of SOX also coincided with a rapid increase in volume and liquidity in overseas exchanges as investors flocked to foreign markets. As countries in Europe and Asia have liberalized their financial sectors and become more prosperous, more companies are turning to their home markets for capital.[44] Meanwhile, these markets have become more accessible for U.S. investors, as indicated by the flood of capital to global mutual funds. Net annual cash flows to global mutual funds tripled from $22.6 billion in 2003 to $66.7 billion in 2004 and continued to rise

39. The AIM website specifically cites AIM's lack of rigid listing criteria and reduced disclosure requirements as primary reasons for companies to join. *See* http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/About+AIM/whyjoin1.htm.

40. Committee on Capital Markets Regulation, *supra* note 23, at 16.

41. *See supra* notes 33–34 and the accompanying text.

42. Committee on Capital Markets Regulation, *supra* note 23, at 15.

43. *Id.*

44. Stavros Peristiani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Current Issues in Econ. and Fin., July 2007, at 4 (available at http://ssrn.com/abstract=1003810).

to $104.8 billion in 2005 and $148.5 billion in 2006.[45] Investment fund managers have increasingly invested in foreign companies directly via overseas exchanges as opposed to trading in American depository receipts ("ADRs"), such that the trading volume of ADRs of some cross-listed companies has declined since 2001 even while the trading volume in their home markets has increased.[46] These trends have bolstered the relative attractiveness of overseas exchanges and reduced the need for a U.S. trading platform, which likely explains some portion of the trend in foreign company IPO listings elsewhere.

In response to these trends, the SEC has taken steps to improve the accessibility of the U.S. public capital markets to foreign private issuers. As we discuss later in this chapter, the SEC has adopted new rules that significantly ease the deregistration process for foreign private issuers, addressing concerns of prospective foreign private issuers that they would be locked into the U.S. reporting regime and SOX compliance indefinitely.[47] The SEC has also adopted rules permitting foreign private issuers to prepare financial statements using international financial reporting standards without requiring reconciliation with U.S. accounting standards[48] and has proposed a roadmap that would allow U.S. issuers to do the same.[49] This trend toward convergence may eventually erode the segmentation between the U.S. and foreign regulatory regimes, albeit such a development will be years away.

THE IMPACT OF SARBANES-OXLEY ON VOLUNTARY DEREGISTRATIONS

Just as SOX increased the cost for a private company to go public, it also increased the incentive for a public company to deregister under the Exchange Act and thereby avoid "issuer" status and the costs of SOX com-

45. Investment Company Institute, *2007 Investment Company Fact Book* (May 2007), at 112 (available at http://www.icifactbook.org/pdf/2007_factbook.pdf).

46. Edgar Ortega, *Around the Markets: ADR listings decline in U.S. markets*, Int'l Herald Trib., Jan. 30, 2006 (available at http://www.iht.com/articles/2006/01/29/bloomberg/bxatm.php) (noting that average daily trading of Vivendi Universal ADRs has declined by 40% since 2001, but trading in Paris-listed shares has increased 21%). *But see* Committee on Capital Markets Regulation, *supra* note 23, at 27–28 (finding no clear trend in overall ADR trading volumes compared to trading volumes in the issuers' home markets).

47. *See infra* notes 66–79 and the accompanying text.

48. Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP, Release Nos. 33-8879; 34-57026; 73 Fed. Reg. 986 (Jan. 4, 2008), *available at* http://www.sec.gov/rules/final/2007/33-8879.pdf.

49. SEC Proposes Roadmap Toward Global Accounting Standards to Help Investors Compare Financial Information More Easily, SEC Press Release 2008-184 (Aug. 27, 2008), *available at* http://www.sec.gov/news/press/2008/2008-184.htm.

pliance.[50] While private companies are generally free to pursue an IPO at any time, an issuer with an existing obligation to file reports with the SEC may not voluntarily deregister unless it meets certain requirements. For those companies that already met the deregistration requirements, however, SOX presented an opportunity to reconsider the benefits of public reporting status compared to the increased costs of compliance.

A public company seeking to exit the Exchange Act reporting regime and SOX compliance can take one of two approaches. The first is a "going private" transaction, which typically involves a tender offer, merger, or other transaction through which ownership becomes concentrated in the hands of management and a limited number of private equity investors. Led by leveraged buyout firms, going private transactions set new records in deal value between 2004 and 2007, reaching a total value of $63 billion in 2005 and $117 billion in 2006, compared to the prior peak of $21 billion in 1998.[51] Although escaping SOX may be a motivation for some public companies to go private, and private equity firms and management are well aware of the cost savings available,[52] it is difficult to quantify the extent to which regulatory considerations have affected going private decisions, compared to the increase in available private equity capital and inexpensive debt financing in recent years.[53] It appears that these fundamental economic factors have been the drivers of going private decisions, rather than a desire to avoid SEC regulation.[54] It remains common for private equity firms that have taken U.S. public companies private to pursue a U.S. IPO as part of their "exit strategy."[55]

The second approach for a reporting company to escape the Exchange Act and SOX compliance is to "go dark." A public company that is eligible

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50. A company that has deregistered under the Exchange Act is no longer an "issuer" for the purposes of Sarbanes-Oxley and is thus exempt from almost all SOX provisions. *See infra* note 109 and the accompanying text.

51. PricewaterhouseCoopers, *Private Equity Fuels Larger, Collaborative Going-Private Transactions*, View, Sept. 2007, at 25 (available at http://cfodirect.pwc.com/CFODirectWeb/cfocontent/begin.do?ContentCode=FSAE-78AHXV&ContentType=Content).

52. As would be expected, it is standard operating procedure for financing models and disclosure associated with going private financing to adjust historical performance figures of the target to remove public company compliance costs.

53. Most observers attribute the wave of mega-buyouts to low interest rates and the availability of low-cost loans to leveraged buyout funds. *See, e.g.,* PricewaterhouseCoopers, *supra* note 51, at 25. However, at least one study has sought to control for other market factors by comparing buyout target companies in the U.S., which are subject to SOX, to foreign target firms, which are not subject to SOX, and found that the passage of SOX was significantly correlated with increased buyouts of smaller U.S. companies. *See* Ehud Kamar, Pinar Karaca-Mandic & Eric Talley, *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*, USC Center in Law, Economics and Organization Research Paper No. C06-5 (Dec. 2008) (available at http://ssrn.com/abstract=901769).

54. Christian Leuz, Alexander J. Triantis & Tracy Yue Wang, *Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations*, ECGI—Finance Working Paper No. 155/2007 (Mar. 2008), at 11 (available at http://ssrn.com/abstract=592421).

55. Yvonne Ball, *Private Equity Seeks IPO Exits*, Wall St. J., May 14, 2007, at C5.

to deregister its shares can typically do so without shareholder approval and with minimal complexity. Such firms are thus in a position to quickly terminate their SEC reporting obligations as soon as such regulation becomes unduly burdensome. This section begins with an overview of the requirements for going dark and then discusses some of the benefits and disadvantages of deregistration. We conclude with an assessment of the impact of SOX on firms' decisions to voluntarily deregister.

Criteria for Deregistration

U.S. Companies

A U.S. company becomes subject to SEC reporting requirements through one of the following three provisions of the Exchange Act:

- Section 12(b), when the company lists securities on a national securities exchange;[56]
- Section 12(g), when the company has a class of securities held by 500 or more persons of record and total assets exceeding $10 million;[57] and
- Section 15(d), when the company has had a registration statement declared effective under the Securities Act.[58]

A reporting issuer with securities listed on NYSE, Nasdaq, or another national securities exchange may end its Section 12(b) obligation by delisting its securities from the exchange and filing Form 25 with the SEC.[59] To terminate its Section 12(g) reporting obligations, the reporting issuer must first terminate any Section 12(b) obligations and then certify on Form 15 that it has fewer than 300 holders of record of any class of securities, or fewer than 500 record holders and $10 million or less in total assets.[60] Section 15(d) reporting requirements are automatically suspended if the company

56. Exchange Act § 12(b).

57. Exchange Act § 12(g); Exchange Act Rule 12g-1.

58. Exchange Act § 15(d).

59. In a voluntary delisting and deregistration scenario, the issuer typically prepares and files Form 25 itself, after providing at least 10 days written notice to the exchange and contemporaneous notice to the public via press release and website. Exchange Act Rule 12d2-2(c)(2). This is a different deregistration process than that following a merger or an involuntary delisting, where typically the exchange will prepare and file Form 25 on behalf of the issuer. Exchange Act Rule 12d2-2(a), 12d2-2(b).

60. Exchange Act Rule 12g-4. The SEC Staff (the "Staff") will not permit an issuer to file Form 15 until its securities are delisted, which will not be effective until at least 10 days after filing Form 25. Interpretation No. S-57 in the Manual of Publicly Available Telephone Interpretations of the Staff of the Division of Corporation Finance (1997) (available at http://www.sec.gov/interps/telephone.shtml). Thus, in terms of timing, an issuer must file Form 25 at least 10 days prior to the date on which it intends to file Form 15 and terminate its Section 12(g) reporting requirements.

has fewer than 300 record holders at the beginning of any fiscal year after the year in which a registration statement has been declared effective.[61]

However, under the SEC's rules for counting record holders, rather than beneficial owners, a U.S. issuer may be eligible to end its Section 12 and Section 15 reporting obligations even when it has more than 300 or 500 beneficial owners of its securities. In determining the number of holders "of record," SEC rules permit issuers to count all securities held by a bank or brokerage as being held by one person, even if those shares are beneficially owned for other individual accounts.[62] As a result, a company may have a relatively small number of record holders of its stock if a large proportion of its actual shareholders hold their shares in "street name" through brokerage firms.

Because of this method for counting shareholders, a number of public companies with stock held by hundreds if not thousands of beneficial owners may nonetheless file for deregistration.[63] This definition of record shareholders has been criticized as a loophole by both a formal petition[64] and an SEC advisory committee,[65] suggesting that the SEC may reconsider it in the future. However, to date it remains in place.

Foreign Private Issuers[66]

The SEC has traditionally used its rulemaking to provide foreign companies with certain exemptions from the securities laws to encourage them to register in the United States. Prior to 2007, however, the rules for a

61. Exchange Act § 15(d). These issuers filing under Section 15(d) are *not* required to file Form 15 with the SEC to give effect to the termination of their filing obligation, because Section 15(d) itself is self-operative. Question 1 of SEC Division of Corporation Finance, Sarbanes-Oxley Act of 2002—Frequently Asked Questions, posted Nov. 8, 2002 (revised Nov. 14, 2002) (available at http://www.sec.gov/divisions/corpfin/faqs/soxact2002.htm). Although the suspension of reporting requirements is automatic, the issuer must still file Form 15 with the SEC within 30 days of its occurrence. Exchange Act Rule 15d-6. In addition to the automatic suspension, an issuer with fewer than 300 record holders, or fewer than 500 record holders and no more than $10 million of assets, can also suspend its Section 15(d) reporting requirements at any time by filing Form 15 in reliance on Exchange Act Rule 12h-3.

62. Exchange Act Rule 12g-4. Most securities today are held in "street name" through depositories such as the Depository Trust Company ("DTC"), and DTC's nominee Cede & Co. will typically be the only securityholder on an issuer's actual records. The Staff does not consider DTC or Cede & Co. to be a single record holder, but it will only "look through" DTC to the level of DTC's members—institutions such as broker-dealers and banks—and no further. Interpretation No. M-30 in the Manual of Publicly Available Telephone Interpretations of the Staff of the Division of Corporation Finance (1997) (available at http://www.sec.gov/interps/telephone.shtml).

63. *See* Stephen J. Nelsen, Petition for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities (July 3, 2003) (available at http://www.sec.gov/rules/petitions/petn4-483.htm).

64. *Id.*

65. SEC Advisory Committee on Smaller Public Companies, *Final Report of the Advisory Committee on Smaller Public Companies* (Apr. 23, 2006) (available at http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf).

66. "Foreign private issuer" is defined in Exchange Act Rule 3b-4.

foreign private issuer to deregister were paradoxically more difficult than those for U.S. issuers.

Under the prior rules, the "300 record holders" standard for deregistration was defined for foreign private issuers as a limit of 300 actual U.S. resident holders.[67] In contrast to the "of record" standard for U.S. companies, the U.S. resident standard required that foreign private issuers "look through" brokerage accounts to the ultimate beneficial shareholders. Perhaps the SEC believed that this regime was an overall accommodation to foreign firms because it did not place a limit on the number of non-U.S. shareholders. The practical implication, however, was that foreign private issuers were required to analyze brokerage accounts on a worldwide basis and determine the residency of each beneficial owner in each account. This was a costly and impractical step for many foreign private issuers, as even those whose securities were thinly traded in the United States had to consider the possibility that the shares of any brokerage holder could be beneficially owned by a number of U.S. residents.

In March 2007, the SEC adopted new rules that significantly eased the deregistration process for foreign private issuers.[68] Most significantly, a new average daily trading volume ("ADTV") test for deregistration of equity securities was introduced. Under the new test, a foreign private issuer may deregister a class of equity securities if its ADTV in the United States in a 12-month period has been 5% or less of the ADTV of those securities on a worldwide basis, subject to certain limitations.[69] The 300 U.S. resident holder standard was also retained as an alternate test, but the counting method was simplified to limit the number of jurisdictions in which the issuer would have to look through brokerage accounts and identify the actual beneficial owners.[70] Regardless of which method is used, the equity issuer must also meet additional criteria regarding its prior Exchange Act

67. Exchange Act Rule 12g-4 (2006); Exchange Act Rule 12h-3 (2006).

68. Termination of a Foreign Private Issuer's Registration of a Class of Securities under Section 12(g) and Duty To File Reports under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Release No. 34-55540, 72 Fed. Reg. 16,933 (Mar. 27, 2007) (available at http://www.sec.gov/rules/final/2007/34-55540.pdf).

69. Exchange Act Rule 12h-6(a)(4)(i). The issuer may not use this method if it has terminated an ADR facility of that class of securities or delisted the same class of securities from a U.S. exchange within the previous 12 months, and the ADTV on the U.S. exchange at the time of either event exceeded 5% of the worldwide ADTV. Exchange Act Rule 12h-6(b)(1); Exchange Act Rule 12h6-(b)(2).

70. The issuer need only look through the accounts located in the United States, the jurisdiction in which the issuer is organized and the jurisdiction of the primary trading market of the securities. Exchange Act Rule 12h-6(e)(1)(i). In conducting its inquiry, the issuer is not required to use unreasonable effort and may rely in good faith on an independent information services provider. Exchange Act Rule 12h-6(e)(2), Rule 12h-6(e)(4).

reporting history,[71] prior offerings of the securities[72] and its foreign listing history.[73] Where a foreign private issuer succeeds to the reporting obligations of another company following a merger, exchange offer, or similar transaction, the successor may take into account the reporting history of the predecessor company in determining whether it meets these prior reporting conditions.[74]

The new rules also simplified the deregistration process for foreign private issuers of debt securities. First, the issuer must have filed all required Exchange Act filings, including at least one Exchange Act annual report.[75] Second, the debt securities must have fewer than 300 record holders worldwide or record holders who are U.S. residents.[76] The method for counting the number of record holders who are U.S. residents was simplified to be the same as that used for equity securities described previously.[77]

An additional feature of the new rules is the opportunity for foreign private issuers of either equity or debt securities to permanently terminate their reporting obligations under Section 15(d).[78] As noted previously, a foreign private issuer that had conducted a registered offering could traditionally only suspend its reporting requirements under Section 15(d), and each year, the issuer would have had to review all holders of the registered securities for U.S. residents to determine if it still satisfied the 300 U.S. resident standard. This created a significant concern among potential issuers of being trapped in the U.S. reporting system and discouraged foreign firms from publicly offering securities in the United States.[79] In contrast, the new rules finally allowed foreign private issuers a true exit and removed that disincentive.

71. The issuer must have at least a 12-month Exchange Act reporting history, have filed at least one Exchange Act annual report, and be current in its reports. Exchange Act Rule 12h-6(a)(1).

72. Subject to limited exceptions, the equity securities to be deregistered must not have been sold through a registered public offering in the 12 months leading up to the filing for deregistration. Exchange Act Rule 12h-6(a)(2). Notably, Rule 144A offerings and other offerings exempt from Securities Act registration are not subject to this limitation. Termination of a Foreign Private Issuer's Registration, *supra* note 68, at 72 Fed. Reg. 16,942-16,943.

73. The class of equity securities to be deregistered must be listed on an exchange in the issuer's primary trading market for at least 12 months leading up to the filing for deregistration. Exchange Act Rule 12h-6(a)(3).

74. Exchange Act Rule 12h-6(d).

75. Exchange Act Rule 12h-6(c)(1).

76. Exchange Act Rule 12h-6(c)(2).

77. Exchange Act Rule 12h-6(e).

78. Exchange Act Rule 12h-6(a); Exchange Act Rule 12h-6(c).

79. Termination of a Foreign Private Issuer's Registration, *supra* note 68, at 72 Fed. Reg. 16,934-16,935.

The Impact of Sarbanes-Oxley on Voluntary Deregistrations

Due to the counting methodology described earlier for U.S. issuers to determine shareholders "of record" and the prevalence of "street name" positions, many public companies that currently report to the SEC have the option to go dark and may voluntarily terminate or suspend their reporting obligations if they choose.[80] One study found that during the period from 1998 to 2004, there were 2,061 reporting companies that were eligible for deregistration based on the number of record holders of the companies' common equity and their asset value.[81] Most of those firms have of course continued to file reports with the SEC,[82] and studies indicate a strongly negative market reaction following a decision to deregister, as well as a significant decline in liquidity.[83]

Nevertheless, of the 484 U.S. companies that filed to deregister with the SEC between 1998 and 2004, 305 companies filed in 2003 and 2004 alone, after the passage of SOX.[84] SOX is believed to have had a significant impact on this increase in going dark filings. Even after controlling for market conditions and other variables, SOX was associated with ten additional going dark deregistrations per month.[85]

SOX has also been cited in connection with an increase in voluntary deregistrations by foreign companies. As described previously, the process of deregistration was significantly more difficult for foreign private issuers than U.S. issuers prior to 2007, and there were accordingly many fewer deregistrations of foreign private issuers than U.S. issuers. Nonetheless, one study found that SOX was significantly correlated to an increase in foreign private issuer deregistrations.[86] Less than 1% of foreign firms

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80. U.S. companies that have conducted a registered offering and suspended their Section 15(d) reporting obligations must consider the possibility that those obligations will resume if the number of shareholders of record is ever 300 or more at the beginning of a fiscal year. This is of even greater concern when the securities are common stock, rather than high yield notes, since stock tends to be more widely and easily traded. Further, if the company deregisters by taking advantage of its shares being held in street name by brokerages, then there is the additional risk that the brokerages that constitute the current record holders may decide to transfer shares directly to the beneficial owners instead. Just one instance of "broker kickout" can greatly increase the number of record shareholders and require a company to resume its Section 15(d) reporting obligations.

81. Leuz et al., *supra* note 54, at 15.

82. *Id.* at 14.

83. *Id.*; *see also* Andras Marosi & Nadia Massoud, *Why Do Firms Go Dark?* (Nov. 2005) (available at http://www.business.ualberta.ca/nmassoud/pdf%20docments/Dark_massoud_Nov2005.pdf).

84. Leuz et al., *supra* note 54, at 48.

85. *Id.* at 24.

86. Andras Marosi & Nadia Massoud, *"You Can Enter But You Cannot Leave . . ."—U.S. Securities Markets and Foreign Firms* (Nov. 2006) (available at http://ssrn.com/abstract=882152).

deregistered per year from 1990 to 2001; however, that number jumped to 2% in 2002 and approached 4% by 2005.[87]

The new rules for deregistration were timed to take effect shortly before the deadline for foreign private issuers to comply with SOX Section 404.[88] The effect of the new rules was immediate and dramatic. Prior to the new deregistration rules, the highest number of foreign private issuer deregistrations in one year was 18 deregistrations in 2005.[89] In 2007, after the adoption of the new deregistration rules, 100 foreign private issuers applied for voluntary deregistration with the SEC, while more than 75 new foreign private issuers registered securities in the United States.[90] Of the 100 deregistering foreign private issuers, 53 came from the European Union alone,[91] including some very large European companies that had seen interest in their ADRs decline as more U.S. investors traded on foreign exchanges.[92] Based on the groundswell of foreign insistence on a new foreign private issuer deregistration regime[93] and the upsurge in foreign private issuer deregistrations since the adoption of that regime, together with the evidence of reductions in dual listings in the United States for major IPOs of foreign private issuers cited previously, there can be little doubt that SOX has played a significant role in reducing the attraction of U.S. listing to foreign private issuers.[94]

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87. *Id.* at 35.

88. The new rules took effect on June 4, 2007, prior to the June 30 filing deadline for Form 20-F and the July 15 deadline for compliance with SOX Section 404. *See* John W. White, Speech by SEC Staff: Corporation Finance and the Foreign Private Issuer Community in 2007 (May 2, 2007) (available at http://www.sec.gov/news/speech/2007/spch050207jww.htm).

89. Nuno Fernandes, Ugur Lel & Darius P. Miller, *Escape from New York: The Market Impact of SEC Rule 12h-6 on Foreign Private Issuers* (Nov. 16, 2007), at 23 (available at http://ssrn.com/abstract=1031398).

90. John W. White, Speech by SEC Staff: Corporation Finance in 2008—A Focus on Financial Reporting, Speech at the 35th Annual Securities Regulation Institute (Jan. 23, 2008) (available at http://www.sec.gov/news/speech/2008/spch012308jww.htm).

91. *Id.*

92. *See, e.g.*, David Wilson, *Around the Markets: Overseas Firms Abandoning U.S. Listings*, Int'l Herald Trib., Apr. 30, 2007 (available at http://www.iht.com/articles/2007/04/29/news/bxatm.php); Matt Krantz, *Big Foreign Firms Bid Adieu to U.S. Markets*, USA Today, Sept. 23, 2007 (available at http://www.usatoday.com/money/markets/2007-09-23-goodbye_N.htm).

93. Proposed Rule: Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty to File Reports Under Section 15(d) of the Securities Exchange Act of 1934, Release No. 34-53020, 70 Fed. Reg. 77,687 (Dec. 23, 2005), at 77,690 (available at http://www.sec.gov/rules/proposed/34-53020.pdf).

94. It remains to be seen whether investors will agree with foreign private issuers that find SOX compliance unduly burdensome and choose to deregister. According to one study, while stock prices for certain foreign private issuers may have been adversely affected by SOX, the market has also tended to react negatively to foreign private issuers that took advantage of the new deregistration rules. *See* Craig Doidge, George Andrew Karolyi & Rene M. Stulz, *Why do foreign firms leave U.S. equity markets? An analysis of deregistrations under SEC Exchange Act Rule 12h-6*, Fisher College of Business Working Paper No. 2008-03-013 (Aug. 4, 2008) (available at http://ssrn.com/abstract=1204442).

HIGH YIELD DEBT VOLUNTARY FILERS UNDER SARBANES-OXLEY

This section addresses the impact of SOX on participants in the high yield debt market, many of which do not remain "issuers" as defined in SOX because they are automatically exempt from continuing obligations to file reports pursuant to the Exchange Act beginning with the first year after they register an "A/B exchange offer."[95] However, these high yield issuers remain subject to many SOX requirements to the extent those requirements are embodied in reports they must continue to file with the SEC pursuant to the reporting covenants usually included in high yield indentures. Because they are required to continue to file contractually rather than pursuant to the Exchange Act, these high yield issuers are considered "voluntary filers" under the Exchange Act. This section also includes a discussion of "144A-for-life" high yield offerings that are allowing some high yield issuers to avoid registration (and therefore SOX) entirely, and a discussion of the disfavored status of voluntary filers under the securities offering reform regulations adopted by the SEC in 2005.

Voluntary Filers in the High Yield Offering Process

The U.S. high yield market has developed procedures that satisfy the primary concerns of issuers and bond investors alike. By offering securities privately, issuers are able to raise capital quickly and before market conditions can change, avoiding the timing uncertainties and delays that often accompany the SEC registration process. Bond investors, on the other hand, have generally required that the privately placed bonds be exchanged for fully registered bonds, thereby achieving liquidity for their securities and the discipline and protections that come from requiring issuers to register under the Securities Act and report and provide required certifications under the Exchange Act. Moreover, the requirement that an exchange offer be registered with the SEC has long been considered by market participants to be an important incentive for issuers to prepare the private offering materials using financial information and other disclosures substantially consistent with those to be filed with the SEC in the exchange offer.

A typical high yield bond offering satisfies these competing demands through a two-step process. First, the company issues bonds to the "initial purchasers" (investment banks leading the offering) as a private placement under Section 4(2) of the Securities Act, and the banks then resell the bonds primarily to "qualified institutional buyers" ("QIBs") under Rule 144A.[96] Because both the initial Section 4(2) placement and the following Rule 144A

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95. Exchange Act Rule 12h-3; *see also infra* notes 104–106 and the accompanying text.

96. Securities Act Rule 144A. In addition, Regulation S generally permits either the issuer or the initial purchasers to make unrestricted sales or resales to buyers outside the U.S. in offshore transactions. Securities Act Rule 901-904. Such securities are still considered restricted securities with respect to further resales in the U.S. Securities Act Rule 144(a)(3).

resale are exempt from registration, the issuer can quickly complete the transaction without waiting for SEC review of a Securities Act registration statement. This timing advantage frequently proves critical. For example, many high yield bonds are issued in connection with acquisition financing, where the offering is timed to close concurrently with the acquisition and other debt and private equity financing. Participants in these transactions are generally unwilling to have their transaction schedules subjected to the uncertainty of SEC review. As a private offering, such a transaction also does not subject the issuer, its officers and directors, or the investment banks to potential liability under Section 11 or Section 12 of the Securities Act.[97]

The bonds sold in the 144A offering process are "restricted securities" under the Securities Act and may not be sold to the public without registration or an exemption from registration.[98] This somewhat limits the liquidity of 144A bonds, although exempt trading among QIBs is common. More importantly, except in the extremely unlikely event that more than 300 record holders of the bonds would result from the 144A offering, the issuer of these privately placed securities would not be under any obligation to report ongoing results of operations or financial condition to the SEC, and therefore to potential investors in and analysts of the bonds. Without a requirement to report results publicly, the issuer's only obligation in these circumstances would be to make available the limited information required by Rule 144A(d)(4),[99] which is widely viewed as adversely affecting secondary market demand for the privately placed bonds.

To address investors' demands for liquidity and public information, there is usually a second step in the high yield offering process known as an A/B exchange offer.[100] Most high yield offerings provide investors with registration rights, under which the issuer promises to effect within a negotiated time (typically four to nine months) a registration statement under the Securities Act that offers investors the right to exchange the restricted securities they bought in the Rule 144A offering (the "Series A" notes) for a new series of

97. The Supreme Court has held that Section 12 liability does not attach to private transactions. *Gustafson v. Alloyd*, 513 U.S. 561 (1995). Liability under Rule 10b-5 of the Exchange Act, however, still attaches in connection with the purchase and sale of the bonds. Thus, as a matter of practice, transaction participants generally follow substantially the same due diligence and disclosure practices in private transactions as used in public offerings.

98. "Restricted securities" is defined in part as securities acquired in a transaction not involving a public offering, in a transaction under Rule 144A, or in an offshore transaction under Regulation S. Securities Act Rule 144(a)(3).

99. Rule 144A(d)(4) requires only that the issuer provide, upon request, a very brief statement of the issuer's business, the issuer's most recent balance sheet and earnings statements, and financial statements for the past two years. Securities Act Rule 144A(d)(4).

100. A/B exchange offers are also known as Exxon Capital exchange offers, after the line of SEC no-action letters that sanctioned the exchange offer. *See Exxon Capital Holdings Corp*, SEC No-Action Letter (avail. May 13, 1988); *Morgan Stanley & Co. Inc.*, SEC No-Action Letter (avail. June 5, 1991). A similar approach was also sanctioned for non-U.S. issuers. *See Vitro, Sociedad Anonima,* SEC No-Action Letter (avail. Nov. 19, 1991)*; Corimon C.A. S.A.C.A.,* SEC No-Action Letter (avail. Mar. 22, 1993).

registered securities (the "Series B" notes) that are otherwise identical to the existing securities.[101] Following the A/B exchange offer, the current noteholders are able to sell their notes without a holding period or other restrictions. The A/B exchange offer also frequently subjects the issuer to an SEC review of the exchange offer registration statement[102] and, most importantly from the bondholder's perspective, makes the issuer a public reporting company under the Exchange Act.[103]

However, this reporting requirement is automatically suspended at the beginning of any fiscal year following the fiscal year that the A/B registration statement was declared effective if there are fewer than 300 record holders of the registered class of securities at that time.[104] Since this is almost always the case for any high yield bond issuer that does not have publicly listed equity securities,[105] the issuer will be required by law to file Exchange Act reports only for the fiscal year in which the A/B exchange offer occurs. The Staff has acknowledged that such issuers are under no statutory obligation to report and may thus cease reporting at any time.[106] To counteract the effects of this automatic suspension, high yield investors have typically demanded that the reporting covenants in high yield indentures obligate issuers to continue filing Exchange Act reports with the SEC whether or not required by the Exchange Act.[107] Thus, even though the issuer's obligation is contractually "mandatory" under its indenture, the issuer is generally a "voluntary filer" under the Exchange Act for each period after the year in which the A/B registration statement was declared effective.

Application of Sarbanes-Oxley to High Yield Bond Issuers That Are Voluntary Filers

As summarized earlier, most SOX provisions apply only to "issuers" (hereafter "statutory issuers"[108]) and prohibit certain types of conduct or man-

101. *Id.*

102. Exchange offers are registered on Form S-4. The Staff reviews the first registration statement filed by an issuer as an IPO, using the same comment process whether the registration statement be a Form S-1 for a public offering or a Form S-4 for an A/B exchange offer.

103. Section 15(d) of the Exchange Act requires issuers to file periodic reports with the SEC following the effectiveness of a registration statement under the Securities Act.

104. *See supra* note 61 and the accompanying text.

105. As described in *supra* note 62, the definition of record holder does not account for beneficial owners. Further, high yield issuers that access the Rule 144A market typically sell to only a small number of institutional investors.

106. *See* Question 1 of Sarbanes-Oxley Act of 2002—Frequently Asked Questions, *supra* note 61.

107. Such covenants frequently provide that the reporting obligation continues "unless the SEC will no longer accept such filings." We are not aware of any instance where the SEC has rejected such continued filings.

108. As explained in this section, the definition of an "issuer" under SOX is more limited than that under the Exchange Act. To avoid ambiguity, this chapter uses "statutory issuer" to refer exclusively to the definition of an issuer under SOX, although the statutory language and SEC rules do not use this term.

date specific disclosures in SEC filings as detailed in subsequent rulemaking by the SEC. A statutory issuer under SOX is defined in relevant part as a company that:

- is *required to file* reports under Section 15(d) of the Exchange Act, or
- files or has filed a registration statement that has not yet become effective under the Securities Act, and has not yet been withdrawn.[109]

Applying this definition to the high yield offering process previously described, a company that has issued high yield bonds through a private placement and Rule 144A resale is not yet within the purview of the Securities Act or the Exchange Act, and SOX generally does not apply. When such a company subsequently files an A/B exchange offer on Form S-4 under the Securities Act, it becomes a statutory issuer under SOX and must comply with all SOX provisions. Such a company continues to be a statutory issuer when the registration statement is declared effective and the company becomes subject to the reporting requirements of Section 15(d) of the Exchange Act. At the beginning of the following fiscal year, assuming there are fewer than 300 bondholders of record and the issuer's equity is not publicly traded, the company is no longer "required" to file reports under Section 15(d) of the Exchange Act. The company may continue to submit Exchange Act reports as a voluntary filer in accordance with its indenture, but it ceases to be a statutory issuer for the purposes of SOX.[110]

Whether or not Congress intended to exclude voluntary filers from the reach of SOX,[111] the Staff has taken the position that SOX provisions that mandate disclosures in SEC filings apply to all filers, including voluntary filers.[112] Voluntary filers are therefore subject to all disclosure requirements of SOX that have resulted in changes to the SEC's mandated forms for filings under the Securities Act and the Exchange Act, including revisions to Regulation S-K,[113] even though they are not statutory issuers. This outcome appears to be consistent with the policy goals of SOX to increase the

109. SOX § 2(a)(7) (emphasis added).

110. Question 1 of Sarbanes-Oxley Act of 2002—Frequently Asked Questions, *supra* note 61.

111. Congress adopted Sarbanes-Oxley hastily in the wake of the Enron and WorldCom scandals. For example, the question of whether SOX should apply to foreign issuers at all was not raised until the last day of the Senate debate. 148 Cong. Rec. S7350-04, S7356 (July 25, 2002).

112. Question 9 of Sarbanes-Oxley Act of 2002—Frequently Asked Questions, *supra* note 61.

113. *See, e.g.,* Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Release Nos. 33-8177, 34-47235 (Jan. 23, 2003) (available at http://www.sec.gov/rules/final/33-8177.htm) (amending Item 401 of Regulation S-K for SOX Section 406 and 407 disclosures); Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Release Nos. 33-8238, 34-47986, IC-26068 (June 5, 2003) (available at http://www.sec.gov/rules/final/33-8238.htm) (adding Item 308 to Regulation S-K for Section 404 disclosures).

accuracy and reliability of disclosures in SEC filings[114] as well as statutory language in those disclosure provisions that suggests Congress may not have been cognizant of the voluntary filer distinction when it addressed public filing requirements.[115] Thus, even though voluntary filers are largely excluded from express coverage of SOX because they are not statutory issuers, they nonetheless become subject to a number of SOX's provisions when they file reports in the form prescribed by the rules and regulations of the SEC.

The most important impact of these "bootstrapped" SOX requirements on voluntary filers is the requirement for annual assessments and auditor attestations of ICFR pursuant to Section 404 of SOX.[116] Section 404 requirements begin with the first full year audited after a registration statement is effective, and this timing generally coincides with the suspension of Section 15(d) reporting obligations for high yield issuers.[117] Thus, absent the SEC's position, a voluntary filer would potentially never have to comply with Section 404 of SOX.

This distinction between the disclosure provisions of SOX, which apply to voluntary filers and statutory issuers alike, and those provisions that govern corporate conduct, which apply only to statutory issuers, provides some flexibility for voluntary filers to take certain corporate actions that SOX prohibits for statutory issuers. This may be a distinction without a difference for many issuers, since they must comply with *all* the SOX requirements summarized later in this chapter for the year in which an A/B exchange offer is filed and may choose (for internal governance reasons) not to dismantle their compliance programs when their status shifts from statutory issuer to voluntary filer. For example, a statutory issuer will have to establish audit committee practices consistent with SOX Sections 201 through 206, and its board and audit committee may be unlikely to relax those practices when it shifts to voluntary filer status.[118] Similarly, a statutory issuer must eliminate loans to executive officers and directors that would otherwise be prohibited by SOX Section 402 and may choose to continue this policy even after becoming a voluntary filer, particularly if third-party credit arrangements have been made during statutory issuer status.

In addition, if a voluntary filer later issues new high yield debt and subsequently files an A/B exchange offer, or files an IPO, the company will once again be a statutory issuer and be subject to all of SOX's provisions immediately upon filing of the new registration statement. For example, a voluntary filer may take advantage of the inapplicability of Section 402 to provide a loan

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114. *See, e.g.,* the preamble to SOX ("To protect investors by improving the accuracy and reliability of corporate disclosures. . . .").

115. *See, e.g.,* SOX § 302, which applies to "each *company* filing periodic reports" (emphasis added).

116. *See infra* note 123.

117. *See supra* note 61 and the accompanying text.

118. It is also unlikely that any audit firm registered with the Public Company Accounting Oversight Board would be willing to relax these practices, even if permitted. For example, Rule 2-01 of Regulation S-X specifically addresses auditor conflicts of interest and would not permit many non-audit services by any audit firm for any public company filing financial statements with the SEC, voluntarily or otherwise.

to its executive officers or directors during its voluntary filer period, but the company may be required to unwind the loan before it files a future registration statement in connection with a later A/B exchange offer or IPO.[119] Those obligations will continue until the second registration statement is withdrawn or at the beginning of the fiscal year following the A/B exchange offer, assuming there are fewer than 300 holders of record. In choosing to pursue a corporate action that would otherwise be prohibited by SOX, voluntary filers should bear in mind this very real possibility of moving in and out of statutory issuer status from one year to the next.

The following table summarizes the effect of key events in the high yield offering process on a high-yield-only issuer's status and obligations under SOX, including as a voluntary filer.

Event	**Issuer Status under SOX**	**Level of Compliance Required**
High yield bonds issued by Section 4(2) private placement and Rule 144A resale	Not an issuer	No compliance necessary[120]
A/B exchange offer registration statement filed	Statutory issuer	Full compliance with all provisions (except Section 404)
Registration statement withdrawn	Not an issuer	No compliance necessary
Registration statement effective	Statutory issuer	Full compliance with all provisions, except those implemented exclusively through NYSE or Nasdaq rules
Section 15(d) reporting requirements automatically suspended (e.g., fewer than 300 holders at the beginning of any fiscal year)	Voluntary filer	Disclosure obligations only, including Section 404
Reporting requirements resumed (e.g., 300 or more holders at the beginning of a fiscal year or new registration or IPO filed)	Statutory issuer	Full compliance with all provisions

119. The SEC has not publicly provided guidance as to whether it will require, as a condition to effectiveness of a registration statement, that such loans be repaid or otherwise unwound, or if the issuer may simply disclose the loan and abstain from modifying or renewing the arrangement thereafter. Underwriters may also require that the issuer unwind the loan, regardless of the SEC's position.

120. The company will still be subject to certain SOX provisions that apply to private companies.

Application of Specific Provisions of Sarbanes-Oxley to Voluntary Filers

The following SOX provisions amend the Exchange Act directly and thus apply to all filers:[121]

- Rapid and current disclosure of material information (SOX § 409).
- Temporary freeze authority of the SEC of extraordinary payments (§ 1103).

The Staff has further explicitly indicated that voluntary filers must comply with the following SOX provisions:

- CEO and CFO certifications of periodic reports (including internal controls and disclosure controls)[122] (§ 302).
- Disclosure of assessments of internal controls and internal control report[123] (§ 404).

The following provisions have not been specifically addressed by the Staff as to their application to voluntary filers. However, since they mandate specific disclosures in SEC filings, voluntary filers generally seek to comply with these requirements:

- Disclosure of material correcting adjustments in all reports that contain financial statements (§ 401(a)).
- Disclosure of all material off-balance sheet transactions in each quarterly and annual report (§ 401(a)).
- Required reconciliation of non-GAAP financial information in periodic reports (§ 401(b)).
- Disclosure regarding the company's code of ethics (§ 406).
- Disclosure of audit committee financial expert (§ 407).

Several important provisions of SOX that regulate conduct apply only to statutory issuers and not voluntary filers.[124] Key provisions that apply only to statutory issuers include:

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121. The definition of an issuer under the Exchange Act encompasses "any person who issues or proposes to issue any security" and is thus broader than the SOX definition.

122. Question 9 of Sarbanes-Oxley Act of 2002—Frequently Asked Questions, *supra* note 61 (referencing Exchange Act Rule 15d-14).

123. *Id.*, referencing Exchange Act Rule 15d-15 and Item 307 of Regulations S-B and S-K.

124. In addition to its own rulemaking, the SEC also required national securities exchanges to adopt rules implementing certain SOX provisions. *See* Exchange Act Rule 10A-3. Accordingly, NYSE and Nasdaq have adopted stricter rules governing director independence, audit committees, and other aspects of corporate governance. *See* NASD and NYSE Rulemaking: Relating to Corporate Governance, Release No. 34-48745, 68 Fed. Reg. 64,154 (Nov. 12, 2003) (available at http://www.sec.gov/rules/sro/34-48745.htm). These rules apply only to companies listing or seeking to list on the respective exchange and therefore are not mandatory for high-yield-only issuers that do not list securities on a national securities exchange.

- Prohibited non-audit services by auditors (§ 201).
- Mandatory audit committee preapproval of other non-audit services (§ 201, § 202).
- Mandatory lead audit partner rotation (§ 203).
- Auditor's mandatory report to the audit committee (§ 204).
- Conflict of interest prohibitions between a company and its auditor relating to hiring of auditor personnel (§ 206).
- Requirements for public company audit committees through exchange rules (§ 301).
- Prohibited influence of auditors (§ 303).
- Forfeiture of bonuses and profits from securities sales in the event of restatement (§ 304).
- Prohibition on insider trades during pension fund blackout periods (§ 306).
- Prohibition on personal loans to directors and executive officers (§ 402).
- Protection of whistleblowers (§ 806).
- New criminal penalties for defrauding security holders of publicly traded companies (§ 807).
- CEO and CFO certifications not included in a periodic report (§ 906).

As a practical matter, we have found that most voluntary filers and their auditors maintain the relationships mandated by SOX, notwithstanding the flexibility to avoid some of those requirements as already described. The Staff has also confirmed that Regulation G,[125] which has a definition of "issuer" similar to SOX and regulates public statements that include non-GAAP financial measures but are not "filed" with the SEC (such as earnings releases that are "furnished" to the SEC pursuant to Item 2.02 of Form 8-K), does not apply to voluntary filers; nevertheless, it has cautioned voluntary filers that failure to comply with Regulation G could result in misleading disclosure.[126] Thus, as a practical matter, voluntary filers generally seek to comply with Regulation G in their public statements that include non-GAAP measures.

144A-for-Life High Yield Securities

Prior to the beginning of the credit market disruptions in mid-2007, high yield issuers seeking to avoid the additional procedures and associated costs resulting from voluntary filer status, particularly the burdens of complying with SOX Section 404, increasingly offered high yield bonds

125. 17 C.F.R. § 244.100-102.

126. Question 33 of SEC Division of Corporation Finance, Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures, posted (June 13, 2003) (available at http://www.sec.gov/divisions/corpfin/faqs/nongaapfaq.htm).

without registration rights.[127] These "144A-for-life" bond issuers are not, as a practical matter, required to become subject to the Exchange Act[128] unless and until they decide to publicly offer equity securities. Instead of agreeing to file an A/B exchange offer on Form S-4 and continue to file reports with the SEC in subsequent years as voluntary filers, these issuers have agreed to indenture reporting covenants that generally require that noteholders and the indenture trustee be provided with only a subset of the disclosure that would otherwise be required to be filed under the Exchange Act. Depending on market conditions, investors will often require somewhat higher interest rates to compensate for the loss of liquidity and SEC oversight.

The scope of these contractual requirements varies widely and has been the subject of deal-by-deal negotiation, but it does not include compliance with SOX Section 302 officer certifications or Section 404 internal control assessments or audits.[129] Based on our review of many of the 144A-for-life bonds that have been issued in recent years, the "bare minimum" covenants include only annual audited and quarterly unaudited financial statements accompanied by "Management's Discussion and Analysis of Financial Condition and Results of Operations." Even these limited requirements are not necessarily tied to compliance with Regulation S-X or Regulation S-K standards, and when Regulation S-X is invoked in the covenant, there are often negotiated exceptions, such as elimination of the requirement to provide consolidating footnote information in respect of guarantors and non-guarantors as would be required by Item 3-10 of Regulation S-X. Most such covenants also mandate disclosure that would otherwise be required in a Current Report on Form 8-K, but often with

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127. From 2000 to 2002, corporate bond issues without registration rights comprised a yearly average of 12.9% of corporate bond issues by volume and 9.4% by value. From 2003 to 2006, the incidence of such deals increased to 33.2% per year by volume and 28.9% by value. Hendrik Bessembinder & William F. Maxwell, *Markets: Transparency and the Corporate Bond Market*, J. of Econ. Persp., Spring 2008, at 217, 229.

128. As described in *supra* note 57 and the accompanying text, the high yield issuer will not be subject to Exchange Act reporting requirements unless it has over 500 record holders of a class of its securities and assets over $10 million. It is highly unlikely that a high yield issuer would have 500 record holders as a result of its Rule 144A offering. *See supra* note 105.

129. Statutory issuers and voluntary filers that fail to meet their Exchange Act reporting deadlines may find themselves under attack by activist bondholders, who can declare the issuer in technical default on its reporting covenants and demand acceleration of payment or other costly concessions. *See* Peter Lattman & Karen Richardson, *Hedge Funds Play Hardball with Firms Filing Late Financials*, Wall St. J., Aug. 29, 2006, at A1. In one case, a statutory issuer was found in default where it identified a material weakness in ICFR and delayed its annual report pending completion of SOX Section 404 compliance. *Bank of New York v. BearingPoint, Inc.*, 824 N.Y.S.2d 752 (N.Y. Sup. Ct. 2006) (unpublished table decision). Although timely reporting is typically a covenant in 144A-for-life offerings, such covenants are not necessarily tied to Regulation S-X. This flexibility, as well as the absence of the requirement to comply with SOX Section 404, may provide 144A-for-life issuers with less risk of default than statutory issuers and voluntary filers in complying with their disclosure covenants.

numerous negotiated exceptions, and also address, in varying detail, mechanisms for the required information to be made available to analysts and prospective investors (frequently via a password-protected website such as IntraLinks). Most of these covenants also require the issuer to participate in quarterly conference calls. They generally do not require the extensive business, compensation, management, or other narrative disclosure that would be required in an Annual Report on Form 10-K and do not require the provision of the exhibits that would be required with Exchange Act filings, such as material contracts.

In addition to 144A-for-life offerings, we have also been involved in a number of consent solicitations whereby voluntary filers solicit their bondholders for consent to amend their indentures to eliminate the continuing requirement to file reports with the SEC. These amendments have generally involved smaller or struggling issuers for whom the cost of compliance with SOX is material to operating performance and cash flow, with appeals to bondholders to reduce overhead and save cash.

Notwithstanding the attractiveness of 144A-for-life to high yield issuers seeking to avoid SOX and the other rigors of public reporting, our discussions with bond investors and high yield capital markets professionals suggest that the increase in 144A-for-life offerings over the past few years has been primarily a function of the strong, issuer-friendly high yield market conditions that prevailed until the summer of 2007. Based on our discussions, major high yield investors are not particularly concerned with the liquidity of 144A-for-life bonds since most trading is between QIBs, but they universally favor the discipline imposed on issuers by the SEC registration and reporting regime—including SOX certification and Section 404 requirements as well as periodic review by the Staff—notwithstanding the incremental cost. As a result, we expect 144A-for-life reporting covenants to continue to appear during stronger high yield markets and to wane during weaker markets as part of the overall covenant negotiation between issuers and bondholders. The overall experience bond investors have with the availability and reliability of information from non-reporting issuers will also affect the relative demand for 144A-for-life securities.

Voluntary Filers in the Securities Offering Reform of 2005

On June 25, 2005, the SEC revised the integrated disclosure system to expedite the registration and public offering processes for many issuers.[130] Among other changes, the reforms created a new category of issuers called well-known seasoned issuers that may take advantage of relaxed gun-jumping restrictions and be entitled to automatic shelf registration

130. Securities Offering Reform, Release Nos. 33-8591, 34-52056, IC-26993, FR-75, 70 Fed. Reg. 44,721 (July 19, 2005) (available at http://www.sec.gov/rules/final/33-8591.pdf).

without SEC review.[131] The new rules also introduced new safe harbors for the release of factual and forward-looking information and amended existing safe harbors regulating research reports on issuers published by research analysts and broker-dealers.[132]

Despite the significance of these reforms, voluntary filers were excluded from its most attractive features. Well-known seasoned issuer status is not available to voluntary filers since the ability to achieve such status by issuing $1 billion or more of debt includes only debt issued pursuant to a registration statement for cash, thereby excluding debt registered in an A/B exchange offer.[133] Reporting issuers and even certain non-reporting foreign private issuers have available a new safe harbor for factual business and forward-looking information,[134] but voluntary filers are eligible only for a separate safe harbor covering only factual business information and not forward-looking information.[135] Existing rules governing the circumstances under which a broker or dealer may publish research reports contemporaneously with a registered offering were also amended to specifically exclude voluntary filers.[136] Prior to the reforms, practitioners had generally been comfortable concluding that research about voluntary filers that met the requirements of the prior rules ought to be permissible.

Perhaps the most immediate and visible change in the reforms is the new disclosure of voluntary filer status required in Exchange Act filings. Form 10-K and Form 20-F have been modified to include a box on the cover page that must be checked if a report is being filed by a voluntary filer.[137] Despite recognizing that many such companies file "voluntarily" to comply with their contractual obligations, the SEC nonetheless adopted the view that voluntary filers could cease reporting at any time and for any reason, and that the public needed to be alerted to this supposed danger.[138] This "scarlet letter" is indicative of the SEC's apparent suspicion of voluntary filers. In its adopting release, the SEC asserted its opinion that voluntary filers should be required to register under the Exchange Act and be subject to all its provisions if they wish to receive the benefits of the offering reforms available to statutory issuers.[139] This may represent the SEC's dissatisfaction with the A/B exchange offer technique and with the not-quite-private, not-quite-public status of voluntary filers.

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131. *Id.* at 70 Fed. Reg. 44,777.
132. *Id.* at 44,733-44,735.
133. *Id.* at 44,730.
134. *Id.* at 44,735.
135. *Id.* at 44,735-44,736.
136. *Id.* at 44,763.
137. *Id.* at 44,788.
138. *Id.*
139. *Id.* at 44,730.

RECENT CHANGES TO RULE 144 AND THE FUTURE OF REGISTERED OFFERINGS

This section addresses the effect that recent changes to Rule 144 could have on the use of A/B exchange offers and potentially reduce the number of voluntary filers among high yield bond issuers. When high yield bonds are first issued through a private placement and Rule 144A resale, the bonds reach the hands of investors as restricted securities under the Securities Act. Restricted securities may be freely resold to other qualified institutional buyers under Rule 144A and offshore to non-U.S. investors under Regulation S,[140] but investors will generally not be able to resell restricted securities to the public until after completion of an exchange offer or until the transaction satisfies the requirements of the Rule 144 safe harbor. Under the previous version of Rule 144 prior to 2008, restricted securities could not be resold until after a holding period of one year, after which resales were still subject to volume and manner-of-sale limitations and other requirements.[141] The restricted securities could not be resold free of limitations until they had been held for two years.[142]

Effective February 15, 2008, the SEC has adopted changes to Rule 144 that, in particular, shorten the holding period and almost completely eliminate the resale limitations for non-affiliate holders of restricted securities.[143] Under the revised rule:

- In the case of issuers subject to Exchange Act reporting requirements, non-affiliates of the issuer are permitted to resell their restricted securities after a holding period of six months, subject to the Rule 144(c) requirement that adequate current public information regarding the issuer is available.[144] After one year, they may be resold without restriction.[145]
- In the case of an issuer not subject to Exchange Act reporting requirements, non-affiliates of the issuer may resell restricted securities after a holding period of one year, free of any restrictions.[146]
- Affiliates of a reporting or non-reporting issuer may also resell restricted securities after a six-month or one-year holding period, respectively, but will be subject to all prior Rule 144 requirements

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140. Securities Act Rule 901-905.
141. Securities Act Rule 144 (2007).
142. Securities Act Rule 144(k) (2007).
143. Revisions to Rules 144 and 145, *supra* note 34.
144. Securities Act Rule 144(b)(1)(i).
145. *Id.*
146. Securities Act Rule 144(b)(1)(ii).

(i.e., volume limitations and current public information, manner of sale and Form 144 filing requirements).[147]

Voluntary filers have an unclear position under revised Rule 144 since the revised rule, much like SOX, draws a sharp distinction between issuers that are subject to Exchange Act reporting requirements and issuers that are not. Although the SEC's final rule release uses the terms "reporting issuer" and "non-reporting issuer,"[148] the text of the rules states that the six-month holding period is only available to an issuer "*subject to* the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934."[149] It is not clear whether the SEC will allow the shortened holding period for those issuers that file reports on a "voluntary" basis, including high yield issuers that have had their Section 15(d) reporting requirements suspended.[150] Pending further guidance from the Staff, holders of securities of voluntary filers should not automatically assume that they may rely on a six-month holding period for resales of their restricted securities.

Revised Rule 144 has significant implications for the future of high yield offerings. For reporting issuers with publicly traded equity, we expect that, over time, A/B exchange offers will be eliminated entirely from the high yield offering process. The registration of the A/B exchange offer would not provide any additional disclosure to that already provided by reporting issuers. In addition, since high yield investors typically expect to wait at least six months for the A/B exchange offer to be completed, the shortened holding period in revised Rule 144 allows the issuer to promise investors enhanced liquidity in a similar timeframe without an A/B exchange offer. Issuers may choose to lift the trading restrictions on the privately placed bonds as early as six months after the closing, provided that they remain current in their SEC filings for an additional six months. Alternatively, issuers may prefer to wait until one year after the private placement, at which point the current information requirement will no longer apply. The prevalent approach will likely emerge over time, but we expect that the latter, more conservative approach is likely to be the majority view in the near term.

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147. Securities Act Rule 144(b)(2).

148. *See, e.g.,* Revisions to Rules 144 and 145, *supra* note 34, at 72 Fed. Reg. 71,549 ("We believe that different holding periods for reporting and non-reporting issuers are appropriate given that reporting issuers have....").

149. Securities Act Rule 144(b)(1)(i) (emphasis added).

150. In its final rule release, the SEC explained that "non-reporting issuers" were not entitled to the shorter holding period since their disclosures are not of the same scope as Exchange Act reports, are not required to include audited financial information and are not publicly available via EDGAR. Revisions to Rules 144 and 145, *supra* note 34, at 72 Fed. Reg. 71,549-71,550. Voluntary filers generally satisfy all these criteria in complying with the covenants of their indentures. However, given the SEC's prior approach to voluntary filers in the Securities Offering Reform release, it seems premature to expect equal treatment for voluntary filers here. *See supra* notes 130–139 and the accompanying text.

We expect the elimination of registration rights for Rule 144A offerings by reporting companies to take time to become widespread, since some investors have internal limitations on the portion of their assets that may be invested in unregistered securities, which would likely include freely tradable securities under revised Rule 144 that were never the subject of a registration statement. Although we believe these internal limitations are not widespread, initial evidence suggests that issuers and their investment banks are not always willing to exclude potential purchasers, particularly in difficult markets. We expect that these limitations can and will be amended over time as investors become more comfortable with unregistered securities under revised Rule 144.

For first-time high yield issuers that have not previously been subject to Exchange Act reporting requirements, we anticipate that investors will continue to demand the disclosures and SEC oversight that comes with being an Exchange Act reporting company. A/B exchange offers are one way to achieve this result, and investors may continue to insist on registration so that issuers are subject to a "full review" by the SEC staff. Alternatively, issuers may also be able to satisfy investors by agreeing to a reporting covenant whereby the issuer will file Exchange Act reports as a voluntary filer. This gives investors the protections afforded by the Exchange Act reporting regime (including the requirement for executive officer certifications with each quarterly and annual report filed), with sufficient liquidity afforded by revised Rule 144, while issuers can avoid a costly registration process and certain SOX governance requirements.

CONCLUSION

There is strong empirical evidence that SOX has been one of the factors contributing to the decline in the predominance of U.S. capital markets. Although an issuer must consider many variables in deciding whether to access the public markets in the United States, the costs and additional regulatory burdens of SOX are undeniable and particularly acute for smaller companies. U.S. companies have explored alternatives to U.S. listings, including looking to overseas exchanges to list their IPOs. Foreign private issuers have taken advantage of greater liquidity on their local exchanges and all but bypassed U.S. listings, particularly since they can still access the Rule 144A market in the United States without subjecting themselves to SOX. Meanwhile, both U.S. and foreign issuers have increasingly sought to deregister their equity securities under the Exchange Act. The SEC's recent adoption of Auditing Standard No. 5 and its interest in accommodating international financial reporting standards alongside U.S. accounting standards may reduce the burdens of U.S. listings on smaller and foreign companies to a degree. However, it remains to be seen whether these efforts can reverse the trends described in this chapter.