Cooley

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Please see the Cooley Alert dated October 8, 2010 for an important update to this Alert

In connection with a number of recent securities offerings by Nasdaq-listed companies, Cooley has observed increased scrutiny by Nasdaq in its assessment of whether the offerings qualify as "public offerings" for Nasdaq purposes. In particular, Nasdaq has recently increased its focus on the details surrounding marketing efforts and the ultimate allocation of securities to investors. This is due in large part to the complexity of and speed at which many securities offerings are taking place today. The determination of whether an offering qualifies as a "public offering" for Nasdaq purposes is of critical importance to Nasdaq-listed companies seeking to engage in a registered securities offering (or a series of offerings) in which 20% or more of an issuer's outstanding stock will or may be issued and/or in which there is insider participation. Failing to satisfy Nasdaq's rules in this area could result in public reprimand and potentially de-listing.

Background

Nasdaq stockholder approval requirements

Nasdaq Listing Rule 5635(d) requires that an issuer obtain prior stockholder approval "in connection with a transaction other than a public offering" involving "the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable [for] common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock." This is commonly referred to as the "20% Rule."

In addition, Nasdaq considers a sale of securities to insiders (which includes officers, directors, employees or consultants, and entities affiliated with each of these persons) in a private placement that is priced at a discount to market value to be a form of "equity compensation" that requires stockholder approval under Nasdaq Listing Rule 5635(c). Accordingly, if insiders are expected to purchase securities in an offering, it can be important that the offering be considered a "public offering" for purposes of Nasdaq's rules.

Formal guidance regarding the "public offering" determination

To date, the most authoritative publicly available guidance from Nasdaq regarding the factors that it considers in determining whether an equity offering qualifies as a "public offering" is IM-5635-3 and Staff Interpretative Letter 2009-13.

View the Nasdaq Listing Rules 5635(c) and (d) and IM-5635-3 in their entirety.

View the Staff Interpretative Letter 2009-13 in its entirety.

Contrary to what some believe (and contrary to a statement in IM-5635-3), Nasdaq has made it clear that, for purposes of the 20% Rule and other Nasdaq rules, an offering is not a "public offering" merely because it is conducted under a registration statement that has been declared effective by the U.S. Securities and Exchange Commission and is a firm commitment underwritten offering.

Recent experience and informal guidance

A Nasdaq-listed issuer engaging in certain registered securities offerings, including offerings in which an issuer is issuing common stock in a transaction that may result in the potential issuance of common stock greater than 10% of either the total shares outstanding or the voting power outstanding on a pre-transaction basis, is required to submit a Listing of Additional Shares notification form to Nasdaq pursuant to Nasdaq Listing Rule 5250(e)(2). In connection with Nasdaq's review of these notification forms, Cooley has had numerous in-depth discussions with Nasdaq in applying the general concepts set forth in Nasdaq's "public offering" interpretive materials referenced above to particular transactions and facts.

The following is a brief summary of our current understanding of the key factors that Nasdaq considers in its "public offering" analysis based on those discussions:

Firm commitment underwriting. When considering whether transactions qualify as "public offerings," Nasdaq views offerings that are underwritten on a firm commitment basis more favorably. Nonetheless, offerings underwritten on a best efforts basis can qualify as "public offerings," but they will likely elicit more fact-specific inquiries from Nasdaq. We understand that an offering that is structured as a "registered direct" offering to investors would not be considered a "public offering."

Marketing to retail investors. Nasdaq has informed us that, for equity offerings, the offering must be actively marketed to retail investors to constitute a "public offering." As a result, it is not sufficient from Nasdaq's perspective that an issuer and its underwriter(s) simply remain open to inbound indications of interest from retail investors. Moreover, this requirement applies regardless of the nature of the issuer and regardless of whether retail investor participation will have a material impact on the pricing of the offering. Nasdaq has informed us that in contrast to this approach with respect to equity offerings, Nasdaq currently does not require retail marketing in connection with registered debt offerings for such offerings to be considered "public offerings" in light of the different investor base that typically participates in debt offerings.

Broad marketing. It is important for the underwriter(s) in an offering to reach out broadly in the marketing portion of the offering (to both institutional and retail accounts in the case of equity offerings, as noted above), including through the issuance of a press release announcing the offering. Nasdaq has not provided a bright line safe harbor for the number of investors included in the marketing effort that would support a determination that the offering constitutes a "public offering." As a general matter, the more investors to whom the underwriters actively market the securities, the more likely it is that Nasdaq would consider the offering to be a "public offering."

Allocation to institutional investors. Nasdaq has not provided a bright line safe harbor for the number of institutional investors that ultimately purchase securities in an offering that would support a determination that the offering constitutes a "public offering." However, we note that in Staff Interpretative Letter 2009-13, the inclusion of 15 to 30+ institutional investors was considered to be sufficient. Nasdaq has informally indicated to us that any offering that includes only a single digit number of investors will likely be evaluated with a higher degree of scrutiny. As with the marketing efforts, the more investors to whom the underwriters allocate securities, the more likely it is that Nasdaq would consider the offering to be a "public offering."

Allocation to retail investors. Nasdaq has also not provided a bright line safe harbor for the number of retail investors who ultimately purchase securities in an offering that would support a determination that the offering constitutes a "public offering." Nasdaq has informally indicated to us that the 300 to 500 retail investors reflected in Staff Interpretative Letter 2009-13 is significantly greater than the number needed from Nasdaq's perspective. Based on our discussions with Nasdaq, subject to compliance with the other factors of the "public offering" analysis, we believe that it would be possible for an offering to constitute a "public offering" without ultimate allocation to retail investors if the offering was actively marketed to retail investors with an expectation at the time of marketing that the offering would include retail participation, but there nonetheless existed facts and circumstances that created a reasonable basis to determine that retail allocation was not appropriate for a particular offering (i.e., after active retail marketing, there was no significant retail investor demand at the public offering price). However, as a general matter, the more retail investors to whom the underwriters allocate securities, the more likely it is that Nasdaq would consider the offering to be a "public offering."

Insider participation. Nasdaq has informed us that participation by insiders as purchasers in an offering is a negative (though not necessarily dispositive) factor in determining whether an offering is a "public offering."

Discount to the market price. As a general matter, from Nasdaq's perspective, the discount to the market price in a "public offering" should be in a range consistent with that of underwritten offerings by comparable companies. A discount that exceeds the level of discount that would be typical for comparable companies in comparable transactions would be a negative factor in Nasdaq's "public offering" analysis.

Issuer control. We understand that Nasdaq generally views issuer (as compared to underwriter) control over marketing efforts and the ultimate allocation of securities as a negative (though not necessarily dispositive) factor in its "public offering" analysis.

"Alternative" structures. While the determination as to whether even a traditional follow-on public offering is a "public offering" under the Nasdaq rules presents challenges, there are additional complexities in determining whether transactions structured to include confidential "wall cross" or other confidential marketing processes, structured as "bought deals," or structured in connection with "share lending arrangements" to help create "borrow" for certain issuers of convertible notes, would be considered "public offerings" from Nasdaq's perspective. We understand, based on our conversations with Nasdaq and Staff Interpretive Letter 2009-13, that it is possible to implement many of the "alternative" structures in a manner that would support a determination that an offering constitutes a "public offering." The assessment of these transactions is fact-specific and will depend on an analysis of the other factors discussed in this *Alert* as applied in the applicable structure.

The summary above reflects our current understanding of a complicated, nuanced and evolving area of practice based on our numerous discussions with Nasdaq and broad experience on specific transactions. Moreover, it is important to note that the analysis is very fact intensive. On any particular deal, Nasdaq may ascribe greater or lesser weight to certain of the factors summarized above based on the applicable facts and circumstances. Therefore, it is important to carefully work through these issues with your deal advisors before engaging in an offering that needs to qualify as a "public offering" for Nasdaq purposes, and it is also often prudent to discuss these issues with Nasdaq in advance, particularly if you determine that you may not be able to optimally satisfy some of the factors summarized above.

We intend to issue additional *Cooley Alerts* if there are further material developments in this area, including any additional interpretive guidance published by Nasdaq on this topic. In the meantime, if you would like to discuss these matters further, please feel free to call the Cooley partners identified in this *Cooley Alert* or others at Cooley with whom you work.

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