Wilmer, Cutler & Pickering

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Securities Law Developments

Corporate Finance Developments

NASDAQ LISTING ISSUES

As listed companies begin finalizing their reports on Form 10-K, they should take a moment to evaluate the status of their compliance with the listing requirements imposed by their stock exchange. Whether a company is listed on the New York Stock Exchange, the American Stock Exchange or the Nasdaq, it must meet certain quantitative standards in order to maintain its listing. Failure to satisfy these "maintenance standards" on an ongoing basis is a serious issue, and can result in a company losing its listing.

While all of the exchanges have begun to scrutinize their listed companies more closely, compliance with the maintenance standards is particularly significant for companies listed on the Nasdaq, where the staff has become increasingly vigilant in its compliance monitoring efforts. In 1998, more than 800 companies were delisted from the Nasdaq. Other companies were required to transfer their listings from the Nasdaq National Market to the SmallCap Market, where the listing criteria are more relaxed. Accordingly, all companies should assess, on an ongoing basis, their continued compliance with exchange requirements.

THE NASDAQ MAINTENANCE STANDARDS

In February 1998, the Nasdaq increased many of the quantitative standards for continued listing. The Nasdaq also adopted an alternative set of maintenance standards, primarily for the benefit of National Market System companies unable to satisfy the net tangible assets test. A Nasdaq National Market company will continue to be listed if it meets all of the criteria in either Maintenance Standard 1 or Maintenance Standard 2. There is only one set of maintenance standards for SmallCap companies, but there are alternatives within that standard.

Listing Criteria	National Market Maintenance Standard 1	National Market Maintenance Standard 2	SmallCap Market Maintenance Standard
Net Tangible Assets	$4 million	N/A	N/A
Market Capitalization Total Assets Total Revenue	N/A	$50 million **or** $50 million **and** $50 million	N/A
Net Tangible Assets Market Capitalization Net Income (in latest fiscal year or 2 of last 3 fiscal years)	N/A	N/A	$2 million **or** $35 million **or** $500,000
Public Float (Shares)	750,000	1.1 million	500,000
Market Value of Public Float	$5 million	$15 million	$1 million
Round Lot Holders	400	400	300
Market Makers	2	4	2
Minimum Bid Price	$1	$5	$1

EVALUATING COMPLIANCE WITH THE APPLICABLE NASDAQ MAINTENANCE STANDARD

In evaluating compliance with the applicable maintenance standard, a company should keep in mind the following definitions and explanations of the criteria:

- **Net Tangible Assets** - Net tangible assets are defined as total assets (excluding goodwill) minus total liabilities. A company may include intangible assets other than goodwill, provided that those assets are carried on the company's audited balance sheet.

- **Public Float** - Public float is defined as outstanding shares that are not held directly or indirectly by any officer or director of the issuer, or by any person who is the beneficial owner of more than 10 percent of the total shares outstanding.

- **Round Lot Holders** - Round lot holders are defined as holders of 100 shares or more.

- **Minimum Bid Price** - Minimum bid price is measured by the closing *bid* for the stock. The closing bid for the stock may not be the same as the closing price of the stock.

As a general matter, a company that is deficient is subject to delisting as soon as the Nasdaq becomes aware that it is not in compliance with a particular criterium. There are special rules, however, governing deficiencies in a company's minimum bid, market value of public float, or number of market makers. For example, a company becomes deficient when it has less than the required minimum bid or market value of public float for 30 consecutive trading days. The company then has 90 calendar days to achieve compliance with the applicable criterium for 10 consecutive business days before the Nasdaq will delist the company. A company that does not have enough market makers is deficient if the condition lasts for 10 consecutive trading days. The company then has 30 calender days to obtain the required number of market makers.

PROBLEM AREAS

There are any number of corporate actions that can affect a company's compliance with the Nasdaq's listing standards. The following are some of the more common problem areas:

- **Acquisitions** - Acquisitions may result in the accumulation of a significant amount of goodwill, which can affect the acquiring company's compliance with the net tangible assets requirement. While companies with low net tangible assets can maintain their listing under alternative standards, it is important to assess the company's ability to meet the heightened alternative criteria before engaging in an acquisition that will reduce net tangible assets below $4 million.

- **Preferred Stock Offering** - Companies often use convertible preferred stock offerings to raise capital and solve net tangible asset deficiencies. The Nasdaq, however, will treat such issuances as a liability unless they are classified under stockholders' equity in the company's audited financial statements. A company's auditors will typically be unwilling to classify a convertible preferred offering as equity if the holders of the stock retain redemption rights.

- **Stock Split/Issuing of Additional Shares** - When engaging in activities designed to increase the number of outstanding shares, the potential impact on the price of the company's stock should be assessed to determine if the action will create a minimum bid problem.

- **Concentration of Stockholders** - The acquisition of stock by insiders or 10% shareholders should be monitored to determine if it will affect the public float and market value of public float.

RESPONDING TO PROBLEMS

While the discovery of a deficiency does not mean that Nasdaq will automatically delist the company, any deficiency is a serious issue that should be addressed immediately. The Nasdaq closely tracks compliance with its listing criteria, and has become increasingly vigilant in taking action against deficient companies. Nevertheless, Wilmer, Cutler & Pickering has had considerable success in working with the Nasdaq staff on behalf of many clients to avoid delisting by developing plans of compliance, obtaining exceptions to the quantitative standards, and facilitating transfers of listing to the Amex or the Nasdaq SmallCap Market.

Upon learning of a deficiency, the Nasdaq will typically send a letter informing the company that it no longer satisfies all criteria, and that its eligibility for continued listing will be reviewed. Issuers are well-advised to involve counsel as soon as such a letter is received. Among other things, the receipt of such notifications and other steps in the delisting process may raise sensitive disclosure issues for the company.

The Nasdaq will typically give the deficient company an opportunity to present a proposal for regaining compliance that sets forth a definite plan along with the time frame necessary for completion. If the presented plan is deemed insufficient by the Nasdaq staff, the delisting process ill continue. A staff recommendation to delist, however, is appealable to a Listing Qualifications Panel, and any delisting action will normally be stayed during the pendency of the appeal.

CONCLUSION

Issuers listed on Nasdaq should create a checklist of maintenance criteria to be used in conjunction with significant corporate transactions, recapitalizations and the review of any financial statements filed with SEC. This checklist will be an invaluable aid in identifying and dealing with potential listing problems early in the process, when a delisting proceeding can be avoided.

If you would like a copy of the relevant Nasdaq rules or have any questions, please call Bob Hoyt (202) 663-6193 or Lyle Roberts (202) 663-6877.

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