

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 73555 / November 6, 2014

Admin. Proc. File No. 3-15508

In the Matter of the Application of

SMARTHEAT INC.
c/o James L. Kopecky
Kopecky, Schumacher, Bleakley & Rosenberg,
P.C.
203 N. LaSalle St., Suite 1620
Chicago, Illinois 60601

For Review of Action Taken by

The NASDAQ Stock Market, LLC

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE—DELISTING FROM THE NASDAQ
STOCK MARKET, LLC

Risks to Prospective Investors Posed by Liquidity Crisis and Related Issues

National securities exchange delisted issuer's securities based on issuer allowing a \$33 million cash balance to decrease to approximately \$25,000 over fourteen months, leaving it without a means to adequately fund its operations. *Held*, the application for review is *dismissed*.

APPEARANCES:

James L. Kopecky, Kopecky, Schumacher, Bleakley & Rosenberg, P.C., for SmartHeat Inc.

Edward S. Knight, Arnold P. Golub, and T. Sean Bennett, for The NASDAQ Stock Market, LLC.

Appeal filed: September 18, 2013
Last brief received: January 2, 2014

SmartHeat Inc. ("SmartHeat" or the "Company") seeks review of The NASDAQ Stock Market's¹ decision to delist SmartHeat's common stock from the NASDAQ Capital Market. NASDAQ based its delisting decision on its finding that SmartHeat, a United States holding company with no material assets other than ownership of its subsidiaries,² allowed a \$33 million cash balance to decrease to approximately \$25,000 over fourteen months, leaving it without a means to adequately fund its operations. NASDAQ found that the Company had been slow to respond to its liquidity crisis, had little control over its subsidiaries and no contractual arrangements for them to transfer funds to the holding company, had considered only one source of financing to avoid insolvency, and had experienced significant management turnover. On the basis of these findings, and to protect the markets and the investing public, NASDAQ delisted the Company. Based on our independent review of the record, we have concluded, for the reasons set forth below, that the specific grounds on which NASDAQ based the delisting exist in fact; that the delisting was in accordance with the applicable NASDAQ rules; and that those rules are consistent with, and were applied in a manner consistent with, the purposes of the Exchange Act. We therefore dismiss SmartHeat's application for review.

I. BACKGROUND

A. **After SmartHeat announced a change in management and disclosed liquidity issues, NASDAQ halted trading in SmartHeat's common stock and conducted an investigation.**

SmartHeat is a U.S. holding company with subsidiaries that design, manufacture and sell service plate heat exchangers and related systems in the People's Republic of China and Germany.³ The Company became public through a reverse merger in 2008⁴ and was listed on NASDAQ in January 2009.⁵ In 2009 and 2010, SmartHeat raised over \$100 million in the U.S.

¹ The name of the market appears in the record as both "Nasdaq" and "NASDAQ." For consistency, we use "NASDAQ."

² SmartHeat's Form 10-K for the period ended Dec. 31, 2012, at 1. Pursuant to Rule of Practice 323, 17 C.F.R. § 201.323, we take official notice of SmartHeat's EDGAR filings.

³ Form 10-K for the period ended Dec. 31, 2012, at 1.

According to SmartHeat, "A [plate heat exchanger ('PHE')] is a device that transfers heat from one fluid to another fluid across large metal plates. PHE units are used in the industrial, residential and commercial sectors to make energy use more efficient and to reduce pollution by reducing the need for coal fired boilers." Form 10-K for the period ended Dec. 31, 2012, at 1.

⁴ Form 10-K for the period ended Dec. 31, 2009, at F-7.

⁵ Form 10-K for the period ended Dec. 31, 2009, at 26.

through public offerings.⁶ In its Form 10-K for the year ended December 31, 2010, the Company reported to the Commission that it had approximately \$33 million in cash in the U.S.⁷ In its Form 10-Q for the quarter ended March 31, 2012, however, it reported only \$27,469 in cash and equivalents in its U.S. accounts.⁸

On May 30, 2012, SmartHeat issued a press release (the "Press Release") announcing a change in management and disclosing liquidity issues. The Press Release stated that four of SmartHeat's executive officers, including both its Chief Executive Officer, James Jung Wang ("J. Wang"), and its CFO had resigned.⁹ Three of the four former officers, including J. Wang, were to continue their roles with SmartHeat's subsidiaries.¹⁰ The Press Release also announced that the Board of Directors had appointed a new President and Director, Oliver Bialowons, and had approved the appointment of Nimbus Restructuring Manager LLC ("Nimbus") as Restructuring Adviser to assist SmartHeat's Board in addressing its financial and liquidity issues. Further, the Press Release disclosed that to address the Company's immediate cash needs, the Board approved borrowing up to \$1,000,000 to fund ordinary course operating expenses under a binding commitment letter, subject to an acceptable fairness opinion and negotiation of final terms and a definitive agreement. Upon reviewing the Press Release, NASDAQ staff immediately halted trading in SmartHeat's common stock and began an investigation.¹¹

⁶ Form 10-K for the period ended Dec. 31, 2010, at F-20.

⁷ Form 10-K for the period ended Dec. 31, 2010, at F-23.

⁸ Form 10-Q for the period ended March 31, 2012, at 8.

⁹ J. Wang also served as SmartHeat's President and Chairman of the Board. In addition to J. Wang, the officers who resigned were Zhijuan Guo, Chief Financial Officer; Wen Sha, Vice President of Marketing; and Xudong Wang, Vice President of Strategy ("X. Wang"). The Press Release is available on EDGAR as Exhibit 99.1 to Smart Heat's Form 8-K dated May 25, 2012.

¹⁰ J. Wang continued to serve as CEO of all of SmartHeat's operating subsidiaries. Form 10-Q for the period ended June 30, 2012, at 2. Sha and X. Wang also continued their involvement with SmartHeat's subsidiaries. Guo resigned from any further responsibilities with SmartHeat and its subsidiaries.

¹¹ Form 10-K for the period ended Dec. 31, 2012, at 4. SmartHeat subsequently admitted, in its written submission to the Hearings Panel, *see infra* at I.C., that "[i]n hindsight, the Company probably should have notified NASDAQ that it would be making an important announcement and asked for a temporary trading halt" in connection with its issuance of the Press Release.

NASDAQ staff attached various letters and emails containing its requests for information and SmartHeat's responses to its submission to the Hearings Panel when SmartHeat sought review of the staff's delisting determination. *See infra* at I.C. (discussing NASDAQ review procedures). These materials thereby became part of the record. But "due to the size of the file and the number of pages," the staff chose to omit attachments to SmartHeat's letters of June 12 and July 10, 2012 from its submission to the Hearings Panel. Those attachments are thus not part of the record, and were not available for our consideration.

During the investigation, NASDAQ staff learned that since December 30, 2010, when SmartHeat had \$33 million in cash, SmartHeat had transferred \$27.8 million to a subsidiary, Shenyang Taiyu Machinery and Electronic Equipment Co., Ltd. ("Taiyu"). SmartHeat told the staff that it projected expenses for the Company during the twelve-month period ending June 30, 2012, at \$1,802,500.

Additionally, NASDAQ staff learned that SmartHeat had not implemented service agreements that would provide for the Chinese operating subsidiaries to make regular payments to the Company, although the Company conceded in a letter to NASDAQ staff that such agreements "are commonly put in place prior to, or in connection with, the structuring of China operations as Wholly Foreign Owned Entities."¹² SmartHeat informed the staff that each of its subsidiaries was responsible for hiring its own personnel, and that it did not believe it had the right to "interfere" with the management of those subsidiaries, nor did its board of directors believe that such interference would serve the best interests of the Company's stockholders.

NASDAQ staff also learned that Northtech, Inc. ("Northtech"), an entity formed solely for the purpose of providing financing to SmartHeat, would provide the revolving line of credit mentioned in the Press Release. J. Wang, SmartHeat's former CEO, served as a principal and director of Northtech. The other two SmartHeat officers who had recently resigned, but stayed with SmartHeat's subsidiaries, were principal shareholders, as was SmartHeat's corporate secretary. As of July 10, 2012, SmartHeat reported, Nimbus had not approached any entities other than Northtech about securing short-term financing for the Company.

In July 2012, SmartHeat's board of directors approved a \$2 million revolving credit line from Northtech, instead of the \$1 million mentioned in the Press Release. The line of credit had a 4% origination fee and an initial term of nine months; SmartHeat could renew the loan for four additional nine-month periods, with a 4% renewal fee payable for each renewal. Despite SmartHeat's payment of this fee, there was no guarantee that any loan would be forthcoming, because Northtech retained complete discretion over whether to make any given loan.

On August 20, 2012, SmartHeat filed its Form 10-Q for the quarter that ended June 30, 2012. In that form, the Company acknowledged the recent "significant changes" in senior management and stated that the transition to the new management team could be disruptive to the Company's operations and could materially adversely affect its business. Additionally, Biolowons and Michael Wilhelm, SmartHeat's recently hired CFO, provided only a qualified attestation to SmartHeat's financial reports filed with the Form 10-Q, citing a lack of opportunity for the new management team to fully assess the Company's internal controls and reporting. The

¹² In the same letter, SmartHeat explained the failure to put into place such agreements was "due to [the Company's] prior history of rapid revenue growth and profitable operations." It went on to state, however, that its management was "working with management of its subsidiaries, local counsel and the appropriate government agencies to obtain approval for such arrangements."

Company also stated that it lacked sufficient personnel with the appropriate level of knowledge, experience, and training in U.S. GAAP for the preparation of financial statements in accordance with U.S. GAAP.

B. After investigating, NASDAQ delisted SmartHeat's securities.

By letter dated August 23, 2012, NASDAQ informed SmartHeat that the staff had decided to delist SmartHeat's securities (the "Delisting Determination").¹³ The staff relied on NASDAQ Listing Rule 5101, which provides NASDAQ with "broad discretionary authority" over the listing of securities on NASDAQ.¹⁴ The staff concluded that "recent events and transactions undertaken by the Company raise public interest concerns regarding the Company's solvency, viability, operational structure and suitability for listing."

The staff had public interest concerns about SmartHeat's solvency, viability, and operational structure because SmartHeat's cash holdings had fallen from over \$33 million in January 2011 to only \$27,469 as of March 31, 2012,¹⁵ and SmartHeat had transferred most of

¹³ The Delisting Determination explicitly relies on one of the attachments to SmartHeat's June 12 letter. It states that "as recently as January 2011, Smart Heat had over \$33 million in cash," and identifies "documents provided by [SmartHeat] as exhibits to a letter dated June 12, 2012" as the source of this information. Letter from Gary N. Sundick to Oliver Bialowons, August 23, 2012, at 5 n.3. Although the exhibits mentioned are not included in the record, *see supra* note 11, SmartHeat's Form 10-K for the period ended December 31, 2010 shows that SmartHeat had approximately \$33 million in cash for the year ending December 31, 2010. Form 10-K for the period ended Dec. 31, 2010, at F-25. Because we take official notice of the filing on EDGAR, *see supra* note 2, the absence of the attachments does not prevent us from making a finding as to the amount of cash SmartHeat had on hand at year-end 2010. We emphasize, however, that the parties should ensure that all materials on which they rely are made part of the record. *See CleanTech Innovations, Inc.*, Exchange Act Rel. No. 69968 (July 11, 2013), 2013 SEC LEXIS 1998, at *33 n.56 (Commission must base decision on record and cannot rely on unsworn representations to fill evidentiary gaps).

¹⁴ Delisting Determination at 1. Rule 5101 recognizes that NASDAQ has broad discretionary authority over the initial and continued listing of securities in Nasdaq in order to maintain the quality of and public confidence in its market, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. Nasdaq may use such discretion to . . . apply additional or more stringent criteria for the initial or continued listing of particular securities, or suspend or delist particular securities based on any event, condition, or circumstance that exists or occurs that makes initial or continued listing of the securities on Nasdaq inadvisable or unwarranted in the opinion of Nasdaq, even though the securities meet all enumerated criteria for initial or continued listing on Nasdaq.

¹⁵ The Delisting Determination states, "[i]n a meeting with Staff on July 24, 2012, the Company represented that the [Company] had roughly \$25,000 in its bank accounts." Delisting Determination at 2. This representation would not support a finding of fact that the Company had only \$25,000 in cash as of July 24, 2012. *See supra* note 13. In the context of a reduction in

this money to subsidiaries in China, with no mechanism for repatriating the funds. In the staff's view, SmartHeat's structure was not conducive to remedying its liquidity problems: the Company could not rely on receiving dividend payments from subsidiary profits in the near future, because the Chinese subsidiaries were not profitable; there were no agreements providing for regular payments from the subsidiaries to the Company, and the Chinese authorities might not accept such agreements; and SmartHeat's management had little ability or willingness to control the management of its subsidiaries. The staff was also concerned that SmartHeat saw the Northtech line of credit as its only option for dealing with its liquidity needs. In addition to noting these concerns, the staff expressed concern about SmartHeat's involvement with a stock promoter. Finally, the staff was concerned about SmartHeat's recent management turnover. Based on these concerns, the staff found that SmartHeat's continued listing was not in the public interest.

C. A NASDAQ Hearings Panel reviewed and affirmed the delisting determination.

NASDAQ's rules provide that an issuer seeking to appeal a delisting decision by the staff may obtain initial review by a NASDAQ Listing Qualifications Hearings Panel ("Hearings Panel").¹⁶ An issuer may appeal a Hearings Panel decision to the NASDAQ Listing and Hearings Review Council (the "Listing Council" or "Council").¹⁷ After the Listing Council has issued a decision, the NASDAQ Board of Directors may, at its discretion, call the matter for additional review.¹⁸

SmartHeat sought initial review of the staff's Delisting Determination, and a Hearings Panel affirmed the determination, finding it in the public interest to delist SmartHeat during its management transition. The Hearings Panel based its findings on both written submissions by SmartHeat and the staff, and a hearing at which Bialowons, the Company's new president; Wilhelm, the new CFO; and William McGrath, a principal of Nimbus, testified for SmartHeat. Three members of NASDAQ's Listing Qualifications staff also participated. At the hearing, McGrath testified that promoters had told SmartHeat's previous management that once the Company's shares were listed, it would be able to raise more money at will simply by issuing more shares.¹⁹ Thus, McGrath testified, SmartHeat had invested the proceeds of its offerings in acquisitions because the board believed it could always turn to the capital markets to replenish its

(...continued)

cash from \$33 million, however, we do not consider the difference between \$27,649 and \$25,000 significant. We understand the reference to "roughly \$25,000" to signify no significant change from the \$27,649 figure used in SmartHeat's filing with the Commission. We note that SmartHeat does not object to NASDAQ's use of the \$25,000 figure in its decision.

¹⁶ See generally NASDAQ Rule 5815 (procedures related to review by Hearings Panel).

¹⁷ See generally NASDAQ Rule 5820 (procedures applicable to review by Listing Council). The Listing Council may also call a Hearings Panel decision for review on its own initiative. *Id.*

¹⁸ See NASDAQ Rule 5825 (procedures applicable to review by NASDAQ Board).

¹⁹ McGrath emphasized that the Company had acted "to clearly separate itself from [the promoter], so that today there is . . . no association" with him.

coffers. McGrath acknowledged that the liquidity situation at the Company had become "quite serious" over the years, but he said that the credit agreement with Northtech would allow the Company to pay some outstanding bills. McGrath said that the recent management changes happened because the former managers realized that they did not understand the capital markets and decided that it would be better for them to focus on the operating subsidiaries. He asserted that the management turnover had benefitted SmartHeat because the newly hired executives better understood the U.S. capital markets, and that SmartHeat's governance was much better than it had been six months earlier.

Wilhelm testified that getting cash from the operating subsidiaries to the Company was still problematic; when SmartHeat was established, no "typical arrangement of contracts between subsidiary and parent [such as] service agreements [or] royalties" was put in place, so that method of moving cash was not available,²⁰ and "the Chinese structure" made it very difficult to move cash to the Company. He testified, however, that the line of credit should be sufficient to handle SmartHeat's anticipated cash needs for the next twelve months.

Wilhelm further testified that SmartHeat had "not been able to find anything better" than the Northtech credit facility in the months between the issuance of the Press Release and the October 11, 2012 hearing. McGrath testified that SmartHeat had contacted "over 700 people" in its attempts to arrange financing, but that "very, very few people . . . have shown any interest and we really had only one person out of that that's actually making a proposal so far."

Wilhelm stated that when he took over as CFO in July 2011, he was unwilling to sign an unqualified certification for the quarter that ended June 30. He explained that SmartHeat's local operations were accounted for under Chinese GAAP, and that translating those results into a consolidated set of financial statements that conform to United States GAAP required multiple steps.

Based on this evidence, the Hearings Panel found that "the extreme fragility of the Company's financial situation and its admitted inability to raise or access funds in the near term, put in doubt the Company's viability." It also found that the new management team faced a steep learning curve regarding the Company's operations, internal controls, and finances, and that the team's task would likely be made more difficult by various factors including their lack of Chinese language skills and their dependence on managers of the Company's subsidiaries, who were not attuned to the regulatory requirements of a listed company. Based on these findings, the Hearings Panel concluded that it was in the public interest to delist the Company while the transition to the new management team was underway.²¹

²⁰ Wilhelm conceded at the hearing that service agreements "really should have been here four and five years ago."

²¹ The Hearings Panel reached this conclusion despite its findings that the Company was "taking steps to resolve some of the issues that have raised Staff's concerns" and that it "appear[ed] to be distancing itself from association" with the promoter.

D. NASDAQ's Listing Council affirmed the Hearings Panel's decision.

On November 19, 2012, SmartHeat appealed the Hearing Panel's decision to the NASDAQ Listing Council. After a de novo review, the Listing Council found that delisting SmartHeat's securities was in the public interest and affirmed the Hearings Panel's decision. The Listing Council found that SmartHeat's actions were "irresponsible, reckless, and inconsistent with the conduct expected" of a company listed on NASDAQ when it allowed its \$33 million cash balance to decrease to approximately \$25,000 over the course of fourteen months without having any means to adequately fund its operations.

The Listing Council criticized SmartHeat for having been "slow to react to its liquidity crisis," finding that the record showed that SmartHeat knew of its liquidity issues several months before it secured the Northtech line of credit. Further, the Council questioned whether the remedial steps taken by SmartHeat would adequately address the issues that gave rise to the Delisting Determination. The Council noted that SmartHeat was unable to require its subsidiaries to fund its operations, and that executives of the subsidiaries controlled the line of credit that the Company depended on for its operating capital. Moreover, the Listing Council noted, the lack of control over the subsidiaries raised other concerns, including questions surrounding the Company's controls over accounting and other U.S. federal regulatory obligations. The Listing Council also observed that SmartHeat's new executives had provided a only a qualified attestation to SmartHeat's financial reports on Form 10-Q.²²

The Listing Council recognized that the Commission has held that even if delisting may hurt existing investors, "the primary emphasis must be placed on the interest of prospective [future] investors," who are entitled to assume that listed securities meet NASDAQ's standards.²³ Although SmartHeat was free to use its business judgment in decisionmaking, those decisions could lead to financial, regulatory, or other consequences. Thus, the Listing Council concluded, SmartHeat was "clearly not prepared for the rigors and responsibilities that are demanded of listed companies," and it was consistent with the discretion afforded to NASDAQ under Rule 5101 to delist the Company to protect investors so that the Company could demonstrate, over time, its ability to act as a responsible corporate citizen.²⁴

On August 5, 2013, NASDAQ notified SmartHeat that the Listing Council's decision had become the final action of NASDAQ when the NASDAQ Board of Directors declined to call it for review. This appeal followed.

²² See *supra* at I.A.

²³ Citing *Tassaway, Inc.*, Securities Exchange Act Release No. 11291, 1975 SEC LEXIS 2057, at *6 (Mar. 13, 1975).

²⁴ The Council reached this conclusion notwithstanding its recognition that SmartHeat had taken steps to resolve some of the issues that had raised the staff's concerns and to sever ties to the promoter and his affiliates. The Council did not consider the relationship with certain affiliates of the promoter a determining factor in its decision.

II. ANALYSIS

A. Standard of Review

Our review is governed by Section 19(f) of the Securities Exchange Act of 1934.²⁵ Section 19(f) requires us to dismiss SmartHeat's appeal if we determine that the specific grounds on which the delisting is based exist in fact, that the delisting is in accordance with the applicable NASDAQ rules, and that those rules are consistent with, and were applied in a manner consistent with, the purposes of the Exchange Act.

B. The specific grounds on which the delisting is based exist in fact.

We find that the specific grounds on which the delisting is based exist in fact. There is no dispute that SmartHeat spent down its cash balance from \$33 million to approximately \$25,000 over a period of approximately fourteen months. Nor does the Company dispute that it depleted its resources to this level notwithstanding the lack of any established way to fund its operations—the Company had no operations that would bring in cash, there were no contractual obligations for the subsidiaries to remit cash to the Company, and there were no arrangements for the Company to borrow money.

The complicating factors to which NASDAQ alluded also are based in fact. SmartHeat does not dispute that it chose to rely on the Northtech line of credit without seeking alternative proposals (although SmartHeat argues that circumstances made that a prudent course of action). SmartHeat admitted in a Commission filing that its management turnover was significant, and it told NASDAQ that it did not (and did not wish to) exercise control over the management of its subsidiaries.

C. The delisting is in accordance with applicable NASDAQ rules.

Under Listing Rule 5101, NASDAQ "has broad discretionary authority over the initial and continued listing of securities in Nasdaq in order to maintain the quality of and public confidence in its market . . . and to protect investors and the public interest."²⁶ Based on the record in this case, we find that NASDAQ acted in accordance with Rule 5101 when it delisted SmartHeat based on its depletion of cash at the holding company level to a mere \$25,000, with

²⁵ 15 U.S.C. § 78s(f); *cf. Fog Cutter Capital Grp., Inc.*, Exchange Act Release No. 52993, 58 SEC 1049, 2005 SEC LEXIS 3280, at *13-14 (Dec. 21, 2005) (applying § 19(f) standard to NASD delisting decision), *petition denied*, 474 F.3d 822 (D.C. Cir. 2007). SmartHeat has not alleged, and the record does not establish, that NASDAQ's action has created "any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]" such that the Commission is required by § 19(f) to set aside NASDAQ's action.

²⁶ On review, we are not free to substitute our discretion for NASDAQ's. *Cf. Tassaway, Inc.*, 1975 SEC LEXIS 2057, at *7 (stating that Commission may not substitute its discretion for the NASD's in determining whether a security should be removed from an automated quotation system).

no means in place to assure more cash, and related considerations. In essence, SmartHeat raised money in the U.S. capital markets, then sent the lion's share of its available cash to its foreign subsidiaries without any way of getting that cash back for the benefit of its shareholders.

The record supports NASDAQ's conclusion that delisting was appropriate because SmartHeat was "clearly not prepared for the rigors and responsibilities that are demanded of listed companies." We agree with NASDAQ's findings that the expenditure of corporate assets until SmartHeat was on the brink of insolvency, with no adequate means to replenish its coffers, and no attention paid to financing such that it had to take the first deal offered, was irresponsible, reckless, and inconsistent with the conduct expected of companies listed on NASDAQ.

SmartHeat does not dispute the facts on which NASDAQ based its decision. Instead, SmartHeat's arguments focus on how those facts should be interpreted. In essence, it argues that its situation was not as dire as NASDAQ thought, and that it has taken steps to remedy any problems that do exist. As explained below, it argues that its liquidity problems were not so serious; that it should not be faulted for problems related to its status as a holding company with Chinese subsidiaries operating under Chinese law; that the decisions to spend down cash and adopt the line of credit were legitimate exercises of business judgment; and that the Company will benefit from the new management team. SmartHeat also argues that NASDAQ's explanation of the basis for delisting was inadequate. We address these arguments in turn.

1. Magnitude of Liquidity Problems

The Company contends that the depletion of holding company cash to approximately \$25,000 did not create a liquidity crisis for the Company, but rather a "short-term liquidity issue." It takes issue with NASDAQ's finding that it was "slow to react" to the liquidity crisis, arguing that the situation "arose quickly—in approximately 14 months."

SmartHeat's attempt to downplay the significance of the liquidity problem it faced in May 2012 by calling it a "short-term liquidity issue" is at odds with the record. SmartHeat's projected expenses for the year ending June 30, 2012 were roughly \$1.8 million; its cash on hand, approximately \$25,000. SmartHeat admitted in its submission to the Hearings Panel that in spring 2012, short-term liquidity was "urgently needed," and Wilhelm testified at the hearing that the liquidity situation at the Company had become "quite serious." Moreover, as NASDAQ found, SmartHeat allowed this situation to develop notwithstanding the lack of contractual arrangements that would move money from the subsidiaries to the Company.

2. Problems Related to Status as Holding Company with Chinese Subsidiaries

SmartHeat also argues that NASDAQ should not fault the Company for the lack of a mechanism for obtaining capital from its subsidiaries because other holding companies also have problems getting cash from their Chinese subsidiaries. But NASDAQ considered the entire constellation of circumstances facing SmartHeat—including cash depletion, new management,

and lack of control over subsidiaries, as well as the lack of funding arrangements—in deciding to delist SmartHeat's shares. The lack of funding arrangements might have been less of a concern if SmartHeat's cash management had been more prudent. SmartHeat knew that the subsidiaries were not obligated to make payments to the Company, and it should have managed its resources accordingly.

SmartHeat contends that NASDAQ based its decision on factors inherent in its status as a holding company with Chinese subsidiaries operating under Chinese law. It argues that its corporate structure was in place when the Company was listed, is shared by many listed companies, and was fully described in its SEC filings. It further contends that the holding company structure is necessary because China does not permit direct ownership by foreign investors of assets in China, that the limitations on obtaining capital from subsidiaries that NASDAQ noted are not unique to the Company and are the effect of law rather than choice or omission, and that "[t]he rights of a parent corporation towards its subsidiaries are strictly limited to the rights of a stockholder and not the rights of a manager."²⁷ But if the constraints of Chinese law cause a listed company to operate in a way that NASDAQ deems inconsistent with the public interest, it is within NASDAQ's discretion to delist the company.

SmartHeat also contends that the issues related to moving cash from the subsidiaries to the Company were disclosed both to NASDAQ staff and to the public. But NASDAQ did not base the delisting on a finding that SmartHeat's disclosures regarding the absence of service agreements were inadequate. In any event, disclosing facts to the public does not preclude NASDAQ from considering such facts in a delisting determination.²⁸

²⁷ SmartHeat cites its Memorandum in Support of Appeal of Staff Delisting Determination as authority for these statements, but that memorandum in most instances simply makes statements about Chinese law and business without offering any support for them. Such unsupported statements do not present an evidentiary basis on which we could make factual findings. See *CleanTech Innovations, Inc.*, 2013 SEC LEXIS 1998, at *33 n.56 (Commission must base decision on record and cannot rely on unsworn representations to fill evidentiary gaps).

A newsletter attached to SmartHeat's Memorandum in Support of Appeal of Staff Delisting Determination provides some support for the proposition that foreign investors may find it difficult to repatriate funds "trapped" in China. But the newsletter was published in 2009. To the extent that "trapped cash" was known to be a problem in 2009, SmartHeat should have taken it into account in its planning.

²⁸ See *Fog Cutter*, 2005 SEC LEXIS 3280 (dismissing review proceeding challenging determination to delist issuer's securities from NASDAQ where securities were delisted "based on public interest concerns relating to [a key executive's] guilty plea and Fog Cutter's response to it," *id.* at *12, even though the issuer had disclosed the guilty plea and facts relevant to its response in a filing with the Commission).

3. Spending Down Cash and Adoption of Line of Credit

SmartHeat argues that the Company's decision to invest approximately \$28 million in its subsidiaries after March 2011—a chief contributor to the liquidity crisis—was a reasonable exercise of business judgment, and that "[d]eciding how to deploy financial assets is fundamentally a decision for [the] Company's management, not NASDAQ." But NASDAQ correctly found that the freedom of listed companies to make business decisions does not exempt those companies from the regulatory consequences of those decisions. In delisting cases, "[t]he issue . . . is not . . . business judgment but, rather, the public interest."²⁹ Here, NASDAQ found that allowing SmartHeat's shares to remain listed was not in the public interest.

SmartHeat does not dispute NASDAQ's finding that it spent down its cash to approximately \$25,000. But it argues that the Northtech line of credit, under consideration by the time the Press Release was issued, would cover the Company's expenses for twelve months. While SmartHeat admits that it chose to accept funding from Northtech without considering other options, it argues that NASDAQ "ignores the many complications that would prevent the rapid recapitalization of [the] Company,"³⁰ and that seeking cash from insiders was its best option because it lacked the time and money to look elsewhere. These arguments do not support SmartHeat's position. Instead, they illustrate the extremity of SmartHeat's circumstances as a result of spending down its cash.

SmartHeat cannot divorce the need to arrange financing from the decision to move cash out of the Company. Although the line of credit was under consideration in late May, it was not finalized until several months later, meaning that SmartHeat drastically depleted its cash with no guarantees that it could obtain credit, much less any agreement as to the terms of such credit. If the Company had begun trying to arrange funding when it still had \$33 million,³¹ it might have had the time and money to explore other options, and it might have had more flexibility to deal with any complications that arose.³² Alternatively, if SmartHeat had recognized the lack of

²⁹ *Fog Cutter*, 2005 SEC LEXIS 3280, at *24.

³⁰ These complications include, according to SmartHeat's reply brief, "a) the time and expense needed to undertake due diligence by third-party lenders, b) the inability to refinance the whole enterprise (parent and subsidiaries) with one comprehensive credit line (as typically done for U.S. Businesses); and c) the complications created by Chinese law," as well as the fact that SmartHeat had been subpoenaed to produce certain information and had been requested not to disclose that fact, which, SmartHeat stated, "severely limited the Company['s] ability to secure funding without disclosing this material information to any potential lender or capital source other than a source with existing inside information."

³¹ As noted above, McGrath testified that contractual arrangements for getting money from the subsidiaries to the Company "really should have been here four and five years ago."

³² SmartHeat argues that the Northtech line of credit benefits the Company in ways that a loan from a third party would not. It contends that having managers of the Chinese subsidiaries involved in the line of credit shows their commitment and provides them with an incentive. It is also possible, however, that giving those managers control over the Company's operating funds

(continued...)

funding arrangements as a possible problem, it could have avoided spending the \$33 million down to \$25,000. Finally, it remains to be seen whether the line of credit will resolve SmartHeat's cash problems. Under the loan agreement, Smartheat will be paying a 4% origination or renewal fee every nine months, whether or not it borrows money, and Northtech retains complete discretion over whether to lend to SmartHeat. Thus, there is no guarantee that the line of credit will make SmartHeat's liquidity situation better rather than worse.

4. New Management Team

SmartHeat argues that it will benefit from the new management team because the managers are experienced executives who are familiar with U.S. corporate governance and accounting standards. But SmartHeat admitted in its Form 10-Q for the period ended June 30, 2012 that the transition to a new team could be disruptive to its operations and could adversely affect its business. It is also clear from the record that the new managers will need time to bring the situation at SmartHeat under control; Wilhelm testified that Chinese accounting practices are very different from U.S. practices, and that arranging for payments from the Chinese subsidiaries to the parent company would be "very difficult." As noted above, Wilhelm refused to provide an unqualified certification when he first joined SmartHeat because he needed more time to familiarize himself with the Company's financials.³³

5. NASDAQ's Criteria for Delisting

SmartHeat criticizes NASDAQ staff's application of "more stringent criteria" in its initial Delisting Determination and argues that because the staff did not identify the "more stringent criteria," SmartHeat could not understand the staff's reasoning or formulate an acceptable restructuring plan. We find no merit in this argument. The plain text of Rule 5101 permits NASDAQ to apply criteria other than those spelled out elsewhere in NASDAQ's rules.³⁴

(...continued)

will create tension in a situation where the Company has traditionally exercised little control over the subsidiaries. The Company also contends that certain terms in the Northtech agreement "may not be available from a third-party lender." But SmartHeat does not know whether such terms would have been available, because it chose to seek financing from Northtech rather than exploring third-party options.

³³ SmartHeat experienced additional management turnover when Wilhelm resigned the position of Chief Financial Officer on February 23, 2013. Form 10-K for the period ended Dec, 31, 2013, at 4. SmartHeat stated in its Form 10-K for the period ended December 31, 2013 that it had "difficulty finding a suitable replacement" for Wilhelm; in the interim, it appointed Yangkai Wang as Acting Chief Accountant on June 7, 2013. *Id.* at 5. SmartHeat further stated that Yang "has limited relevant education and training in U.S. GAAP and related SEC rules and regulations." *Id.* Our decision that NASDAQ's delisting decision should not be set aside is not based on these subsequent developments.

³⁴ See *supra* note 14 (quoting Rule 5101). See also *Fog Cutter*, 2005 SEC LEXIS 3280, at *21 (dismissing a review proceeding in which the delisting decision was based on a rule that allowed the exercise of discretion, and although no violations of other rules were charged or

(continued...)

NASDAQ laid out its concerns at every stage of the proceeding. Our review is of the Listing Council decision, not the staff's initial Delisting Determination, and that decision clearly sets forth the basis for delisting.³⁵

For the reasons discussed above, we find NASDAQ's action consistent with Rule 5101 in that the delisting helps to maintain public confidence in the market and to protect investors and the public interest. As we have held, "listing a security on a market creates expectations among investors that listed companies meet basic standards of corporate governance and financial soundness."³⁶ NASDAQ reasonably determined that SmartHeat did not meet its standards, and accordingly delisted the Company's securities.

(...continued)

found, the issuer was found to have "presented inappropriate non-market risk to public investors").

³⁵ In its petition for review and its brief, SmartHeat makes three arguments based on the Delisting Determination: (1) NASDAQ "explicitly stated that it was applying 'more stringent' listing criteria to the company, but never stated what criteria were being applied"; (2) NASDAQ based its decision on SmartHeat's past association with a promoter, "without any evidence, or even allegation, of wrong doing by the Company or even [the promoter]"; and (3) NASDAQ based its decision "on allegations regarding stock trading activity by the Company's former CEO that were without any foundation or evidence and clearly contrary to the factual evidence presented in the Company's public SEC filings and stock records." Because our review is of the Listing Council's decision—NASDAQ's final decision—rather than the staff's Delisting Determination, these arguments would be relevant to our review only if the issues they raise also are present in NASDAQ's decision. NASDAQ's decision says nothing about more stringent criteria, but we address the argument above under heading C.5. to the extent it raises procedural issues that could have tainted the proceeding. NASDAQ's decision also says nothing about stock trading by a former CEO. Although NASDAQ's decision mentions the promoter, it states that SmartHeat's relationship to affiliates of the promoter was not a determining factor in its delisting decision. Thus, these three arguments provide no basis for overturning NASDAQ's delisting decision.

In its reply brief, SmartHeat argues that the promoter's "presence clearly shaped and tainted NASDAQ's investigation" and its delisting decision. But the record indicates that NASDAQ's investigation was in response to issues raised by the Press Release, which did not mention the promoter. To the extent NASDAQ may have made inquiries regarding the promoter, it is not uncommon for investigations to touch on people or issues that do not, in the end, give rise to regulatory action. And as noted above, NASDAQ based its delisting decision on factors other than SmartHeat's involvement with the promoter or his affiliates.

³⁶ *Fog Cutter*, 2005 SEC LEXIS 3280, at *24.

D. Rule 5101 is consistent with, and was applied in a manner consistent with, the purposes of the Exchange Act.

Section 12(d) of the Exchange Act, 15 U.S.C. § 78l(d), provides that a security registered with a national securities exchange "may be withdrawn or stricken from listing . . . in accordance with the rules of the exchange." Section 6(b)(5) of the Exchange Act requires that the rules of a national securities exchange be designed, among other things, "to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade...to perfect the mechanism of a free and open market . . . and . . . to protect investors and the public interest."³⁷ The relevant language of Rule 5101, under which NASDAQ exercised its authority to delist "in order to maintain the quality of and public confidence in the market" and "to protect investors and the public interest," is consistent with these Exchange Act provisions. We have previously found that the inclusion of such standards in the rules of NASDAQ is consistent with Section 6(b)(5) of the Act.³⁸

We find that NASDAQ applied Rule 5101 in a manner consistent with the Exchange Act. SmartHeat argues that its liquidity problems were the result of a reasonable business decision that turned out badly, and that outcome "should not allow NASDAQ, with the benefit of hindsight, to punish [the] Company and its investors with the extraordinary remedy of delisting."

³⁷ Before January, 2006, NASDAQ was part of the NASD, a registered national securities association. In January, 2006, NASDAQ became a registered national securities exchange under the Exchange Act. Section 15A(b)(6) of the Exchange Act, 15 U.S.C § 78o(b)(6), requires that the rules of a national securities association be designed, among other things, "to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade...to perfect the mechanism of a free and open market . . . and . . . to protect investors and the public interest." These statutory standards are identical to the standards, noted in the accompanying text, that apply to the rules of a national securities exchange under Section 6(b)(5) of the Exchange Act.

³⁸ See Exchange Act Release No. 52342, 2005 SEC LEXIS 2234, at *11-12 (Aug. 26, 2005) (approving proposed rule language directly linking NASD's broad discretionary authority over initial and continued inclusion of securities in NASDAQ to "protect[ion of] investors and the public interest"). This rule was later incorporated into the rules of NASDAQ when the Commission approved NASDAQ's registration as a national securities exchange. At that time the Commission found that the August 2005 NASDAQ rule changes concerning delisting were "consistent with Section 6(b)(5) of the Exchange Act for the same reasons that the Commission approved them under Section 15A(b)(6) of the Exchange Act." See Exchange Act Release No. 53128, 2006 SEC LEXIS 86, at *101 n.213 (Jan. 13, 2006). The NASDAQ rule has subsequently been renumbered and is currently Rule 5101. See also *Fog Cutter Capital Group Inc. v. SEC*, 474 F.3d 822, 825 26 (D.C. Cir. 2007) (finding that NASD rules giving the Nasdaq market "broad discretion to determine whether the public interest requires delisting securities" were "obviously consistent with the Exchange Act").

In determining to delist, NASDAQ acted in accordance with our long-held view that the primary emphasis in such listing determinations must be the protection of prospective investors.³⁹ The delisting decision is not punitive, but instead serves to protect those prospective investors.

Finally, SmartHeat contends that NASDAQ's delisting decision was "unwarranted, unnecessary, and inappropriate in the circumstances, *ultra vires* and contrary to the public interest because there is nothing in the record showing, and no other evidence of, self-dealing, lack of due care, absence of good faith, breach of fiduciary duty, or failure to make adequate and timely disclosure." The types of misconduct SmartHeat enumerates are by no means the only permissible bases for a delisting decision, and NASDAQ's decision to delist SmartHeat's securities was a permissible exercise of its discretion under Rule 5101. Thus we find, pursuant to Exchange Act Section 19(f), that Rule 5101 is consistent with the purposes of the Exchange Act and that NASDAQ applied Rule 5101 in a manner consistent with the purposes of the Exchange Act, acting for the good of both the market and prospective investors.

III. CONCLUSION

For the reasons discussed above, we conclude that the grounds on which the delisting was based exist in fact; that NASDAQ acted in accordance with its applicable rules in delisting SmartHeat's securities; and that those rules are, and were applied in a manner consistent with, the purposes of the Exchange Act. Accordingly, we dismiss this review proceeding.

An appropriate order will issue.⁴⁰

By the Commission (Chair WHITE and Commissioners AGUILAR, STEIN and PIWOWAR; Commissioner GALLAGHER not participating).

Brent J. Fields
Secretary

³⁹ *Tassaway, Inc.*, 1975 SEC LEXIS 2057, at *6; *See also Biorelease Corp.*, Exchange Act Release No. 35575, 1995 SEC LEXIS 818, at *13 (Apr. 6, 1995) (citing *Tassaway, Inc.* for the proposition that "[a]lthough exclusion from the system may hurt existing investors, primary emphasis must be placed on the interests of prospective future investors.")

⁴⁰ We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein. Because the issues have been thoroughly briefed and can be adequately determined on the basis of the record filed by the parties, the Company's request for oral argument is denied. Rule of Practice 451, 17 C.F.R. § 201.451.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73555 / November 6, 2014

Admin. Proc. File No. 3-15508

In the Matter of the Application of

SMARTHEAT INC.
c/o James L. Kopecky
Kopecky, Schumacher, Bleakley & Rosenberg,
P.C.
203 N. LaSalle St., Suite 1620
Chicago, Illinois 60601

For Review of Action Taken by

The NASDAQ Stock Market, LLC

ORDER DISMISSING APPLICATION FOR REVIEW OF ACTION OF NATIONAL
SECURITIES EXCHANGE

On the basis of the Commission's opinion issued this day, it is

ORDERED that the application for review of action taken by The NASDAQ Stock
Market, LLC against SmartHeat Inc. is hereby dismissed.

By the Commission.

Brent J. Fields
Secretary