Why Rule 500 should be repealed

The rule that makes it hard for companies to leave the New York Stock Exchange has become an anachronism. It's time for a change, argues **Dr Jeffrey Harris**.

Imagine checking into a luxury hotel for a stay. You have visited the hotel for many years with nary a concern. They treat you well and you really don't mind paying a little extra for it. Initially, your expectations are fulfilled – the service is impeccable. Life seems to be grand, business is good and, although the hotel charges dear rates, you are satisfied and comfortable with your choice.

Meantime, you watch a new hotel under construction next door. This hotel, although not constructed with the same bricks and mortar, purports to offer similar amenities to your current digs. Perhaps you consider the newcomer a novelty – it shares the neighborhood, but will likely never be an attractive alternative to your preferred inn.

After some time, however, you begin to notice a slip in service at your regular hotel. At first, the slip is not bothersome, but over time you come to realize that you simply must notify the manager. In an attentive luxury hotel, the slip is rectified. But what happens when, visit after visit, the service becomes erratic? What options might you have? Apart from continuous complaining, you may decide to try out the newer hotel next door. After all, you think, the newcomer seems to have a steady flow of customers each day. In fact, others have suggested that the competing inn purportedly offers an equally good or even better service at a much-reduced price.

One day, after much consternation (you have indeed grown fond of the place after so many years), you approach the front desk and ask to check out. The clerk informs you that you need to provide advance notice, as per hotel policy. Somewhat taken aback, you agree and ask for clarification about the terms of your stay. (You really never considered this possibility, since your hotel has a long and storied history.)

Reading the fine print, you discover that you must first provide written notice to your department and have a majority of your co-workers agree with your decision to check out. Then, and only then, you may indeed change hotels, a minimum of 20 days later of course. Meet Rule 500.

Out-of-date purpose

The New York Stock Exchange's Rule 500, that is. The rule that outlines procedures that listed companies must follow in order to voluntarily delist from the NYSE. A remnant of the 1930s, this rule originally helped to protect the investing public from company delistings. Back in those days, a delisting might leave stock shares nearly worthless for lack of a public trading venue. The 1930s brought unprecedented investor protections with the formation of the Securities and Exchange Commission, myriad securities law and new exchange rules on the heels of the 1929 crash.

Like the SEC and securities law in general, Rule 500 has been updated and revised throughout the past 70 years. Currently, the rule requires written notification to at least the top 35 shareholders accompanied by a press release announcing the delisting proposal. Additionally, each delisting proposal must be approved by both a majority of the company's board of directors (according to applicable state law requirements pertaining to majority votes) and its audit committee. The actual delisting may then occur between 20 and 60 business days later.

Like exchange regulations, the U.S.

Illustration: Simon Emery/Heart Agency

The NYSE rule limits the flexibility of firms to list on their venue of choice. Once a firm checks in, the firm is virtually forced to stay

financial markets have also changed through the years. Investors and companies are inextricably linked via technology which can be used to create a fairer, more accessible, more openly competitive market for trading shares.

In fact, technology insures that a public market for shares can form wherever demand exists, which itself is providing investors with more choice and objectivity as they seek to buy or sell shares.

Stock listings are governed by rules and regulations on every exchange. For most exchanges, listing and delisting rules are similar and typically require board of director authorization and perhaps shareholder notice or approval. The NYSE's Rule 500 remains an outlier among U.S. exchanges.

NASDAQ, for instance, nominally requires issuers to submit a written request to be removed from the market. As a matter or course, these requests are honored the following business day.

A question of fairness

Rule 500 has not been without its detractors over the years. The NYSE itself has amended Rule 500 to relax the stringent requirements set forth in its original incarnation.

The rule, nonetheless, remains contentious. The American Stock Exchange, which amended a similar rule in mid-2000, recently wrote to SEC secretary Jonathan G. Katz arguing that further NYSE issuer fee increases should be approved only after the repeal of Rule 500. Similarly, NASDAQ, in a petition letter to Katz in May, argues for the repeal of Rule 500 as well, citing shareholder interest, corporate governance issues and fair-competition arguments.

The SEC's mandate to "assure… fair competition… among exchange markets" (under Section 11A of the 1934 Securities and Exchange Act) raises the question of fairness. NASDAQ's open architecture has invited competition from electronic communication networks (ECNs) and has fostered an open, accessible and highly competitive marketplace.

Likewise, NASDAQ has honored the business decisions of listing companies when they have chosen to list elsewhere. The NYSE should follow suit and eliminate the Rule 500 maze that has come to be known as the Roach Motel Rule – companies can check in, but they cannot check out.

Limiting flexibility

Of course, exchange listing differs somewhat from the choice of your favorite hotel. Nonetheless, the NYSE rule limits the flexibility of firms to list on their venue of choice. Once a firm checks in, the firm is virtually forced to stay.

Under normal circumstances, such an arrangement can be a win-win situation. When listing firms are happy, the NYSE is assured to have consistent, predictable listings with the considerable fees that result. In exchange, listing companies wield power through access to the NYSE's 'front desk'. NYSE specialists and exchange officials work closely with companies to ensure compatibility and satisfaction with the specialist system.

But these are not normal times. Stock markets are suffering from investor skepticism about company motives and exchange competence. NYSE specialist firms are under public scrutiny for the breach of trust in handling public orders. Corporate accounting scandals abound. U.S. markets bear the burden of nearly three years of falling prices. Corporate governance has become the mantra in the popular press. How can shareholders exert more effective control over corporate decisions?

How many NYSE firms are unhappy with their current trading environment? We may never know. The clerk at the front desk won't let them check out. N

Dr Jeffrey Harris is associate professor of finance at the Lerner College of Business at the University of Delaware.

RULE 500 | DELISTING STEPS

Rule 500 restricts the ability of companies that list their stock on the NYSE to delist voluntarily any class of their securities from that market.

In its present form, the rule requires that in order to delist its securities from the NYSE a domestic company must:

- Provide actual written notice to at least its 35 largest shareholders of record and issue a press release announcing the delisting proposal;
- Delay delisting for 20-60 business days from the later of the written notice or the press release; and
- Obtain the approval of the audit committee, in addition to the approval of the issuer's board.
- A foreign company has to comply with the same requirements, except that it must provide actual written notice to its 35 largest U.S. shareholders.