

## **NYSE and NASDAQ Propose More Stringent Listing Requirements for Reverse Merger Companies**

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Reverse merger transactions, where a private operating company goes public by merging into a public shell company, have recently received greater public scrutiny. In the first half of 2011 alone, the Securities and Exchange Commission suspended or revoked trading in the securities of a number of reverse merger companies due to allegations of fraud and other regulatory concerns. In response to such concerns, the New York Stock Exchange and NASDAQ recently proposed more stringent rules for reverse merger companies seeking to list on their exchanges.

Earlier in the year, NASDAQ filed with the SEC an initial proposal to adopt stricter listing requirements for reverse merger companies, which was subsequently withdrawn and replaced by a revised proposal on May 26, 2011. On July 22, 2011, the NYSE filed with the SEC proposed rules to adopt comparable additional listing requirements for companies going public through a reverse merger transaction. Both the proposed NYSE and NASDAQ rules seek to increase transparency and protect investors from fraud and other inappropriate behavior by private companies looking to become public by merging with public shell companies. The two sets of proposed rules closely mirror each other in their requirements and require a "seasoning" period before a company resulting from a reverse merger can be eligible for listing. The proposed rules require that:

- the equity securities of the reverse merger company must trade in the U.S. over-the-counter market, another national securities exchange, or a regulated foreign exchange following the consummation of the reverse merger for at least one year prior to a NYSE listing or six months prior to a NASDAQ listing. The seasoning period is designed to provide time for the regulatory authorities and the market to scrutinize the reverse merger company before it gains eligibility to list on the exchanges.
- the reverse merger company must maintain a minimum stock price of at least \$4 per share. The NYSE proposed rules require that the minimum stock price be "maintained on both an absolute and an average basis for a sustained period" (which period is not defined) and through listing, whereas the NASDAQ proposed rules only require a reverse merger company to maintain this minimum stock price on "at least 30 of the most recent 60 trading days."
- the reverse merger company must file with the SEC information about the reverse merger transaction through which it was formed. While the NASDAQ proposed rules require that the reverse merger company file "all required information about the transaction, including audited financial statements," the NYSE proposed rules specify that a reverse merger company that is (i) a

domestic issuer must file a Form 8-K which includes Form 10-equivalent information and all required audited financial statements or (ii) a foreign private issuer must file a Form 20-F including comparable information.

- the reverse merger company must make additional post-reverse merger disclosures of information regarding the reverse merger company during the seasoning period. During the minimum one year seasoning period, the NYSE proposed rules require a reverse merger company to file all required reports, including at least one annual report on Form 10-K or 20-F, containing audited financial statements for a full fiscal year since the reverse merger. The NASDAQ proposed rules, which mandate only a six-month seasoning period, require a reverse merger company with domestic issuer status to file its most recent two periodic financial reports on Form 10-Q or 10-K containing at least six months of post-merger information or for foreign private issuers, comparable information on Form 6-K, 20-F or 40-F.

Notwithstanding the strict requirements described above, both the NYSE and NASDAQ reserve the authority to impose at their discretion even more stringent requirements on a case-by-case basis for particular reverse merger companies. The NYSE proposed rules indicate that such action would be based on, among other things, "an inactive trading market in the reverse merger company's securities, the existence of a low number of publicly held shares that were not subject to transfer restrictions, if the reverse merger company had not had a Securities Act registration statement or other filing subjected to a comprehensive review by the Commission, or if the reverse merger company had disclosed that it had material weaknesses in its internal controls which had been identified ... and had not yet implemented an appropriate corrective action plan." Similarly, the NASDAQ proposal indicates that "[e]ven if a company meets these proposed new requirements, NASDAQ could still deny listing ... [or] apply additional or more stringent criteria."

Both the NYSE and NASDAQ proposed rules exempt companies formed by reverse mergers with special purpose acquisition companies (SPACs) listed on their exchange from the seasoning requirements because unlike many public shell companies that engage in reverse mergers, SPACs have a specific business plan to raise capital in an initial public offering in order to merge with or acquire a private company.

In addition, the NYSE proposed rules exempt reverse merger companies from such additional listing requirements if: (i) the reverse merger company is listing in connection with an initial firm commitment underwritten public offering, (ii) the proceeds to the reverse merger company generate \$40 million in aggregate market value of publicly-held shares, and (iii) the public offering is occurring at the same time or after the reverse merger. The rationale for this exemption is that reverse merger companies that are listing in conjunction with such a sizable offering would be subject to the same level of review by the SEC and due diligence by the underwriters as a company going public through an initial public offering.

Interestingly, NASDAQ's initial proposed rules had included a similar exemption for reverse merger companies seeking to list in conjunction with a firm commitment underwritten public offering. However, prior to the filing of the NYSE proposed rules, NASDAQ eliminated the exemption in its revised proposal.

On July 22, 2011, NYSE Amex (formerly the American Stock Exchange) also filed proposed rules substantially identical to the NYSE's, except for the minimum stock price requirement. The deadline for comments on the NYSE and NYSE Amex proposed rules was August 31, 2011. A copy of the NYSE's proposed rules can be found at:

[http://www.chadbourne.com/files/upload/Corporate\\_ca8-19\\_NYSE Proposed Rules.pdf](http://www.chadbourne.com/files/upload/Corporate_ca8-19_NYSE_Proposed_Rules.pdf). A

copy of the NYSE Amex's proposed rules can be found at:

[http://www.chadbourne.com/files/upload/Corporate\\_ca-8-19\\_NYSE Amex Proposed Rules.pdf](http://www.chadbourne.com/files/upload/Corporate_ca-8-19_NYSE_Amex_Proposed_Rules.pdf).

The comment period for the NASDAQ proposed rules has closed and the SEC is expected to take action on the rules by September 12, 2011. A copy of NASDAQ's proposed rules can be found at: [http://www.chadbourne.com/files/upload/Corporate\\_ca-8-19\\_NASDAQ Proposed Rules %28revised%29.pdf](http://www.chadbourne.com/files/upload/Corporate_ca-8-19_NASDAQ_Proposed_Rules_%28revised%29.pdf).

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