

# NASDAQ, NYSE and NYSE Amex Propose Stricter Listing Standards for Reverse Merger IPO Companies

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Initial public offerings effected through a reverse merger, exchange offer or other non-traditional process involving a shell company have garnered increased attention by the Securities and Exchange Commission, the Financial Industry Regulatory Authority and the national listing exchanges. As a result of recent and highly publicized allegations of fraud, offerings involving promoters with questionable regulatory histories<sup>[1]</sup> and certain auditing issues related to these transactions, on May 26, 2011, NASDAQ proposed a new, more stringent, listing requirement for such companies – specifically, a "seasoning" requirement on the part of reverse merger applicants.<sup>[2]</sup>

Subsequent to NASDAQ's proposal, on July 22, 2011, each of the New York Stock Exchange and the NYSE Amex LLC followed suit and filed a proposed rule change to adopt additional listing requirements for a company that has become public through a reverse merger. The SEC, which almost certainly encouraged the exchanges to propose these rule changes, has sought comment on each of the foregoing proposals as part of its approval process.

What is a Reverse Merger?

A reverse merger is the acquisition of a public company by a private company by means of a merger in which the public company is the surviving entity, but the stockholders of the private company retain control. Such a merger permits the private company to bypass the lengthy and complex process of going public via the traditional IPO process. <sup>[3]</sup> Through such a transaction, the private company becomes an SEC reporting company without having had to file a registration statement with the SEC or be subject to the SEC scrutiny and review involved in a traditional IPO. Often, the public company engaging in the reverse merger is only a shell company with no meaningful business or operations, while the private company has a business and wants to gain access to the public capital markets.

## The Purpose for the Proposed Rule Change

The SEC has had significant concerns with the way some reverse mergers were implemented, and with respect to their financial reporting and accounting practices. In the months leading up to the proposed rule changes, there had been an extraordinary level of public attention given to listed companies that became public via a reverse merger. Many market participants, including short sellers, the financial press and others, have raised allegations of fraud involving these companies, which led to concerns that the financial statements of these companies could not be relied upon. Issues surrounding the individuals promoting reverse merger transactions also arose – for example, certain promoters had significant negative regulatory histories or allegedly have manipulated the reverse merger company's stock prices higher to meet initial listing bid price and minimum round-lot shareholder requirements.[\[4\]](#)

In addition, the Public Company Accounting Oversight Board has identified issues relating to the audits of certain of these companies, resulting in a staff "Audit Practice Alert" on July 12, 2010 that stated that some U.S.-based firms had been issuing audit reports based on work performed by others outside the United States, *but not properly applying PCAOB standards*. On March 14, 2011, the PCAOB also issued a "Research Note" providing new and troubling data on reverse merger transactions involving companies from the People's Republic of China and other countries in the region, and cautioned registered accounting firms to follow certain specified auditing practices.[\[5\]](#)

## NASDAQ, NYSE and the NYSE Amex's Proposed Rule Change

As a result of the foregoing concerns, over the past year, the NASDAQ, NYSE and NYSE Amex have each adopted heightened review procedures for reverse merger applicants. In order to further discourage improper behavior on the part of those involved in reverse mergers, these exchanges have proposed a "seasoning" requirement for reverse merger applicants. The seasoning requirement is intended to prohibit a company that became public via a reverse merger from submitting an application for initial listing until the combined entity, immediately preceding the filing of such listing application, has satisfied certain requirements. The NASDAQ proposed rules would require that:

(i) the equity securities of the reverse merger company must trade in the U.S. over-the-counter market, on another national securities exchange, or on a regulated foreign exchange, following the filing with the SEC or other regulatory authority (i.e., following the consummation of the reverse merger) of all required information about the transaction, including audited financial statements for the combined entity for at least six months prior to a NASDAQ listing; and

(ii) they have maintained a minimum bid price of \$4 per share or higher on at least 30 of the most recent 60 trading days.

In addition, such a Company may only be approved for NASDAQ listing if, at the time of approval, it has timely filed: (i) in the case of a domestic issuer, its most recent two required periodic financial reports with the SEC (Forms 10-Q or 10-K) containing at least six months of information about the combined entity; or (ii) in the case of a Foreign Private Issuer, comparable information as described in (i) above on Forms 6-K, 20-F or 40-F.[\[6\]](#)

#### Distinctions between the NASDAQ and the NYSE /NYSE Amex Proposals

The NYSE and NYSE Amex proposals are similar in many respects to the NASDAQ proposal set forth above; however, they contain certain provisions that differ from the NASDAQ proposal in the following material respects:

(1) the maintenance of the minimum stock price for listing on an "*absolute and an average basis for a sustained period*" of time (not defined) immediately preceding the filing of the initial listing application and through listing;

(2) the NYSE and NYSE Amex would not approve any reverse merger company for listing unless the company has timely filed with the Commission all required reports since the consummation of the reverse merger, including at least one annual report containing audited financial statements for a full fiscal year commencing on a date after the date of filing of a Form 8-K, or Form 20-F, relating to the reverse merger; and

(3) the NYSE and NYSE Amex proposals include an **exemption** from the proposed listing requirements for reverse merger companies when the listing is in connection with an initial firm commitment underwritten public offering where the proceeds will be at least \$40 million and the offering is occurring subsequent to or concurrently with the reverse merger.[\[7\]](#)

Each of the NASDAQ, the NYSE and the NYSE Amex believes that the additional listing requirements will result in increased investor protections. Specifically, a six-month (NASDAQ) or one-year (NYSE / NYSE Amex) seasoning requirement will allow FINRA and other regulators more time to view trading patterns and uncover potentially manipulative behavior, to develop a bona fide shareholder base and to assure that the minimum bid price requirement is not satisfied through a manipulative scheme.

The SEC comment period related to NASDAQ's proposed rule change expired on September 12, 2011; however, as expressed by the SEC in its release of September 16, 2011[\[8\]](#), because of the overlapping concerns of the exchanges, and due to certain material differences between the proposals, the comment period for the NYSE/NYSE Amex proposal would extend to and expire on 10/17/11, and the rebuttal period on 10/26/11. The SEC further expressed that because of the importance of this issue, it believes that the NASDAQ proposal should be considered together with the NYSE and NYSE Amex proposals to assure that the exchanges develop and implement consistent and effective enhancements to their listing standards, to best address the serious concerns that have arisen with respect to the listing of reverse merger companies. Therefore, it appears that the SEC prefers to implement and accept one consistent exchange listing rule in this regard.

We will keep you apprised of any changes and/or further proposals surrounding the foregoing matter as they occur.

[\[1\]](#) Concerns have been raised that "certain individuals who aggressively promote these transactions have...engaged in transactions that are disproportionately beneficial to them at the expense of public shareholders." SEC Release #34-64371, dated April 19, 2011.

[\[2\]](#) SEC Release # 34-64633, dated May 26, 2011.

[3] Traditional IPOs typically involve the preparation of numerous drafts of its registration statement (and multiple rounds of SEC and FINRA comments) and the preparation and review of lengthy financial statements that will be included in the registration statement, among other processes.

[4] Among other requirements, e.g., NASDAQ's initial listing rules require a minimum bid price of \$4 per share and a minimum of 400 round lot holders (holders of 100 or more shares).

[5] Wall Street Journal, June 2011: SEC Regulators publicly warned investors about the risks of "reverse merger" companies, in the wake of accounting questions and investor losses at some Chinese companies that have used such transactions to list on U.S. exchanges. The SEC's bulletin isn't specifically aimed at Chinese companies, but those firms have been particularly active in using reverse mergers in recent years. In the past few months, about 40 Chinese companies, mostly reverse-merger firms, have acknowledged accounting issues.

[6] In the case of a Foreign Private Issuer, a Form 6-K would be considered timely if, consistent with Rule 5250(c)(2), it includes an interim balance sheet and income statement, which must be presented in English, and is filed no later than six months following the end of the applicable quarter.

[7] The rationale for the NYSE/NYSE Amex exemption is: reverse merger companies conducting such a sizable offering would be subject to the same level of review by the SEC and the concomitant due diligence review by the underwriters as a company going public through a traditional IPO.

[8] See SEC Release No. 34-65319; Federal Register / Vol. 76, No. 180 / Friday, September 16, 2011 / Notices.

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#### Related Professionals

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