

## SEC Approves Tougher Listing Standards for Reverse Merger Companies

On November 9, 2011, the Securities and Exchange Commission (the "SEC") announced the accelerated approval of new rules promulgated by the three major U.S. listing markets: The New York Stock Exchange ("NYSE"), the NASDAQ Stock Market and the NYSE Amex. These rules pertain to the use of public "shell" companies -- having few or no operations -- for the purpose of acquiring a private operating company and giving it instant access to the public markets.

Such acquisitions, known as reverse mergers, have drawn considerable regulatory scrutiny in recent years because the acquired private operating companies have frequently had financial accounting and reporting deficiencies that caused the SEC to suspend trading in their stocks. These reverse merger companies have also been frequently associated with promoter price manipulation to meet initial bid price requirements, as well as failure to comply with corporate governance and disclosure rules.

As a result, the major stock exchanges each issued within the past several months proposed new rules targeted at reverse merger companies. The proposed rule changes and proposed amendments made in response to public comments, which the SEC has now adopted, would in all cases prohibit a reverse merger company from applying to list its securities on the major exchanges until:

- The company in question has completed a "seasoning period" by trading in the U.S. over-the-counter market or another regulated U.S. or foreign exchange following the reverse merger;
- The company has filed all required reports with the SEC, including audited financial statements (including at least two financial reports in the case of NASDAQ); and

- The company has maintained a requisite minimum share price for a sustained period immediately prior to its listing application and approval, as defined by the new rules of each exchange.

"Placing heightened requirements on reverse merger companies before they can become listed on an exchange will provide greater protections for investors," said SEC Chair Mary L. Schapiro.

As proposed, a reverse merger company can be exempted from the new requirements of any of the three major exchanges if the company is listing in connection with a substantial firm commitment underwritten public offering, as defined by the applicable exchange rules, or if the company has filed at least four annual reports with audited financial information after the reverse merger was concluded.

This update provides an overview of the new rules for each exchange, which have been approved by the SEC on an expedited basis subject to further public comment, which could engender some additional modification. For a full copy of the SEC's findings and decision to approve the new exchange rules, see: (a) the SEC Release No. 34-65709 related to NYSE rules at <http://www.sec.gov/rules/sro/nyse/2011/34-65709.pdf>; (b) the SEC Release No. 34-65710 related to the NYSE Amex rules at <http://www.sec.gov/rules/sro/nyseamex/2011/34-65710.pdf>; and (c) the SEC Release No. 34-65708 related to the NASDAQ rules at <http://www.sec.gov/rules/sro/nasdaq/2011/34-65708.pdf>.

### THE NEW YORK STOCK EXCHANGE RULES

The NYSE rules, as approved on an accelerated basis, pertain to companies that have become reporting companies under the Securities Exchange Act of 1934 by combining with a public shell company, whether through a reverse merger, exchange offer, or other similar arrangement.

### New Rules

The new rules impose three new burdens on companies that have gone public via reverse merger transactions:

1. Such a reverse merger company may not list its securities on the NYSE until the new combined entity has traded in the U.S. over-the-counter market, on another national securities exchange, or on a regulated foreign exchange for at least one year following the filing with the SEC of all required information about the reverse merger transaction, including audited financial statements.
2. Such a reverse merger company must also timely file with the SEC all required reports (including all required audited financial information) since the consummation of the reverse merger, including the filing of at least one annual report containing financial statements for a full fiscal year commencing on a date after the date of filing with the SEC of all required information about the reverse merger transaction, and must satisfy the one-year trading requirement.
3. Such a reverse merger company must maintain on both an absolute and on an average basis for "a sustained period" a minimum stock price of \$4 per share both immediately preceding the filing of an initial listing application and the company's listing on the NYSE, but in no event for less than 30 of the most recent 60 trading days prior to the filing of the initial listing application and actual listing.

### Exceptions

The NYSE rules permit an exemption for the new requirements under any of the following circumstances:

1. The reverse merger company is listing on the NYSE in connection with an initial firm commitment underwritten public offering where the proceeds to the company are sufficient on a stand alone basis to meet the aggregate market value of publicly held shares requirements set forth in Section

102.01B of the NYSE Listed Company Manual (which requires an aggregate market value of \$40 million for companies that list either at the time of their initial public offerings, or as a result of spin-offs, or under the affiliated company standard, or, for companies that list at the time of their initial firm commitment underwritten public offering, and \$100 million for other companies).

2. The reverse merger company has satisfied the one-year trading requirement and has filed at least four annual reports with the SEC that each contain all required audited financial statements for a full fiscal year commencing after filing the required information.

#### **Other Listing Requirements**

The NYSE also clarified that “all other listing requirements are applicable to all reverse merger companies,” including those that can take advantage of any eligibility for listing exceptions. These requirements explicitly include but are not limited to corporate governance requirements and applicable distribution, stock price and market value requirements as well.

#### **THE NYSE AMEX RULES**

The NYSE Amex rules, as approved on an accelerated basis, pertain to companies that have become reporting companies under the Securities Exchange Act of 1934 by combining with a public shell company, whether through a reverse merger, exchange offer, or other similar arrangement.

#### **New Rules**

These new rules impose three new burdens on companies that have gone public via reverse merger transactions:

1. Such a reverse merger company may not list its securities on the NYSE Amex until the new combined entity has traded in the U.S. over-the-counter market, on another national securities exchange, or on a regulated foreign exchange for at least one year following the filing with the SEC of all required information about the reverse merger transaction, including audited financial statements.

2. Such a reverse merger company must also timely file with the SEC all required reports (including all required audited financial

information) since the consummation of the reverse merger, including the filing of at least one annual report containing financial statements for a full fiscal year commencing on a date after the date of filing with the SEC of all required information about the reverse merger transaction, and must satisfy the one-year trading requirement.

3. Such a reverse merger company must maintain on both an absolute and on an average basis for “a sustained period” a minimum stock price equal to the stock price requirement applicable to the initial listing standard under which the reverse merger company is qualifying to list, but in no event for less than 30 of the most recent 60 trading days prior to the filing of the initial listing application and actual listing.

#### **Exceptions**

The NYSE Amex rules permit an exemption for the new requirements under any of the following circumstances:

1. The reverse merger company is listing in connection with an initial firm commitment underwritten public offering where the proceeds to the company are at least \$40 million and the offering is occurring subsequent to or concurrently with the reverse merger.

2. The reverse merger company has satisfied the one-year trading requirement and has filed at least four annual reports with the SEC that each contain all required audited financial statements for a full fiscal year commencing after filing the required information.

#### **Other Listing Requirements**

The NYSE Amex also clarified that “all other listing requirements are applicable to all reverse merger companies” including those that can take advantage of any eligibility for listing exceptions. These requirements explicitly include but are not limited to corporate governance requirements and applicable distribution, stock price and market value requirements as well.

#### **THE NASDAQ RULES**

The NASDAQ rules, as approved on an accelerated basis, pertain to companies that have become reporting companies under the Securities Exchange Act of 1934 by combining with a public shell company,

whether through a reverse merger, exchange offer, or other similarly effective arrangement, either directly or indirectly.

#### **New Rules**

These new NASDAQ rules impose four new burdens on companies that have gone public via reverse merger transactions:

1. Such a reverse merger company may not list its securities on NASDAQ until the new combined entity has traded in the U.S. over-the-counter market, on another national securities exchange, or on a regulated foreign exchange for at least one year following the filing with the SEC of all required information about the reverse merger transaction, including audited financial statements.

2. The company must, prior to listing, file all required financial reports for the prior year, including at least one full annual report containing audited financial statements for a full fiscal year following the filing of all required information about the reverse merger transaction (to allow FINRA and other regulators sufficient time to uncover any potentially manipulative trading patterns).

3. Such a reverse merger company must also timely file its two most recent financial reports with the SEC if it is a domestic issuer, or comparable information for a foreign issuer prior to listing application.

4. Such a reverse merger company must maintain on both an absolute and on an average basis for “a sustained period” a minimum stock price of \$4 per share both immediately preceding the filing of an initial listing application and the company’s listing on the exchange, but in no event for less than 30 of the most recent 60 trading days prior to the filing of the initial listing application and actual listing.

#### **Exceptions**

The NASDAQ rules permit an exemption for the new requirements under any of the following circumstances:

1. The reverse merger company is listing in connection with an initial firm commitment underwritten public offering where the proceeds to the company are at least \$40 million.

2. The reverse merger company has satisfied

the one-year trading requirement and has filed at least four annual reports with the SEC that each contain all required audited financial statements for a full fiscal year commencing after filing the required information.

#### ***Other Listing Requirements***

The NASDAQ also clarified that “all other listing requirements are applicable to all reverse merger companies,” including those that can take advantage of any eligibility for listing exceptions.

#### **EFFECTIVE DATES**

All rules for each exchange were approved by the SEC on an “accelerated basis” without the usual minimum waiting period for at least 30 days after publication in the Federal Register. However, the SEC did continue to accept public comments through early December.

#### ***Explanatory Notes:***

*This update is intended to call your attention to rule changes of possible interest and relevance to you, but it is not intended to constitute a legal opinion or definitive summary of all changes that could be material to you.*

*Please contact a member of the Securities Law Group at Burns & Levinson if you have any questions about these rule changes or want to learn more about our expertise in this area.*

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In the securities compliance area, we advise our clients on corporate governance/Sarbanes-Oxley and SEC and stock exchange reporting and compliance. Specifically, we assist our clients in fulfilling their ongoing SEC and stock exchange reporting obligations, managing sensitive disclosure issues internally and with industry analysts, preparing proxy statements and handling stockholder meetings, structuring employee benefit plans and executive compensation packages under the SEC's "short-swing profit" reporting and liability rules, effecting resales of securities in the public trading markets under

the SEC's Rule 144, and advising boards of directors and board committees concerning the requirements and restrictions imposed on their actions by the securities laws and corporate governance laws such as Sarbanes-Oxley. We have served as special securities counsel to the Boards and Audit Committees of publicly traded companies looking for opinions or advice of counsel other than their regular outside counsel.

We have counseled clients both domestic and international, from emerging growth companies to large public companies, and are positioned to provide clients with timely, expert, efficient and cost effective advice that they need to meet their business objectives. We take a practical and proactive approach to the rapidly changing securities disclosure and corporate governance laws, providing our clients with timely updates, identifying specific situations in which the new laws will impact particular clients either operationally or structurally, and working with clients to implement the changes that are either required or advisable to comply with the new regulatory schemes and investor sentiment.

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