

The NASDAQ Stock Market

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1. Introduction

With approximately 3,200 companies, The NASDAQ Stock Market, Inc is the largest electronic stock market in the United States, listing more companies and, on average, trading more shares per day than any other US market.¹ The companies that list on NASDAQ operate in diverse industries. As of December 31 2005, the percentage of NASDAQ-listed US companies by industry was as follows:²

| Industry | Percentage |
|----------------------------|------------|
| Information technology | 25% |
| Financial services | 24% |
| Healthcare | 18% |
| Consumer discretionary | 13% |
| Industrials | 10% |
| Consumer staples | 3% |
| Energy | 2% |
| Materials | 2% |
| Telecommunication services | 2% |
| Utilities | 1% |

¹ www.NASDAQ.com/about/overview.stm.

² The NASDAQ Stock Market, Inc, Form 10-K, filed March 15 2006, page 9 of 150, available at www.sec.gov/Archives/edgar/data/1120193/000119312506054916/d10k.htm.

NASDAQ is a dealers' market, meaning brokers buy and sell stocks through market makers³ rather than from each other. NASDAQ is a publicly owned company and trades its shares on its own exchange under the ticker symbol NDAQ.

NASDAQ is an electronic exchange with no physical trading floor. As such, NASDAQ makes all its trades through a computer and telecommunications system. Since there is no trading floor where NASDAQ operates, the stock exchange built the NASDAQ MarketSite, a tower in New York's Times Square with a large outdoor electronic display offering current financial information 24 hours a day. NASDAQ MarketSite is a broadcast facility that provides a backdrop for initial public offering (IPO) ceremonies and for business reporters to conduct market reports on developments within the marketplace.

NASDAQ was developed in 1971 as the first electronic stock exchange in the world.⁴ It was created as a means to increase the trading of over-the-counter (OTC) stocks – that is, those stocks that were unable to meet the listing requirements for larger exchanges. On NASDAQ's first trading day, February 8 1971, 2,500 OTC stocks were traded.⁵

NASDAQ divided into two separate market tiers from 1982 to 1986, with larger companies trading on the NASDAQ National Market and smaller companies trading on the NASDAQ Small-Cap Market. In the 1990s NASDAQ began to be seen as a competitor of the New York Stock Exchange (NYSE), and in 1994 NASDAQ exceeded the NYSE in annual shares traded.⁶

2. Regulatory framework

US securities laws establish a two-tiered system for the regulation of securities markets, market participants and listed companies. The US Securities and Exchange Commission (SEC) occupies the first tier and has primary responsibility for enforcing federal securities laws. Self-regulatory organisations occupy the second tier. Self-regulatory organisations are non-governmental agencies registered with the SEC and are subject to the SEC's extensive regulation and oversight. The National Association of Securities Dealers, Inc (NASD) is the largest self-regulatory organisation in the United States, with a membership that includes virtually every broker-dealer that engages in the securities business within the United States.⁷ NASDAQ was founded as a wholly owned subsidiary of NASD, which itself is subject to the oversight of the SEC.⁸

Beginning in 2000, NASD restructured and broadened NASDAQ's ownership through a two-phase private placement of securities, which were offered to all NASD members, as well as issuers listed on NASDAQ and investment

3 A 'market maker' is a broker-dealer firm that accepts the risk of holding a particular number of shares of a particular security in order to facilitate trading in that security. Each market maker competes for customer order flow by displaying buy and sell quotations for a guaranteed number of shares. Once an order is received, the market maker immediately sells from its own inventory or seeks an offsetting order. This process takes place in mere seconds.

4 www.advfn.com/StockExchanges/history/NASDAQ/NASDAQ.html.

5 *Id.*

6 *Id.*

7 The NASDAQ Stock Market, Inc, Form 10-K, page 16 of 150.

8 *Id.*

companies.⁹ In connection with the restructuring, on November 9 2000 NASDAQ applied to the SEC for registration as a national securities exchange.¹⁰ On January 13 2006 the SEC approved NASDAQ's exchange application.¹¹ On August 1 2006, NASDAQ became operational as an exchange in NASDAQ-listed securities.¹²

Now that NASDAQ is operating as an exchange, NASDAQ is itself a self-regulatory organisation separate from NASD.¹³ As such, and pursuant to US securities laws, NASDAQ is now responsible for regulating its members through the adoption and enforcement of rules and regulations governing the business conduct of its members.¹⁴ As a self-regulatory organisation, NASDAQ now has its own rules pertaining to its members and listed companies regarding listing, membership and trading that are distinct and separate from those rules applicable to broker-dealers that are administered by NASD.¹⁵ Broker-dealers can now become members of NASDAQ, in addition to their memberships with other self-regulatory organisations, including NASD.¹⁶ However, NASD continues to provide regulatory services to NASDAQ under a regulatory services agreement, under which NASD:¹⁷

- reviews and approves new member applications;
- performs automated surveillance of trading on NASDAQ;
- reviews member firm compliance with the rules and regulations applicable to trading and market-making functions in NASDAQ;
- investigates suspicious activity in quoting and trading on NASDAQ;
- conducts examinations of member firms;
- initiates the disciplinary process once it is determined that a potential violation of a federal securities law or rule, or a self-regulatory organisation rule, may have occurred; and
- operates an arbitration programme and a mediation programme for the resolution of customer, member firm employee and NASDAQ member-to-member disputes.

3. Eligibility requirements

The minimum requirements for listing on NASDAQ are exactly that – *minimum* requirements. As such, all companies are subject to NASDAQ's discretionary authority, as set forth in NASDAQ's Marketplace Rule 4300¹⁸ (Listing Requirements for NASDAQ Securities), which states as follows:

NASDAQ is entrusted with the authority to preserve and strengthen the quality of and public confidence in its market. NASDAQ stands for integrity and ethical business practices

9 *Id* at 16-17.

10 *Id.*

11 *Id.*

12 www.complinet.com/file_store/pdf/rulebooks/NASDAQ_ra2006-001.pdf.

13 The NASDAQ Stock Exchange, Form 10-K, page 17 of 150.

14 *Id.*

15 *Id.*

16 *Id.*

17 *Id.*

18 NASDAQ's Marketplace Rules are cited throughout this chapter as 'Rule xxxx'. The Marketplace Rules can be found at www.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=13.

in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process. NASDAQ issuers, from new public companies to companies of international stature, are publicly recognized as sharing these important objectives.

NASDAQ, therefore, in addition to applying the enumerated criteria set forth in the Rule 4300 and 4400 Series, has broad discretionary authority over the initial and continued listing of securities in NASDAQ in order to maintain the quality of and public confidence in its market, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. NASDAQ may use such discretion to deny initial listing, apply additional or more stringent criteria for the initial or continued listing of particular securities, or suspend or delist particular securities based on any event, condition, or circumstance that exists or occurs that makes initial or continued listing of the securities on NASDAQ inadvisable or unwarranted in the opinion of NASDAQ, even though the securities meet all enumerated criteria for initial or continued listing on NASDAQ. In all circumstances where the Listing Department (as defined in Rule 4801) exercises its authority under Rule 4300, the Listing Department shall issue a Staff Determination under Rule 4804, and in all circumstances where an Adjudicatory Body (as defined in Rule 4801) exercises such authority, the use of the authority shall be described in the written decision of the Adjudicatory Body.

In order for a domestic or Canadian corporation to list on NASDAQ, such issuer must satisfy Rule 4310 (Listing Requirements for Domestic and Canadian Securities). Foreign incorporated companies may also list on NASDAQ and are governed by Rule 4320 (Listing Requirements for Non-Canadian Foreign Securities and American Depositary Receipts). In general, both domestic and foreign issuers can join the NASDAQ Capital Market, the NASDAQ Global Market or the NASDAQ Global Select Market. Domestic issuers that meet the requirements of Rule 4310, and foreign issuers that meet the requirements of Rule 4320 but that are not listed on the Global Market or Global Select Market (as described below), are listed on the Capital Market. The difference between the three markets lies in the listing standards required for each, with measures including market value, liquidity and earnings. For instance, the market value of publicly held shares required for listing is as follows:

- for listing on the Capital Market, \$5 million;
- for listing on the Global Market, \$5 million, \$8 million or \$20 million, depending on which alternative initial listing standard is employed; and
- for listing on the Global Select Market, \$70 million.

Pursuant to the NASDAQ Marketplace Rules, a security¹⁹ of a domestic or foreign issuer shall be considered for listing on NASDAQ provided that it meets and maintains certain requirements. First, the security must be registered pursuant to Section 12(b) of the US Securities Exchange Act of 1934, or subject to an exemption issued by the SEC that permits the listing of the security notwithstanding its failure to be registered

¹⁹ In the case of foreign issuers, an American depositary receipt (ADR) or similar security issued in respect of a security of a foreign issuer may be listed provided the requirements of Rule 4320 are met.

pursuant to Section 12(b).²⁰ An issuer must also submit to NASDAQ a listing application that provides the information required by Section 12(b) of the Exchange Act on the form designated by NASDAQ.²¹ Upon approval, NASDAQ shall certify to the SEC, pursuant to Section 12(d) of the Securities Exchange Act and the rules thereunder, that it has approved the security for listing and registration.²² Listing can commence only upon the effectiveness of the security's registration pursuant to Section 12(d).²³

In addition, for initial and continued listing on NASDAQ, issuers must meet minimum quantitative financial requirements. Also, Rule 4350 sets forth qualitative corporate governance standards that issuers must follow and maintain, and is discussed in further detail below. For both quantitative and qualitative standards, should an issuer fall below the minimum requirements after listing, NASDAQ permits grace periods during which issuers can achieve compliance.²⁴

3.1 Capital Market

For initial and continued listing on the Capital Market, the domestic or foreign issuer must meet the minimum financial requirements set out in the following table.

| Requirements | Initial listing | Continued listing |
|---|--|--|
| Stockholders' equity or Market value of listed securities ²⁵ or Net income from continuing operations (in the latest fiscal year or in two of the last three fiscal years) | \$5 million or \$50 million or \$750,000 | \$2.5 million or \$35 million or \$500,000 |
| Publicly held shares ²⁶ | 1 million | 500,000 |
| Market value of publicly held shares | \$5 million | \$1 million |

20 Rule 4310(a)(1) and (2); Rule 4320(a)(1) & (2).

21 Rule 4310(b); Rule 4320(b).

22 *Id.*

23 *Id.*

24 For instance, pursuant to Rule 4310(c)(8)(B), a failure to meet the continued listing requirement for market value of publicly held shares shall be determined to exist only if the deficiency continues for a period of 30 consecutive business days. Upon such failure, the issuer shall be notified promptly and shall have a period of 90 calendar days from such notification to achieve compliance. Compliance can be achieved by meeting the applicable standard for a minimum of 10 consecutive business days during the 90-day compliance period. See also Rule 4350(d)(4), providing a cure period if an issuer fails to comply with the audit committee composition requirement because an audit committee member ceases to be independent for reasons outside the member's reasonable control. The audit committee member may remain on the audit committee until the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement.

25 Under Rule 4200(a)(20), 'listed securities' are defined as "securities quoted on NASDAQ or listed on a national securities exchange".

26 'Publicly held shares' are defined as total shares outstanding, less any shares held by officers, directors or beneficial owners of 10% or more. In the case of ADRs, for initial inclusion only, at least 100,000 shall be issued.

| Requirements | Initial listing | Continued listing |
|--|----------------------------------|--------------------------|
| Bid price | \$4 | \$1 |
| Shareholders (round lot holders) ²⁷ | 300 | 300 |
| Market makers | 3 | 2 |
| Operating history or Market value of listed securities ²⁸ | 1 year or \$50 million | N/A |
| Corporate governance | Yes | Yes |

3.2 Global Market

For initial and continued listing on the Global Market, a company must comply with Rule 4420 and Rule 4450 respectively. Pursuant to these rules, an issuer is required to meet substantially the criteria set forth in one of three alternative entry standards and one of two alternative continued listing standards, summarised in the following table.

| Requirements | Initial listing | | Continued listing | | |
|---|------------------------|-------------------|---|-------------------|---|
| | Standard 1 | Standard 2 | Standard 3 | Standard 1 | Standard 2 |
| Stockholders' equity | \$15 million | \$30 million | N/A | \$10 million | N/A |
| Market value of listed securities or Total assets and total revenue | N/A | N/A | \$75 million or \$75 million and \$75 million | N/A | \$50 million or \$50 million and \$50 million |
| Income from continuing operations before income taxes (in latest fiscal year or in two of last three fiscal years) | \$1 million | N/A | N/A | N/A | N/A |

²⁷ Round lot holders are shareholders of 100 shares or more.

²⁸ The operating history/market value of listed securities requirement is not applicable to non-Canadian foreign securities.

| Requirements | Initial listing | | | Continued listing | |
|--------------------------------------|-----------------|--------------|--------------|-------------------|--------------|
| | Standard 1 | Standard 2 | Standard 3 | Standard 1 | Standard 2 |
| Publicly held shares | 1.1 million | 1.1 million | 1.1 million | 750,000 | 1.1 million |
| Market value of publicly held shares | \$8 million | \$18 million | \$20 million | \$5 million | \$15 million |
| Bid price | \$5 | \$5 | \$5 | \$1 | \$1 |
| Shareholders (round lot holders) | 400 | 400 | 400 | 400 | 400 |
| Market makers | 3 | 3 | 4 | 2 | 4 |
| Operating history | N/A | Two years | N/A | N/A | N/A |
| Corporate governance | Yes | Yes | Yes | Yes | Yes |

3.3 Global Select Market

Pursuant to Rule 4426, for initial listing on the Global Select Market, a company must meet the more rigorous quantitative eligibility requirements of one of the three alternative standards summarised in the following table.

| Requirements | Standard 1 | Standard 2 | Standard 3 |
|--|---|--|------------|
| Pre-tax earnings (income from continuing operations before income taxes) | Aggregate in prior three fiscal years \geq \$11 million and Each of the two most recent fiscal years \geq \$2.2 million and Each of the prior three fiscal years \geq \$0 | N/A | N/A |
| Cash flows | N/A | Aggregate in prior three fiscal years \geq | N/A |