

any special requirements.¹² If the issuer still fails the bid price test at the end of the 180 days, it could be granted an additional 180-day grace period if it meets one of the quantitative initial listing standards (rather than the lesser maintenance standards) of the National Market.¹³ If an issuer were still deficient at the end of the second 180-day grace period (or does not qualify for the second 180-day grace period), Nasdaq could delist the security, subject to the procedural requirements of the NASD Rule 4800 Series. Thus, Nasdaq's maintenance listing standards currently allow a National Market issuer a theoretical maximum of approximately 1.0 years of non-compliance with the bid price test before facing delisting. A National Market security that meets the maintenance listing standards for the SmallCap Market could "phase down" to the SmallCap Market to take advantage of the additional grace period offered there.¹⁴

The second 180-day grace period and the additional 90-day grace period on the SmallCap Market were established by pilot rules adopted by Nasdaq in February 2002 and modified in March 2003.¹⁵ Also as part of the pilot program, Nasdaq extended the first grace period on the National Market from 90 days to 180 days and established the second 180-day grace period.¹⁶ This pilot program expires on December 31, 2004.

Nasdaq has committed to study the effect of these changes to the maintenance listing standards during the pilot period.¹⁷

Nasdaq is now proposing to amend the pilot program by further extending the bid price grace periods. For the National Market, Nasdaq would provide an issuer with a third 180-calendar-day grace period if, at the end of the second 180-day period, the issuer meets all of the initial listing standards of the National Market (except for the bid price test).¹⁸ Thus, a National Market

issuer could fail the bid price test for a theoretical maximum of approximately 1.5 years before being delisted. For the SmallCap Market, Nasdaq would replace the current 90-day grace period (which comes after the two 180-day grace periods), with a grace period that would last up to the issuer's next shareholder meeting,¹⁹ provided four conditions are met: (1) The issuer meets all of the initial listing standards for the SmallCap Market (other than the bid price test); (2) the shareholder meeting is scheduled to occur no later than two years from the original notification of the bid price deficiency; (3) the issuer obtains shareholder approval at the meeting to carry out the reverse stock split; and (4) the issuer executes the reverse stock split promptly after the shareholder meeting. If the issuer fails to timely propose, obtain approval for, or promptly execute the reverse stock split, Nasdaq would immediately institute delisting proceedings. Thus, Nasdaq's proposal would allow SmallCap issuers to fail the bid price test for a theoretical maximum of 2.0 years before being delisted.²⁰

In addition, Nasdaq is proposing to amend the second of the two 180-day grace periods in the SmallCap Market by requiring that an issuer, at the end of the first 180-day period, meet all of the initial listing requirements to the

automatic; the second 180-day grace period would be available only if the issuer meets one (as opposed to all) of the quantitative initial listing requirements for the National Market.

¹⁹ As originally proposed, the second year of the grace period would have lasted until the next annual shareholder meeting of the issuer. In Amendment No. 3, Nasdaq deleted the word "annual" and clarified that the shareholder meeting at which the reverse stock split is approved could be a special meeting rather than a regular annual meeting.

²⁰ In most cases, a SmallCap issuer would have a grace period of less than the two full years that is theoretically available. This can be demonstrated with the following example. Assume a SmallCap issuer receives an initial notice of bid price deficiency from Nasdaq on October 16, 2004. The issuer uses the first and the second 180-day grace periods, so the date is now October 11, 2005 (*i.e.*, 360 days after October 16, 2004). Assume further that the issuer's annual shareholder meeting is scheduled to occur on November 16, 2005. Although there is a theoretical maximum grace period of two years, the grace period in this case would extend only to November 16, 2005—a total of one year and one month. Now assume instead that the issuer holds its next annual shareholder meeting on October 10, 2006. The third grace period, therefore, could last until this annual meeting, if there is no intervening shareholder meeting. However, if there is a special shareholder meeting before October 10, 2006, authorization for the reverse stock split *must* be obtained at that meeting, because the pilot rule provides that the third grace period for the SmallCap Market extends only until the *next* shareholder meeting in the two-year window, not a shareholder meeting of the issuer's choosing. See e-mail from Sara Bloom, Nasdaq, to Michael Gaw, Division of Market Regulation, Commission, dated December 9, 2003.

SmallCap Market before entering the second grace period. Currently, the issuer need meet only one of the quantitative initial listing requirements of the SmallCap Market to receive the second grace period. The first 180-day grace period would continue to be available without any stipulations.

Special provisions would apply during the transition period between the old and new rules. An issuer currently in the delisting process for bid price deficiency could avail itself of any grace period to which it would have been entitled had the new pilot rules been in effect when the issuer received the original notification of the deficiency.²¹ Furthermore, upon Commission approval of the new pilot rules, an issuer that is currently using a grace period offered by the old rules could remain listed for the duration of the period even though such period would be eliminated under the new rules. For example, a SmallCap issuer currently in the final 90-day grace period under the old rules would be permitted to maintain its listing on the SmallCap Market at least until the end of this period. At the end of the 90 days, the issuer could avail itself of the new rules and remain listed up to its next shareholder meeting, provided that it meets all of the initial listing criteria of the SmallCap Market (except the bid price test) and commits to seek shareholder approval for a reverse stock split, receives such approval, and promptly thereafter carries out the reverse stock split. However, in no event would a SmallCap issuer be afforded a cumulative grace period longer than two years from the date of the notification of the original bid price deficiency, absent "extraordinary circumstances."²²

This proposal would not change the termination date of the pilot program. The pilot program will expire on December 31, 2004.

Finally, Nasdaq is proposing to amend NASD Rule 4820(a) to reference

¹² See NASD Rule 4450(e)(2).

¹³ See *id.* (requiring issuer to meet the criteria for initial listing set forth in NASD Rules 4420(a)(1) and (5), Rule 4420(b)(1), or 4420(c)(6)).

¹⁴ See NASD Rule 4450(i).

¹⁵ See Securities Exchange Act Release No. 45387 (February 4, 2002), 67 FR 6306 (February 11, 2002) (SR-NASD-2002-13); Securities Exchange Act Release No. 47482 (March 11, 2003), 68 FR 12729 (March 17, 2003) (SR-NASD-2003-34).

¹⁶ See *id.*

¹⁷ See letter from Sara Nelson Bloom, Nasdaq, to Katherine A. England, Division of Market Regulation, Commission, dated January 31, 2002; letter from Florence Harmon, Division of Market Regulation, Commission, to Sara Nelson Bloom, Nasdaq, dated April 4, 2003.

¹⁸ Under the proposal, the conditions relating to the first two 180-day grace periods would remain unchanged. The first 180-day grace period would be

²¹ Nasdaq has stated that, during the pendency of this rule proposal, panels convened pursuant to the NASD Rule 4800 Series to consider delistings have been granting exemptions from the bid price rules consistent with the new pilot grace periods.

²² Existing NASD Rule 4810(b) provides that Nasdaq may grant exceptions to its listing rules. In Amendment No. 3, Nasdaq clarified that it would be unwilling to exercise this discretion to allow a SmallCap issuer to maintain its listing beyond two years from the date of the notification of the original bid price deficiency, absent "extraordinary circumstances." Nasdaq stated that adverse financial developments affecting the issuer would not support a finding of "extraordinary circumstances." Rather, the term "extraordinary circumstances" is intended to refer to a *force majeure* event that, in the opinion of Nasdaq, makes it impossible for the issuer to effect the actions necessary to achieve compliance within the specified compliance period.