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MITCHELL SILBERBERG & KNUPP LLP
A LAW PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

February 15, 2016

Nasdaq Listing Qualifications
c/o Stan Higgins
805 King Farm Blv.
Rockville, MD 20850

Re: Re: NASDAQ Listing and Hearing Review Council Review of Shareholder Approval Rules

Dear Mr. Higgins:

We appreciate the opportunity to provide comments to the NASDAQ Listing and Hearing Review Council (the "Council") regarding potential revisions to NASDAQ Rule 5635 ("Rule 5635"), which requires listed companies to obtain shareholder approval in certain circumstances.

Given our firm's extensive representation of early stage listed companies backed by venture capital funds, which we refer to in this letter as venture stage companies, we will focus our comments on what we believe to be the disproportionate disadvantages faced by such companies as they relate to subsections (b) and (d) of Rule 5635. We believe that subsection (b), which requires shareholder approval if the issuance of securities will result in a change of control, and subsection (d), which requires shareholder approval for certain private placements at a price less than the greater of book or market value of the stock, create the most consistently adverse and unintended consequences for venture stage companies. In regards to subsection (b), NASDAQ presumes that a change of control would occur when, as a result of the issuance, an investor or group of investors would own or have the right to acquire 20% or more of the outstanding shares or voting power of the company and such ownership or voting power would be the largest position. In regards to subsection (d), Rule 5635 prohibits, unless shareholder approval is first obtained, the issuance of common stock or securities convertible into common stock equal to 20% or more of the common stock or voting power outstanding at a price less than the greater of book or market value of the stock.

Change of Control

The 20% threshold that triggers subsection (b) of Rule 5635 should be increased to 50% for venture stage companies.

The economic reality of most venture stage companies is their continuing reliance on existing venture capital fund shareholders ("VC shareholders") to sustain their growth and operations through repeat investment. Because these venture capital funds have often made substantial investments in these companies before going public and collectively own much more

than a majority of the outstanding shares, each VC shareholder typically already owns a significant percentage of the common stock or voting power outstanding. However, after a venture capital backed company becomes listed, its existing VC shareholders do not necessarily maintain their pro rata share of the company through subsequent private placements, and the largest position holder may change as a result of modest percentage shifts among the controlling shareholder base. These percentage ownership changes generally occur with the full support of the VC shareholders who typically have the opportunity to participate in each subsequent private placement. This means that a new holder of the largest position can easily arise in a private placement, notwithstanding participation by existing investors. In such a scenario, the 20% limitation under Rule 5635(b) does not protect shareholders; rather it can harm both institutional and retail shareholders who would otherwise benefit from the company quickly receiving the amount of growth capital it needs to sustain and grow the company.

Moreover, we believe that ownership by a new position holder of 20% or more of the common stock or voting power of a company does not support the presumption of a change of control. While ownership of 20% of a company's common stock may give an investor influence, it does not allow the investor, by itself, to remove directors or cause its nominee to the board of directors to be elected. To obtain control of any company, we believe that a shareholder or group of shareholders must own or otherwise control more than 50% of the outstanding common stock or voting power. This is supported by the basic description of control in FASB ASC 810-10-15-8, as follows: "*The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity is a condition pointing toward consolidation. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement and with other stockholders, or by court decree.*" Accordingly, we believe that investors in a venture stage company should be permitted to obtain up to 50% of the outstanding common stock or voting power without shareholder approval, provided that if the largest position holder remains unchanged, then no limit would apply. Any more stringent restrictions on issuances should be left for contracting parties to implement pursuant to investor rights or shareholders' agreements at the time of investment in the company, subject to the judgment of the company's board of directors.

We do not believe that Rule 5635 should impose a shareholder approval requirement for contractual arrangements that grant elements of the power to control, as such power to control generally can be determined only through subjective analysis. The market itself already regulates such contractual arrangements by reacting to them positively, negatively or not at all, and directors of a company will factor in the likely market effect of such contractual arrangements before authorizing the company to enter into them. In our experience, by the time a venture stage company becomes listed, VC shareholders have relinquished their rights under shareholders agreements and investor rights agreements and have entrusted the direction of the company to a highly sophisticated (and, of course, majority independent) board of directors. We believe the directors of a company, exercising their fiduciary duties and business judgment, are best positioned to protect the company's shareholders from the potential adverse effects of

dilutive issuances to the extent practicable, and the directors should have greater flexibility to enable venture stage companies to raise capital more quickly and efficiently.

Private Placements

Subsection (d) of Rule 5635 can result in predatory lending.

Venture stage companies depend heavily on equity financings to sustain their operations and growth. Unfortunately, due to the 20% limit imposed by subsection (d) of Rule 5635, venture stage companies must often make a choice between delaying an equity financing to obtain shareholder approval, which is a lengthy and costly process, or otherwise accepting some form of secured convertible debt financing with onerous terms and 20% conversion blockers. In our experience, when a venture stage company is compelled to issue secured convertible debt due to pressing needs for capital, the end result is almost always worse for shareholders than if the shareholders had merely suffered dilution from an equity private placement.

Scheduling, noticing, soliciting proxies for and holding special meetings, or preparing and filing an information statement following a written consent of majority shareholders, require a significant amount of lead time, are time consuming for management and are exceedingly expensive for the company, taking precious management and financial resources away from the company's business. As a result, venture stage companies that have a pressing need for capital often accept debt financing with provisions that have the potential, if not the likelihood, to dramatically destabilize the company and put the shareholders' investments at the greatest risk. Unable to quickly and efficiently raise a sufficient amount of capital through equity financings not requiring shareholder approval, venture stage companies are often left with the undesirable option of issuing excessively complex secured convertible debt securities with priority liens on the company's assets, extensive default provisions and penalties, acceleration of principal payments even when no default exists, registration rights and penalties, restrictions on further issuances and anti-dilution protections, all of which invariably result in worse outcomes for existing shareholders. While there are ways to structure convertible debt securities without containing coercive alternative outcomes as described under NASDAQ IM 5635-2, so that shareholder approval may be obtained properly following the transaction, the mere (though unlikely) possibility that a company may fail to obtain shareholder approval for full conversion of the debt securities provides lenders with a strong negotiating position, inevitably leading to harsher terms.

Furthermore, as NASDAQ's solicitation of comments suggests, new investors often demand that existing investors and other insiders invest on the same terms that the new investors have negotiated. A request for this participation by existing investors is understandable, since it signals to the new investors that the existing investors continue to have faith in the company. Existing VC shareholders often have *de facto* representatives on the board who are associated with the fund, without a stockholders' agreement requiring such board representation. As a result, an investment by an existing VC shareholder often raises the question of whether an issuance to the fund could be deemed to be an issuance to the individual director who serves as its *de facto* representative on the board. Unless the director has proper grounds to disclaim

beneficial ownership of the securities held by the VC shareholder, the VC shareholder could be prohibited from participating in a private placement by Rule 5635 if the private placement is at a discount to market, which is often the case. Moreover, new investors and insiders alike have no guarantee that six months after the offering their securities will be worth what they paid for them, that six months after the offering the company will have current information in the marketplace, so that they can sell their securities pursuant to Rule 144, or that any registration statement the company has agreed to prepare and file allowing for the resale of their securities will be declared effective by the Securities and Exchange Commission. Therefore, while insiders and existing shareholders may have the opportunity to purchase the company's stock at a discount to market, they undertake substantial investment risks with these purchases.

Increasing the shareholder approval threshold from 20% to 50% in the context of private placements, including private placements in which insiders participate, would provide venture stage companies with the much needed flexibility required to quickly obtain financing on the best available terms. While we understand that the purpose of Rule 5635 is to protect existing shareholders, and in particular small shareholders, from suffering substantial dilution from securities offerings made at a price below market or book value, we believe that while shareholders may be protected from dilution, the value of their investments may decline rapidly if the company cannot raise working capital quickly or if the terms of obtaining capital are so onerous that the reaction of investors is to "dump" shares in the market.

While we have not addressed needed changes to Rule 5635(a) in this letter, we believe that the benefits of the changes to Rule 5635(d) should extend to venture stage companies that use the proceeds of a private placement to fund an acquisition, so long as the private placement and acquisition combined do not cause a change of control within the revised version of Rule 5635(b) as we proposed above.

Venture Stage Company Defined

We believe that NASDAQ should adopt a new category of issuer called "venture stage company" to be the beneficiaries of the changes to Rule 5635. We believe that the existing definition of "emerging growth company" includes companies that would be too large, both in terms of being too widely held by smaller position holders and having revenues up to $1 billion, to receive the relief sought for smaller companies under Rule 5635. We also believe that using the existing definition of "smaller reporting company" would leave many venture stage companies without relief, as venture backed listed companies can quickly exceed a $75 million public float while still being at the venture stage in terms of revenues, if the company has any revenues at all. Therefore, we believe NASDAQ should designate a new category of issuer for relief under Rule 5635, referred to as "venture stage issuers", which would mean any issuer whose public float is less than $300 million and whose revenues in each of the preceding two fiscal years is less than $100 million. In our experience, companies with less than $100 million in revenues are still at the venture stage in that they require repeated equity financings to establish, maintain and grow their businesses, and such financings typically include a combination of existing and new investors.

Conclusion

We believe that Rule 5635 adversely impacts venture stage companies and that NASDAQ should consider changing subsections (b) and (d) of Rule 5635, as described above, to provide relief for venture stage companies. We believe that an increase in the shareholder approval threshold to greater than 50% as it relates to both a change of control and the sale of equity securities in a private placement, along with an elimination of the limitations on insider participation in private placements at a discount to market, combine to provide the necessary flexibility for venture stage public companies operating in a market dominated by larger and later stage entities. After consideration, we believe that those companies that have both a public float less than $300 million and revenues in each of the last two fiscal years less than $100 million, should be the beneficiaries of any such changes.

We eagerly await the Council's revisions to NASDAQ Rule 5635 and ask that the Council consider the foregoing in its determinations.

If you have any questions regarding these comments, please contact Kevin Friedmann, Esq., Chairman of the Corporate Department of Mitchell Silberberg & Knupp LLP, at (310) 312-3106 or by email to kxf@msk.com; or Gabrielle Napolitano, Esq. at (917) 546-7719 or by email to ggn@msk.com.

Sincerely,

Mitchell, Silberberg & Knupp LLP,

kxf for
MITCHELL SILBERBERG & KNUPP LLP

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