



# Stock Exchange Deficiency Notices and Reverse Stock Split Considerations

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With unprecedented market volatility tied to the global coronavirus outbreak and crude oil price drops, many publicly traded companies have experienced considerable declines in their share prices. Depending on the extent and duration of the decline, some public companies may soon receive a notice regarding non-compliance with stock exchange minimum listing standards – namely, that their share price has fallen below the \$1.00 per share minimum closing price threshold for more than 30 consecutive trading days.

In this post, we will discuss the mechanics of stock exchange notices of non-compliance and take a closer look at a popular cure to lift per-share prices – a reverse stock split.

## Failure to Comply with Minimum Listing Standards

The NYSE and NASDAQ require listed companies to maintain a minimum price of \$1.00. For NYSE-listed companies, the minimum price is based on the average closing price over a consecutive 30-trading-day period. Companies listed on NASDAQ must maintain at least a \$1.00 minimum closing bid price for 30 consecutive trading days. In the event a listed company falls below this threshold, the applicable exchanges automatically will send non-compliance notices. Unless otherwise stated, references to NASDAQ refer to the NASDAQ Global Select Market.

### **NYSE-Listed Companies**

Upon receipt of a non-compliance notice, an NYSE-listed company has six months to bring its share price and average closing price above \$1.00. NYSE companies must notify the exchange within 10 business days of receipt of the notification of its intent to cure the deficiency. NYSE rules also require a listed company to issue a press release disclosing the fact that it has fallen below NYSE continued listing standards within four business days after notification. A company can regain compliance at any time during the six-month cure period if, on the last trading day of any calendar month during the cure period, the company has both a closing share price of at least \$1.00 and an average closing share price of at least \$1.00 over the 30-trading-day period ending on the last trading day of the month.

### **NASDAQ-Listed Companies**

Upon receipt of a non-compliance notice, a NASDAQ-listed company has 180 calendar days to regain compliance

with the \$1.00 minimum bid price requirement. In order to regain compliance, a security must have a closing bid price of \$1.00 or more for 10 consecutive business days. In certain circumstances, the applicable NASDAQ exchange may require the closing bid price to exceed the minimum requirement for more than 10 consecutive business days before determining that a company has regained compliance. If a company is unable to resolve its bid price deficiency during the applicable compliance period, the exchange will issue a delisting letter. A company listed on the NASDAQ Global Select Market or Global Market may transfer to the NASDAQ Capital Market to take advantage of additional compliance periods.

### SEC Requirements

Upon receipt of a notice of non-compliance from any national securities exchange, public companies are required under SEC rules to file a Form 8-K under Item 3.01 disclosing (i) the date that the company received the notice, (ii) the rule or standard for continued listing that the company failed to satisfy, and (iii) any action or response that, at the time of filing, the company has determined to take in response to the notice. The filing of the Form 8-K is required even if the company intends to take advantage of any grace periods to cure the deficiency.

## Reverse Stock Splits as a Cure

Many companies look to reverse stock splits as a means to increase share prices and cure minimum share price listing deficiencies. In a reverse stock split, the outstanding common shares are reduced by a factor that affects all stockholders uniformly. The market capitalization of the company remains unchanged. As an example, if a company with 1,000 common shares outstanding, each worth \$1.00, effects a 1-for-10 reverse stock split, the company would then have 100 shares outstanding with a value of \$10 per share.

Below is summary of key issues when considering a reverse stock split.

- **Reverse Stock Split Ratio.** The company must carefully consider what ratio to apply to its reverse stock split, including reviewing applicable state law. Consideration should also be given to exchange listing standards. For example, the NYSE requires at least (a) 400 holders, (b) 1,200 holders and an average monthly trading volume of at least 100,000 shares for the most recent 12-month period, or (c) 600,000 shares held publicly. Nasdaq requires at least (a) two registered and active market makers, (b) 400 public holders for Global Select Market and Global Market companies (300 non-affiliate holders for Capital Market companies), and (c) 500,000 publicly held shares. Companies should confirm that the number of shares outstanding post-split meet applicable exchange standards.
- **Fractional Shares.** Applying the reverse split ratio will result in fractional shares. State law may dictate how fractional shares are treated. In Delaware, a company may issue fractional shares or (a) pay fair value of the fractional shares in cash, (b) aggregate the fractional shares and arrange for their sale on behalf of the affected stockholders, or (c) issue scrip to the affected stockholders, which can be traded in for a full share by a stockholder once it has aggregated enough to equal one full share.
- **Charter Amendment and Approvals.** Many states, including Delaware, require an amendment to the certificate of incorporation to effect a reverse stock split. Delaware corporations must amend their organizational documents to reflect a stock split, which requires both board and stockholder approval at the company's annual meeting, a special meeting called for such purpose or by written consent if provided for in the company's organizational documents. Additional approvals may be required by stockholders' agreements, credit agreements, or similar agreements. Board resolutions should set forth a description of the reverse stock split, any reductions to the company's authorized capital, and a description of how fractional shares will be treated. Companies should also determine whether to reduce the number of authorized shares or the par value of their stock to reflect the reverse stock split.
- **SEC Requirements.** Companies undergoing reverse stock splits that require stockholder approval will need to prepare and file a preliminary proxy statement with the SEC at least ten calendar days before mailing proxy materials to stockholders. Proxy statements seeking approval of reverse stock splits typically discuss the reasons and background for the reverse stock split, risk factors, accounting treatment, mechanics and procedures for conducting the reverse stock split, tax impact, and other matters.

- **Exchange Requirements.** The NYSE and NASDAQ have additional procedural requirements in connection with reverse stock splits. A brief outline of these requirements is set forth below.
  - NASDAQ-listed companies must (a) prepare and file a Company Event Notification Form for any class of capital stock impacted by the reverse stock split at least 15 calendar days before the effective date of the reverse stock split along with a filing fee, (b) submit a Shares Outstanding Change Form no later than ten calendar days after the effective date of the stock split (if the event causes a decrease of any class of shares by 5% or more), and (c) notify the exchange at least ten minutes prior to any public announcement of the transaction.
  - NYSE-listed companies are required to (a) immediately notify the exchange regarding the calling of a stockholders' meeting and provide the meeting date, record date and the matters to be voted on at least 10 days prior to the record date, (b) provide written notice of at least 20 days prior to the effective date of the reverse stock split, (c) prepare and file a supplemental listing application for each class of stock affected by the reverse stock split at least two weeks before the effective date of the stock split, and (d) notify the exchange at least ten minutes prior to releasing any public information regarding the stock split. With respect to stockholder approval of a charter amendment, such approval must be obtained by no later than a company's next annual meeting and the action must be implemented promptly thereafter.

As market volatility continues to apply downward pressure on stock prices, many issuers will look to reverse stock splits to maintain exchange listing compliance. As outlined above, the process involves analysis and procedural complexities. Companies considering implementing a reverse stock split should consult with their legal, tax, and financial advisors.

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