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What The NYSE Proposed Delisting Rule Could Mean For Cos.

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On April 17, the New York Stock Exchange proposed a rule that would amend Section 802.01D of the NYSE Listed Company Manual.[1]

If adopted by the U.S. Securities and Exchange Commission, the rule would provide the NYSE with discretionary authority to commence immediate suspension and delisting proceedings for a listed company that has "changed its primary business focus to a new area of business that is substantially different from the business it was engaged in at the time of its original listing or which was immaterial to its operations at the time of its original listing."

The NYSE noted that it would commence delisting under such rule only after "a careful analysis of the company's suitability for continued listing, taking into account all relevant factors, including, but not limited to, changes in the management, board of directors, voting power, ownership, and financial structure of the company" that accompanied the change in primary business focus.

Such analysis will not involve applying quantitative standards for initial listing but instead will focus on the qualitative aspects of a company's suitability for listing, with an eye toward whether such company would have been accepted for listing if it had its new primary business focus at the time of its initial listing.

RATIONALE FOR THE PROPOSED RULE

The NYSE expressed concern that investors who acquired stock of a company, including in an initial public offering, or IPO, prior to its change in primary business focus may not have done so had they been aware that the company would change its primary business focus.

In addition, the NYSE stated that such a change may raise concerns about whether the company would have been suitable for listing had it been engaged in its new primary business focus at the time of its original listing application.

The NYSE also noted that, in some cases, there has been a significant decline in a company's stock price subsequent to its change in business focus, ultimately leading to investor losses and an inability to meet continued listing standards.

As an example, the NYSE cited the case of Bit Brother, a formerly Nasdaq-listed company that, in February 2021 under its then-name Urban Tea Inc., announced that it would be changing its primary business focus from selling specialty tea products to blockchain and cryptocurrency mining. This followed in the footsteps of Long Island Tea Corp., another Nasdaq-listed tea products company that rebranded as Long Blockchain Corp. in December 2017 in conjunction with its change in business focus to cryptocurrency mining.

Although not discussed by the NYSE in its rule proposal, Bit Brother's SEC filings in February and March 2021 disclosed multiple resignations and appointments of board members and executive officers in the weeks following the announcement of the pivot, most notably the resignation of its chairman and CEO on March 21, 2021, and the appointment of a new chairman and CEO the following day.

Such changes to the management and the board of directors in the immediate aftermath of its change in business focus presumably would have affected the qualitative assessment of Bit Brother's suitability for continued listing had it been subject to the NYSE's proposed rule at the time. Subsequently, in June 2021, the company announced in a press release that it had changed its name to Bit Brother Ltd., aligning its name with its new focus on blockchain and cryptocurrency mining.

Although not stated directly by the NYSE as a rationale, the proposed rule may be related to the NYSE's and Nasdaq's recent actions aimed at reducing financial losses suffered by brokers as a result of reverse stock splits by listed companies, including the NYSE's and Nasdaq's recent implementation of regulatory halt procedures in connection with reverse stock splits.

The NYSE's discussion of Bit Brother points out that Bit Brother underwent three reverse stock splits, including a 1,000-1 reverse stock split in January, which the NYSE characterized as "quite large," before being delisted from Nasdaq in February.

Additionally, the NYSE's discussion of Bit Brother in the rule proposal cites a February article in The Wall Street Journal, "As Trading Frenzies Grip Penny Stocks, Criticism of Nasdaq Grows," that described the significant financial losses experienced by brokers recently as a result of reverse stock splits, which have become increasingly common since early 2021 due to the dramatic increase in the number of listed companies, particularly Nasdaq-listed companies, trading below $1 per share.[2]

Since Nasdaq rules require companies to be delisted if their bid price falls below $1 per share for an extended period of time, many companies have conducted reverse stock splits, sometimes repeatedly as in the case of Bit Brother, to boost their share price and retain their listing.

Processing errors in the aftermath of such reverse stock splits have resulted in significant financial losses for brokers, with Robinhood Markets losing $57 million in the aftermath of just one such reverse stock split in December 2022, according to the WSJ article cited by the NYSE.

THE "SUBSTANTIALLY DIFFERENT" STANDARD

The proposed "substantially different" standard raises a number of concerns for NYSE-listed companies.

First, what constitutes a substantially different primary business focus may not be readily apparent in all cases, adding a layer of uncertainty for NYSE-listed companies contemplating a shift in business focus.

Second, since some public companies have experienced significant growth following substantial changes in their business focus subsequent to their IPO, to the extent that the proposed rule discourages all such pivots, including those that would turn out to be successful as well as those that would turn out to be unsuccessful, the proposed rule may not be consistent with the SEC's mission to facilitate capital formation.

Netflix and Amazon are two companies that have achieved extraordinary success after substantial changes in their business focus following their IPOs.

Netflix debuted on the Nasdaq National Market in May 2002 as a U.S.-only DVD-by-mail subscription service with an accumulated deficit of $141.8 million since its founding in 1997. Today, it is the leading digital streaming subscription service, with customers in over 190 countries, and a major film studio, with an annual net income of $5.4 billion in 2023, having shuttered its DVD-by-mail business in September 2023.

Similarly, Amazon was an unprofitable online bookstore at the time of its IPO in May 1997 before evolving into the multinational technology company with multiple lines of business that it is today. As of year-end 2023, 62% of Amazon's operating income was from its Amazon Web Services subsidiary, which provides cloud computing services — an industry that didn't even exist until several years after Amazon's 1997 IPO.

KEY TAKEAWAYS

If the proposed rule is adopted, the NYSE expects that it will "seldom" invoke its new discretionary authority, and we do not expect that the NYSE would have viewed the "pivots" by Bit Brother, Amazon and Netflix as equally deserving of heightened scrutiny had they each been subject to the proposed rule.

That said, if the NYSE undertakes a delisting action under the proposed rule, NYSE-listed companies should learn the specific facts involved to gain a better understanding of the "substantially different" standard.

Additionally, if the proposed rule is adopted, any NYSE-listed company considering a shift in business focus should be aware that it could trigger scrutiny and should consider how such a shift would be viewed by the NYSE if it decides to conduct a fresh qualitative assessment of the company's suitability for listing.

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[1] https://www.sec.gov/files/rules/sro/nyse/2024/34-99992.pdf.

[2] https://www.wsj.com/finance/stocks/as-trading-frenzies-grip-penny-stocks-criticism-of-nasdaq-grows-8bd4118b.

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