

## **SEC Approves More Stringent Exchange Listing Rules for Reverse Merger Companies**

On November 8, 2011, the Securities and Exchange Commission (the “SEC”) approved additional exchange listing requirements for companies that use a reverse merger transaction as a means to becoming an exchange listed company (referred to as “Reverse Merger Companies”).<sup>1</sup> The rules were proposed by the New York Stock Exchange LLC (“NYSE”), the NYSE Amex LLC (“NYSE Amex”) and The NASDAQ Stock Market (“Nasdaq,” and together with the NYSE and NYSE Amex, the “Exchanges”).

The SEC’s approval of the new rules follows a year-long effort by the SEC to protect investors in publicly traded companies which accomplish exchange listing of their securities without first going through an SEC review process that would typically be part of a listing made in connection with an initial public offering, for example. Companies that use the technique of a reverse merger to avail themselves of the surviving company’s exchange listing typically would report the transaction on Form 8-K, but such filings are not reviewed by the SEC staff before being filed. As a result, investors in Reverse Merger Companies may have little publicly available financial or other information about such a company to make informed investment decisions. As noted in the SEC releases approving the new listing rules, factors prompting the SEC’s approval of the more stringent standards were “significant regulatory concerns including accounting fraud allegations that have arisen with respect to Reverse Merger Companies.”<sup>2</sup> These concerns triggered the suspension of listings of some Reverse Merger Companies and at least one SEC enforcement action against an audit firm relating to its work for Reverse Merger Companies. In addition, in June 2011, the SEC issued a bulletin on the risks of investing in Reverse Merger Companies, noting potential market and regulatory risks related to investing in such companies.<sup>3</sup> The requirements included in the new rules are in addition to the requirements an applicant must otherwise meet when applying for listing on one of the Exchanges. A summary of the new rules follows.

### **I. Definition of “Reverse Merger”**

Each of the Exchanges define a Reverse Merger as:

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<sup>1</sup> See: *Self-Regulatory Organizations; New York Stock Exchange LLC; Notice and Order Granting Accelerated Approval to Proposed Rule Change, as Modified by Amendment No. 2, Amending Sections 102.01 and 103.01 of the Exchange’s Listed Company Manual Adopting Additional Listing Requirements for Companies Applying to List After Consummation of a “Reverse Merger” With a Shell Company*, Release No. 34-65709, (November 8, 2011) available at <http://www.sec.gov/rules/sro/nyse/2011/34-65709.pdf> (the “NYSE Rule Approval Release”).

*Self-Regulatory Organizations; NYSE Amex LLC; Notice and Order Granting Accelerated Approval to Proposed Rule Change, as Modified by Amendment No. 2, Amending Section 101 of the NYSE Amex Company Guide To Adopt Additional Listing Requirements for Companies Applying to List After Consummation of a “Reverse Merger” With a Shell Company*, Release No. 34-65710 (November 8, 2011), available at <http://sec.gov/rules/sro/nyseamex/2011/34-65710.pdf>.

*Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice and Order Granting Accelerated Approval to Proposed Rule Change, as Modified by Amendment No. 1, Adopting Additional Listing Requirements for Companies Applying to List After Consummation of a “Reverse Merger” With a Shell Company*, Release No. 34-65708 (November 8, 2011), available at <http://sec.gov/rules/sro/nasdaq/2011/34-65708.pdf>.

<sup>2</sup> NYSE Rule Approval Release at 2.

<sup>3</sup> See NYSE Approval Release at 3 and SEC Investor Bulletin *Reverse Mergers* (June 9, 2011) available at <http://investor.gov/news-alerts/investor-bulletins/reverse-mergers>.

“any transaction whereby an operating company becomes an Exchange Act reporting company by combining directly or indirectly with a shell company which is an Exchange Act reporting company, whether through a reverse merger, exchange offer, or otherwise.”<sup>4</sup>

The defined term Reverse Merger does not include the acquisition of an operating company by a listed company that qualified for initial listing under the Exchanges’ listing standards for special purpose acquisition companies, or SPACs.<sup>5</sup>

## II. Seasoning, Minimum Share Price and Filing Requirements

The new rules impose a one year seasoning period requirement as follows. The Reverse Merger Company must have (with the rule variations noted below):

- Traded for at least one year in the U.S. over-the-counter market, on another national securities exchange, or on a regulated foreign exchange following the Reverse Merger and
  - if a U.S. domestic issuer applying for NYSE or NYSE Amex listing, file with the SEC a Form 8-K containing all information required by Item 2.01(f) including audited financial statements; or
  - if a foreign private issuer applying for NYSE or NYSE Amex listing, file with the SEC comparable information on Form 20-F.<sup>6</sup>
- Maintained a closing stock price of \$4 or higher for not less than 30 of the most recent 60 trading days prior to the filing of the initial listing application and for a similar period prior to the date of listing.<sup>7</sup>

<sup>4</sup> NYSE Listed Company Manual Sections 102.01F first paragraph and 103.01E first paragraph; NYSE Amex Company Guide Section 101(e) first paragraph; Nasdaq Rule 5005(a)(35). The Exchanges will look to Exchange Act Rule 12b-2 to determine what constitutes a “shell company.”

The text of new Sections 102.01F and 103.01E of the NYSE Listed Company Manual is available at <http://www.sec.gov/rules/sro/nyse/2011/34-65709-ex5.pdf>.

The text of new Section 101(e) of the NYSE Amex Company Guide is available at <http://www.sec.gov/rules/sro/nyseamex/2011/34-65710-ex5.pdf>.

The text of new Nasdaq listing rules 5005(a)(35), 5110(c) and 5210(i) is available at <http://www.sec.gov/rules/sro/nasdaq/2011/34-65708-ex5.pdf>.

<sup>5</sup> The carve out for SPACs is accomplished by cross references in the definitions of Reverse Merger to companies that qualify for initial listing under NYSE Listed Company Manual Section 102.06, NYSE Amex Company Guide Section 119 and Nasdaq IM-5101-2, respectively.

<sup>6</sup> Form 8-K Item 2.01(f) is triggered by a significant acquisition or disposition transaction and generally requires shell companies to make the disclosures required by Form 10. The new Nasdaq rule is drafted in more general terms simply stating that a Reverse Merger Company must make a filing containing “all required information.” However, as the Nasdaq rule uses the same definition of Reverse Merger quoted above, the required disclosure would be that called for by Form 8-K, Item 2.01(f). See NYSE Listed Company Manual Sections 102.01F(1) and 103.01E(1), NYSE Amex Company Guide Section 101(e)(1) and Nasdaq Rule 5110(c)(1)(A).

<sup>7</sup> NYSE Listed Company Manual Section 102.01F(2) and third paragraph, and Section 103.01E(2) and third paragraph; and Nasdaq Rule 5110(c)(1)(B) and (c)(2)(B). The NYSE Amex rule states that the Reverse Merger Company must maintain a stock price equal to the stock price requirement applicable to the initial listing standard under which it seeks to list (either \$3 per share or \$2 per share depending on which listing standard an applicant seeks listing under). NYSE Amex Company Guide Section 101(e)(2) and third paragraph and Section 102.

- Timely filed with the SEC all required reports since consummation of the Reverse Merger, including the filing of one annual report containing audited financial statements for a full fiscal year commencing after the date of the Form 8-K or Form 20-F filing noted above.<sup>8</sup>

Both the NYSE and NYSE Amex rules state that those Exchanges may in their discretion impose more stringent requirements than those set forth in the rules if they believe it is warranted in the case of a particular Reverse Merger Company. Factors they would consider in this regard are, 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 are not subject to transfer restrictions, if the Reverse Merger Company has not had a registration statement or other filing subjected to a comprehensive review by the SEC, or if the Reverse Merger Company has disclosed that it has material weaknesses in its internal controls which have been identified by management and/or the Reverse Merger Company's independent auditor and has not yet implemented an appropriate corrective action plan.<sup>9</sup> The Nasdaq rules do not contain a similar reservation to impose more stringent standards.

### III. Exceptions to the Additional Requirements

The new rules carve out two exceptions from the new listing standards. First, if a Reverse Merger Company completes a firm commitment underwritten public offering that generates at least \$40,000,000 in proceeds to the Reverse Merger Company contemporaneously with its listing, it will be exempt from the new additional requirements.<sup>10</sup>

Second, a listing applicant will be excepted from the requirement to maintain a closing stock price for the periods noted above if it:

- has satisfied the one-year trading requirement noted above;
- has filed the required information about the Reverse Merger as noted above; and
- has filed with the SEC at least four annual reports that include all required audited financial statements since the date of filing the information about the Reverse Merger.<sup>11</sup>

To avail itself of either of the foregoing exceptions, a Reverse Merger Company must meet the applicable requirements for an initial listing on the relevant Exchange, including any minimum stock price requirements.

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<sup>8</sup> NYSE Listed Company Manual Section 102.01F(3) and Section 103.01E(3); NYSE Amex Company Guide Section 101(e)(3); and Nasdaq Rule 5110(c)(2)(A).

<sup>9</sup> NYSE Listed Company Manual Section 102.01F fourth paragraph and Section 103.01E fourth paragraph; and NYSE Amex Company Guide Section 101(e) fourth paragraph.

<sup>10</sup> NYSE Listed Company Manual Section 102.01F fifth paragraph (cross referencing the dollar threshold for Initial Firm Commitment Underwritten Public Offerings in Section 102.01B) and Section 103.01E fifth paragraph; NYSE Amex Company Guide Section 101(e) fifth paragraph; and Nasdaq Rule 5110(c)(3). The Nasdaq Rule uses the phrase "gross proceeds to the Reverse Merger Company" which is likely what the other two Exchanges' rules intend.

<sup>11</sup> NYSE Listed Company Manual Section 102.01F fifth paragraph and Section 103.01E fifth paragraph; NYSE Amex Company Guide Section 101(e) fifth paragraph; and Nasdaq Rule 5110(c)(3).

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); or John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com).

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