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CAN EUROPEAN COMPANIES ESCAPE U.S. LISTINGS?

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Abstract

European companies would like to deregister from the SEC system in light of Sarbanes Oxley. However, this takes at least 18 months for a foreign company listed on a US market, and is virtually impossible for a foreign company that has made a public offering in the US. Therefore, the SEC should adopt a geographic going private rule allowing a foreign issuer to opt out of the SEC system if the foreign issuer makes an offer to buy all shares of its US holders at a fair price as determined by an independent appraiser.

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Since the passage of the Sarbanes Oxley Act (SOX), almost no European companies have chosen to list their shares for trading on U.S. markets. And many of the European companies already listed on U.S. markets would like to escape the burdens imposed by SOX — which has roughly doubled the cost of a U.S. listing.

However, escaping the U.S. securities system is time-consuming at best and impractical at worst. Therefore, the SEC should adopt rules allowing a foreign company to opt out of SEC disclosures and SOX's requirements if it offers to buy back all its shares held by U.S. investors at a "fair" price — as determined by an independent appraiser.

Most dramatically, SOX requires both the CEO and CFO of a foreign listed company to certify personally that its financial statements do not contain any material misstatements or omissions, and that the company has in place internal controls designed to generate complete and accurate financial information. The uncertain civil and criminal liabilities implicated by these certifications are truly daunting to top executives of foreign companies.

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Other provisions of SOX mandate specific relationships between the foreign listed company and its management team. These include prohibitions on almost all loans from the company to its officers and directors, as well as the repayment by senior company officials of certain bonuses and trading profits following an accounting restatement “resulting from misconduct”.

SOX imposes particularly intrusive requirements on the audit process of foreign listed companies, despite recent SEC accommodations. SOX requires an audit committee of a supervisory board to be composed entirely of independent directors, except for government and employee representatives pursuant to home country laws. It also mandates U.S. inspection of any foreign firm auditing the books of a foreign listed company, although the U.S. authorities will work together with the foreign authorities.

Faced with these sharp and unexpected increases in the costs of a U.S. listing, many foreign companies would choose to delist from U.S. markets and escape the extraterritorial reach of SOX. However, a delisted foreign company with 300 or more U.S. shareholders would still be subject to the SEC's disclosure system, including the SOX requirements.

Although a delisted foreign listed company could offer to buy back all shares of U.S. shareholders, it is almost certain that more than 300 U.S. shareholders would not accept the offer — because of ownership splitting, price disagreements or pure inertia. Some foreign companies with 300 U.S. shareholders could ultimately escape the SEC reporting system and SOX by delisting, applying for an SEC exemption and waiting for 18 months. But if a foreign company has ever made a SEC-registered public offering of equity securities to American investors, including securities offered as part of an acquisition, it would always be subject to the SEC's disclosure system and SOX's requirements so long as it has at least 300 U.S. shareholders.

In response, the SEC should adopt a geographic variant of its "going private" rules. These new rules would allow a foreign company not only to delist from U.S. trading but also to deregister from the SEC's disclosure system if the foreign company made a "fair" offer to buy back all its shares held by U.S. investors. The "fairness" of this offer would be determined by an appraiser, independent of the company, based on three main factors.

* First, the appraiser would compare the costs to U.S. investors of trading shares of a foreign company on the NYSE or NASDAQ with the costs to U.S. investors of trading such shares abroad.

* Second, the appraiser would evaluate the disclosures made by a foreign company listed in the U.S. versus the disclosures required by the home country of that company.

* Third, the appraiser would compute the incremental income taxes — mainly on dividends—that would be paid by U.S. shareholders of a foreign company before and after delisting.

If the buy-back offer is at a "fair" price, as determined by an independent appraiser, foreign companies should be permitted to opt out of the SEC's disclosure system and SOX's requirements — even if 300 U.S. shareholders choose not to accept this offer. While corporate executives must generally live with their financial decisions, no one could have foreseen the tremendous increase in costs and unprecedented extraterritorial reach of SOX.