Nasdaq Delisting: Process, Implications and Strategies

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Nasdaq delistings have soared as a result of the precipitous decline in technology and Internet stocks over the past year. The Nasdaq composite index has tumbled by two-thirds from its record high in March 2000, and many tech stocks no longer comply with the requirements for continued Nasdaq listing.

In addition to the Nasdaq National Market ("NNM"), where most companies are listed following their IPOs, Nasdaq also operates the Nasdaq SmallCap Market ("SmallCap") and the over-the-counter electronic bulletin board ("OTCBB"). Issuers must meet various requirements for initial and continued listing on the NNM or SmallCap. The stock of any company in compliance with its SEC reporting obligations can be traded on the OTCBB, but only market makers (and not issuers) can apply to quote securities on the OTCBB. There are approximately 3,700 stocks traded on the NNM, 850 stocks traded on the SmallCap and 3,800 stocks traded on the OTCBB. Stocks may also trade on the Pink Sheets, a largely unregulated electronic market that is not operated by Nasdaq.

Nasdaq's requirements for initial and continued listing on the NNM and SmallCap are shown here. Companies can be delisted for various reasons, including for violations of Nasdaq's corporate governance rules. With the market decline over the past year, delistings based on the failure to meet the minimum bid price, market capitalization or public float tests have substantially increased.

In 2000, Nasdaq delisted 128 companies from the NNM and 112 companies from the SmallCap for failing to meet the applicable maintenance standards. Through March 31 of this year, 43 companies have been delisted from the NNM and 52 from the SmallCap, and scores of additional delisting proceedings are under way. This year's casualties include more than a dozen tech companies that went public in 1999 and 2000. Delisted companies can reapply if they subsequently meet Nasdaq's initial listing standards, but these standards are more rigorous than the maintenance standards for continued listing

Delisting Process

The Nasdaq delisting process generally proceeds as follows:

Deficiency Notice. If a company does not meet the minimum bid price or market value of public float requirements for 30 consecutive trading days, Nasdaq sends a "deficiency notice" identifying the listing deficiency and informing the company that it will be delisted after 90 calendar days unless it meets the required minimum bid price or market value of public float for at least 10 consecutive trading days during the 90-day cure period. If the deficiency is based on insufficient market capitalization, the company is notified after 10 consecutive trading days and must achieve compliance for 10 consecutive trading days within 30 calendar days. Nasdaq employs an automated computer system to track compliance by each listed company with these requirements. If the deficiency is based on insufficient net tangible assets, total assets, total revenue or pretax income, the notice is usually triggered by public filing of an SEC report (typically a Form 10-K or 10-Q) disclosing the deficiency.

Determination Letter. If the company is not in compliance within the time period prescribed in the deficiency notice, Nasdaq sends a "determination letter" informing the company that Nasdaq has determined that the company does not meet the standards for continued listing. The company then has seven days to appeal the determination. Under Nasdaq rules, the company must publicly announce within seven calendar days that it has received a determination letter and the basis for the delisting.

Appeal to Nasdaq Panel. The company's appeal may be made through a written submission to, or at a hearing before, a Nasdaq listing qualifications panel of two or three persons selected by Nasdaq. The panelists are independent representatives of the business community and cannot be employees of the National Association of Securities Dealers, Inc., the organization which operates Nasdaq. If a hearing is requested, it is generally held within four to six weeks. The company must pay a fee of $2,300 for a hearing and $1,400 for a written appeal.

Plan of Compliance. In the appeal, company representatives present a "plan of compliance" ¾ the company's plan to achieve and sustain compliance with the Nasdaq maintenance standards. Without a credible plan, delisting is usually swift and certain. The mere assertion that the company believes its stock will trade above the minimum price is insufficient.

Decision. The Nasdaq panel renders its decision, typically within two to four weeks after the written submission or hearing. If the decision is to delist, the delisting becomes effective at the close of trading on the day the company is informed of the decision.

Further Appeals. The company may appeal the Nasdaq panel's delisting decision to the Nasdaq Listing and Hearing Review Council within 15days, and the Review Council may on its own motion elect to review any decision within 45 days. The NASD Board of Governors may, in its discretion, review any decision by the Review Council. Aggrieved issuers may also appeal any Nasdaq decision to the SEC or federal court. Appeals beyond the Nasdaq panel do not stay delisting and are rarely pursued.

Delisting Implications

Delisting has a number of negative implications, depending on whether the company is delisted to the SmallCap or OTCBB as well as company-specific factors:

Covenants. Delisting may violate covenants contained in the company's equity or debt agreements, such as registration rights agreements, stock purchase agreements, preferred stock terms, warrant agreements, indentures or bank agreements.

Blue Sky Laws. A company trading on the SmallCap or OTCBB cannot avail itself of federal preemption of state securities laws, also called "blue sky" laws, and the company's securities must either be registered or exempt in each applicable state. Although there are a number of available exemptions, they vary from state to state. As a result, the Blue Sky laws of each state need to be examined with respect to continued trading in the delisted company's outstanding securities and for each proposed issuance of securities, including pursuant to employee option plans, stock purchase plans and private or public offerings of securities.

Form S-3 Eligibility. There is no impact on a company's eligibility to use FormS-3 if it is delisted to the SmallCap so long as it continues to meet the Form S-3 eligibility rules for the particular type of transaction proposed. For example, one requirement for primary offerings on

Form S-3 is that the issuer's public float must exceed $75 million. However, a company transferred to the OTCBB loses S-3 eligibility for all purposes if its public float does not exceed $75 million. Loss of S-3 eligibility is significant because it results in the inability to automatically incorporate information contained in subsequent SEC filings into registration statements, thereby increasing the burden of keeping registration statements current.

Penny Stock Rules. A company trading on the SmallCap is not subject to the SEC's penny stock rules. However, if listing is transferred to the OTCBB the company becomes subject to the penny stock rules unless its average annual revenue in the preceding three years exceeds $6 million. If applicable, the penny stock rules impose additional disclosure and sales practice requirements on broker-dealers who sell such securities to persons other than established customers and "accredited investors".

Rule 144 Sales. A listing transfer to the SmallCap does not affect the operation of Rule 144. However, the market-based volume limitation set forth in Rule 144(e) is not available for securities quoted only over the OTCBB. Delisting to either the SmallCap or OTCBB does not affect the availability of Rule 144(k), which greatly facilitates the ability of non-affiliates of a company to publicly resell stock that they acquired in a private placement and have held for at least two years.

Margin Loans. If a company is delisted to either the SmallCap or OTCBB, its common stock is no longer eligible for margin loans.

Liquidity. As a result of the loss of market efficiencies associated with the NNM and the loss of federal preemption of state securities laws, delisting from the NNM to the SmallCap generally reduces liquidity in the stock. The market liquidity is further reduced if the stock is transferred to the OTCBB.

Nasdaq Corporate Governance Requirements. A company delisted to the SmallCap must still comply with Nasdaq's corporate governance requirements, including Nasdaq's stockholder approval and audit committee requirements. A company transferred to the OTCBB need no longer comply with Nasdaq's corporate governance requirements.

Other Factors. Delisting from the NNM ¾ especially to the OTCBB ¾ can result in a loss of confidence by suppliers, customers and employees, the loss of analyst coverage and institutional investor interest, fewer business development opportunities and greater difficulty in obtaining financing.

Strategies to Avoid Delisting

Many companies accept delisting ¾ especially if there is fundamentally nothing the company can do to prevent it. Others choose to fight delisting, employing different strategies depending on the nature of the non-compliance.

If delisting is initiated because of a low stock price, a reverse stock split or stock repurchase program can increase the stock price. A stock repurchase can usually be implemented more quickly because it does not require stockholder approval, but it consumes cash. Neither technique is certain to provide a long-term fix, since stock prices often drift back downward after a reverse split or buyback.

If delisting is predicated on an inadequate market cap or public float, a reverse stock split or stock repurchase will not help, and can even hurt if it reduces the number of shares held by non-affiliates below the required minimum.

Another possible response to a low stock price is to cut expenses, pursue new strategic relationships or major contracts or otherwise improve the business, hoping that improved profitability will increase the market price. In reality, this is easier said than done and usually cannot be accomplished in time to stave off delisting.

Conclusion

The recent surge in Nasdaq delistings is a predictable consequence of the tech market deterioration over the past year. Delisted issuers can take solace from the fact that they have a lot of company these days.

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NASDAQ LISTING REQUIREMENTS

Nasdaq National Market Requirements

A company must meet one of three standards for initial listing and one of two standards for continued listing:

	Initial Listing			Continued Listing	
Requirements	**Standard 1**	**Standard 2**	**Standard 3**	**Standard 1**	**Standard 2**
Net Tangible Assets	$6 million	$18 million	N/A	$4 million	N/A
Market Capitalization Total Assets Total Revenue	N/A	N/A	$75 million or $75 million and $75 million	N/A	$50 million or $50 million and $50 million
Pretax Income (in latest fiscal year or 2 of last 3 fiscal years)	$1 million	N/A	N/A	N/A	N/A
Public Float (shares)	1.1 million	1.1 million	1.1 million	750,000	1.1 million

Operating History	N/A	2 years	N/A	N/A	N/A
Market Value of Public Float	$8 million	$18 million	$20 million	$5 million	$15 million
Minimum Bid Price	$5.00	$5.00	$5.00	$1.00	$5.00
Round Lot Shareholders	400	400	400	400	400
Market Makers	3	3	4	2	4
Corporate Governance	Yes	Yes	Yes	Yes	Yes

Nasdaq SmallCap Market Requirements

Requirements	Initial Listing	Continued Listing
Net Tangible	$4 million	$2 million

Assets[1] Market Capitalization Net Income (most recently completed fiscal year or 2 of the last 3 years)	or $50 million or $750,000	or $35 million or $500,000
Public Float (shares)[3]	1 million	500,000
Market Value of Public Float	$5 million	$1 million
Minimum Bid Price	$4.00	$1.00
Round Lot Shareholders[4]	300	300
Operating History Market Capitalization	1 year or $50 million	N/A
	3	2

Market Makers 5		
Corporate Governance	Yes	Yes

1 Net Tangible Assets equals Total Assets minus Total Liabilities minus Goodwill minus Redeemable Securities.

2 For initial listing under Standard 3, or continued listing under Standard 2, a company must satisfy either (a) the market capitalization requirement or (b) the total assets and total revenue requirement.

3 Public Float is defined as total shares outstanding less any shares held by officers, directors or beneficial owners of 10% or more.

4 Round lot holders are holders of 100 shares or more.

5 An Electronic Communication Network is not considered an active market maker.

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