

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64371; File No. SR-NASDAQ-2011-056)

April 29, 2011

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Additional Listing Requirements for Reverse Mergers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 18, 2011, The NASDAQ Stock Market LLC (“Nasdaq”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of the Substance of the Proposed Rule Change

Nasdaq proposes to adopt additional listing requirements for a company that has become public through a reverse merger. Nasdaq will implement the proposed rule for applications received after approval.

The text of the proposed rule change is below. Proposed new language is in italics; proposed deletions are in brackets.<sup>3</sup>

**5110. Change of Control, Bankruptcy and Liquidation, and Reverse Mergers**

(a) – (b) No change

**(c) Reverse Mergers between a Private Operating Company and a Public Shell Company**

A Company that is formed by a combination between a private operating company and a public

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Changes are marked to the rule text that appears in the electronic manual of Nasdaq found at <http://nasdaqomx.cchwallstreet.com>.

shell company shall be eligible to submit an application for initial listing only after the combined entity has: (i) traded for at least six months in the over-the-counter market, on another national securities exchange, or on a listed foreign market, following the filing with the Commission or Other Regulatory Authority of audited financial statements for the combined entity; and (ii) maintained a Bid Price of \$4 per share or higher on at least 30 of the 60 trading days immediately preceding the filing of the initial listing application.

In addition, such a company may only be approved for listing if, following the business combination, it has timely filed: (i) in the case of a domestic issuer, at least two required periodic financial reports with the Commission or Other Regulatory Authority; or (ii) in the case of a Foreign Private Issuer, one or more reports including financial statements for a period not less than six months.

This Rule 5110(c) shall not apply if the Company lists in connection with a firm commitment, underwritten public offering.

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## **5210. Prerequisites for Applying to List on The Nasdaq Stock Market**

(a) – (h) No change

### **(i) Reverse Mergers between a Private Operating Company and a Public Shell Company**

A security issued by a Company formed by a combination between a private operating company and a public shell company shall be eligible for initial listing only if the conditions set forth in Rule 5110(c) are satisfied.

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## **II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

In recent months there has been an extraordinary level of public attention to listed companies that went public via a reverse merger, where an unlisted operating company becomes a public company by merging with a public shell.<sup>4</sup> The financial press, short sellers and others have raised allegations of widespread fraudulent behavior by these companies, leading to concerns that their financial statements cannot be relied upon. Concerns have also been raised that certain individuals who aggressively promote these transactions have significant regulatory histories or have engaged in transactions that are disproportionately beneficial to them at the expense of public shareholders. The Public Company Accounting Oversight Board ("PCAOB") has also identified issues with the audits of these companies and, in response, has issued Staff Audit Practice Alert No. 6/July 12, 2010 and Staff Research Note #2011-P1/March 2011, cautioning registered accounting firms to follow certain specified auditing practices. The SEC recently took an enforcement action based on a firm's audit of a reverse merger company.<sup>5</sup> In addition, Nasdaq is aware of situations where it appeared that promoters and others intended to manipulate prices higher to satisfy Nasdaq's initial listing bid price requirement and where companies have, for example, gifted stock to artificially satisfy the 300 round lot public holder requirement. Nasdaq does not list companies in instances such as these, where it appears the

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<sup>4</sup> See, e.g., Beware This Chinese Expor, Barron's (August 28, 2010), available at <http://online.barrons.com/article/SB50001424052970204304404575449812943183940.html>. See also Speech by SEC Commissioner by Commissioner Luis A. Aguilar: Facilitating Real Capital Formation (April 4, 2011), available at <http://www.sec.gov/news/speech/2011/spch040411laa.htm>. [sic]

<sup>5</sup> In re Moore Stephens Wurth Frazer and Torbet, Order Instituting Public Administrative and Cease-and-Desist Proceedings, Securities Act Release No. 9166 (December 20, 2010).

company has achieved compliance with a requirement in an inappropriate manner.

In response to these concerns, Nasdaq staff has, over the past year, adopted heightened review procedures for reverse merger applicants. However, Nasdaq also believes that additional requirements for listing reverse merger companies are appropriate to discourage inappropriate behavior on the part of companies, promoters and others. Accordingly, Nasdaq proposes to adopt certain “seasoning” requirements for reverse mergers.<sup>6</sup>

Specifically, Nasdaq proposes to prohibit a company going public via a reverse merger from applying to list until six months after the combined entity submits audited financial statements to the SEC.<sup>7</sup> Further, Nasdaq proposes to require that the company maintain a \$4 bid price on at least 30 of the 60 trading days immediately prior to submitting the application. Finally, under the proposed rule, Nasdaq would not approve any reverse merger for listing until the company has filed at least two financial reports with the SEC if it is a domestic issuer (this could be two quarterly filings or a quarterly and an annual filing) or one financial report covering at least a six month period if it is a foreign private issuer (this could be an interim report on Form 6-K or an annual report on Form 20-F). While most companies will satisfy this requirement due to the six month delay before they can apply, Nasdaq believes that it is important to assure that this requirement be satisfied in all cases.

Nasdaq believes that this proposal will result in significant investor protection benefits.

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<sup>6</sup> Reverse merger companies that list on Nasdaq in conjunction with a firm commitment underwritten public offering will not be subject to the proposed rule. These transactions are more similar to IPO’s, in that the SEC reviews the registration statement and the underwriters and other experts are strictly liable under the federal securities laws for any misstatements.

<sup>7</sup> A company must file a Form 8-K within four days of completing a reverse merger. The Form 8-K must contain audited financial statements and information comparable to the information provided in a Form 10 for the registration of securities. See Form 8-K Items 2.01, 5.06, and 9.01(c).

Specifically, a six month seasoning requirement will allow FINRA more time to view trading patterns and uncover potentially manipulative trading.<sup>8</sup> It will also result in a more bona fide shareholder base and assure that the \$4 bid price was not satisfied through a quick manipulative scheme. Requiring additional SEC filings will tend to improve the reliability of the reported financial results, since the auditors will have reviewed several quarters, at least, of the public company's operating results, as will the company's audit committee. To the extent the company had adopted new internal controls at the time of the merger, those too will have been in place and able to exert a corrective influence over any previous flaws in the company's financial reporting process.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>9</sup> in general and with Section 6(b)(5) of the Act,<sup>10</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The proposed rule change is designed to enhance investor protection by imposing additional requirements on a category of companies that have raised regulatory concerns.

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<sup>8</sup> The Commission notes that FINRA has regulatory authority over transactions in the over-the-counter market.

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(5).

B. Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve or disapprove such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the

Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2011-056 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2011-056. This file number should be included on the subject line if e-mail is used.

To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-NASDAQ-2011-056, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>11</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).