

FEATURED ARTICLE:

CURRENT TRENDS IN REVERSE MERGERS

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INTRODUCTION TO REVERSE MERGERS

There are many reasons for a company to go public. One is to allow greater access to capital. Another reason is for liquidity, since shareholders will be able to sell their shares more readily if a public trading market exists. Acquisitions are made easier via the public markets with the potential use of stock as currency. In addition, publicly traded shares aid in the recruitment and retention of key employees through the utilization of stock options.

A company has several alternative routes to become public. First, there is the traditional initial public offering (IPO), which, while coveted, is a highly regulated and costly method to achieve public status, dependent on opportune market conditions. A reverse merger is a viable and increasingly popular alternative to an IPO. In a reverse merger, the owners of a private company typically acquire control of a dormant public company, called a "shell." When the merger has been completed, the private company becomes public and its stock can be publicly traded.

CHOICE OF LISTING

Public companies can trade on a national exchange, such as the New York Stock Exchange (NYSE), the NYSE Amex (AMEX), or the Nasdaq Global Markets (NASDAQ), which provide significant exposure and liquidity for a company, but also have initial and continued listing requirements that may be difficult to satisfy and result in significant additional expenses. While a limited number of NASDAQ and AMEX shells do exist, because shell companies do not have an operating business, they are not, as a rule, qualified to trade on a senior securities exchange.

The OTC Bulletin Board or OTCBB is an electronic trading market maintained by the Financial Industry Regulatory Authority (FINRA) (formerly the NASD) that displays real-time quotes, last-sale prices, and volume information for many over-the-counter (OTC) equity securities that are not listed on NASDAQ, AMEX, or another national securities exchange. Although FINRA oversees the OTCBB, it is not part of NASDAQ. Companies listed on the OTCBB have similar SEC filing requirements to those listed on NASDAQ. One can expect public disclosure from companies whose securities are traded on the OTCBB to be similar to that provided by NASDAQ-listed companies.

The Pink OTC Markets is another computerized OTC market (technically, it is a quotation service), which, like the OTCBB, provides quotes for the trading of OTC securities. The Pink OTC Markets is comprised of three disclosure tiers: (i) the OTCQX, which provides the highest level of quality control and includes primarily foreign issuers; (ii) the OTCQB, the middle level disclosure tier, comprised of U.S. companies that are SEC reporting; and (iii) the Pink Sheets, which is more speculative and includes companies that provide limited or no information to the public markets. Similar to the OTCBB, companies whose securities are quoted on one of the OTCQB and Pink Sheets tiers of the Pink OTC Markets do not generally need to satisfy the types of listing requirements required by the senior exchanges such as NASDAQ and AMEX. The OTCQX and OTCQB tiers of the Pink OTC Markets are required to provide public disclosure similar to that required by the OTCBB and senior securities exchanges such as NASDAQ and AMEX. Only those companies whose securities are quoted on the lowest tier, the Pink Sheets, are not required to provide public disclosure, such as financial results and material information relating to their businesses (though they are strongly encouraged by the Pink OTC Markets to do so). The goal normally is to establish credibility with the marketplace, and perhaps make it easier to achieve an OTCBB or senior exchange listing in the future.

CHOICE OF SHELL

An OTCBB shell normally is created when an exchange-listed company terminates or divests its operating business and its listing is terminated by the exchange and thereafter continues trading on the OTCBB. The most popular type of shell companies over the past few years have been OTCBB shells. Investors generally have preferred OTCBB shells, because these companies are required to be fully reporting with the SEC, they typically have a large shareholder base, and there is an existing public trading market for their shares at the time of the reverse merger closing, albeit limited to the size of the public float. OTCBB shells, which sold for as much as \$1 million a few years ago, still command a price of between \$300,000 and \$450,000, and sometimes more. In addition, the acquirer normally must relinquish some equity in the company to the shell's existing shareholders. In contrast, Pink Sheets shells usually range in price from \$150,000 to \$200,000.

The biggest concern for companies conducting a reverse merger with a shell, as well as the investors who provide PIPE (Private Investment in Public Equity) financing, is that a shell that originally had an operating business may have significant undisclosed liabilities, related to the shell's former business, which may not be discovered until after the completion of the transaction. It is for this reason that companies and investors spend so much in time and resources to "scrub" OTCBB or Pink Sheets shells with the hope of limiting their potential exposure to any such liabilities. A legal counsel experienced with these types of shells can be a very valuable resource in such a transaction.

Another type of shell company commonly used in reverse merger transactions is the Form 10 shell (Form 10 is the registration statement filed with the SEC to register a class of a company's shares with the SEC), also known as a "virgin shell." This type of shell is formed specifically to facilitate a transaction with a reverse merger candidate and thus never had an operating business. This registration does not actually register specific shares for sale by the company or any of its shareholders, but instead imposes an obligation on the company to file public reports with the SEC.

The most significant differences between a Form 10 shell and an OTCBB shell are: (1) no trading market will exist for the shares of a Form 10 shell at the time of the closing of a reverse merger (in fact, there will not be one for at least four to six months after the closing, assuming a concurrent PIPE financing and the ability of the PIPE investors to begin selling their shares at that time); (2) Form 10 shells typically have a much smaller shareholder base than an OTCBB shell (often fewer than five shareholders); and (3) compared to OTCBB shells, new company shareholders and investors face virtually no potential exposure to undisclosed liabilities, since Form 10 shells have never been engaged in an operating business. A Form 10 shell can be obtained today for between \$40,000 and \$75,000, requiring little or no equity dilution from existing shareholders.

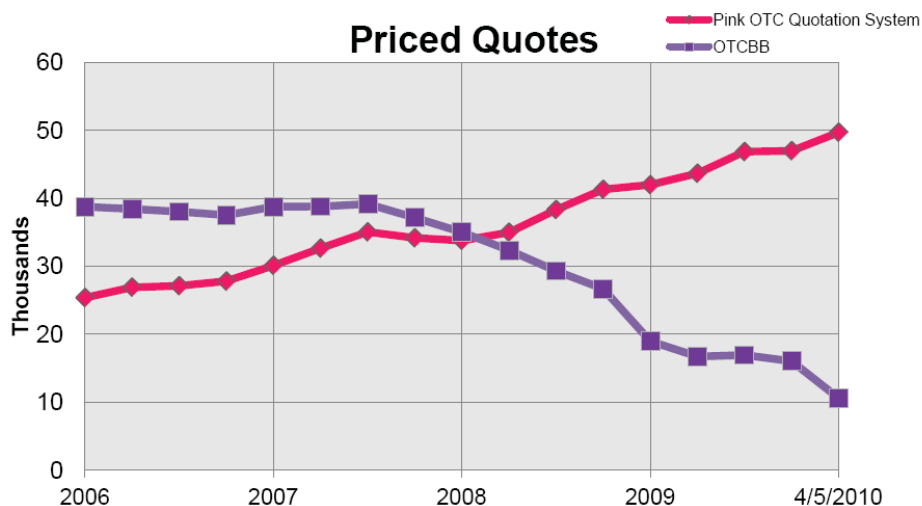
ALTERNATIVE PUBLIC OFFERINGS ("APO")

An APO is a combination of a reverse merger and a PIPE investment. In a PIPE transaction, the company is typically required to file a registration statement with the SEC shortly after the transaction. Although some investors have a longer term outlook and will hold their shares for several years, many PIPE investors desire to begin selling the shares they acquire in a PIPE financing within four to six months after the completion of the reverse merger. It is around this time that the PIPE investors' shares typically become fully registered under a registration statement filed by the company with the SEC. PIPE proceeds normally are provided by hedge funds or other institutional investors, or raised by investment bankers from their retail clients. Many companies that "go public" by means of a reverse merger also seek to raise financing concurrently with the closing of the merger. An APO also can be a complementary capital raising strategy for companies seeking liquidity, if as a result of the PIPE investment the shell company ends up meeting the minimum shareholder requirements for a senior exchange (assuming it meets the other listing requirements).

LIQUIDITY ON THE OTCBB VS. PINK SHEETS

Next to the success of the operating company's business, liquidity often is considered the most important factor in determining a company's success following a reverse merger. While achieving liquidity in a company's stock often begins with the company's engagement of an investor relations firm to deliver the company's message, it ultimately is the liquidity of the trading market where the company's shares are traded that determines its success.

Historically, OTCBB shells have been the preferred choice for reverse mergers, because of the existence of an investor base and of an immediate trading market. However, it is important to note that the trading activity would be limited to only those shares in the public float prior to the closing of the reverse merger, which is often limited. Shareholders of the operating company and PIPE investors will not be able to sell their shares, absent registration, for at least 12 months after the closing of the reverse merger, which as previously noted, takes four to six months.



In addition, as the adjacent chart provided by the Pink OTC Markets illustrates, the Pink OTC Markets has recently surpassed the OTCBB in trading volume for OTC securities. E*Trade, Fidelity, Scottrade, TD Ameritrade, and other online broker-dealers provide real-time Pink OTC Markets' quotation information to their customers for point and click trading. Real-time market data for professional traders are available from Bloomberg, Thomson Reuters, and other leading market data providers. Over 160 broker-dealers access Pink Link®, which is Pink OTC Markets' electronic messaging system. In 2009, broker-dealers communicated 35% of all OTCBB trades via Pink Link.

The following are certain relevant 2009 year- end trading statistics provided by the Pink OTC Markets:

OTC Market Tier	# of Securities at Dec. 31, 2009	% Total 2009 Dollar Volume	Avg. 2009 \$ Volume per Security
OTCQX *	78	9.50%	\$131,448,901
Pink Sheets Current Info.	1,695	67.60%	\$43,282,661
Pink Sheets Limited Info.	739	5.60%	\$8,198,443
OTCBB on Pink Quote **	3,321	15.10%	\$4,935,986
OTCBB Only	69	0.20%	\$2,883,275
Pink Sheets No Info.	3,445	2.40%	\$743,063

*OTCQX is the top tier designation of the OTC market, which requires that companies meet the financial requirements of NASDAQ's Capital Market Continued Listing Standards in order to be eligible.

** OTCBB on Pink Quote reflects OTCBB companies that are quoted on the Pink Sheets' electronic quotation system.

In light of the liquidity and transparency offered by the OTCQX and OTCQB tiers of the Pink OTC Markets, a growing number of companies and investors are starting to recognize that the higher cost of an OTCBB shell may no longer be justified.

THE NEW PATH TO LIQUIDITY

Whether a company's shares are quoted on the OTCBB or one of the Pink OTC Markets, the goal of nearly every public company is to move trading of its stock to a senior securities exchange such as NASDAQ or AMEX as soon as possible. The advantage of moving to a senior exchange is not limited to liquidity; rather, the operating company becomes the additional beneficiary of robust research and institutional coverage, better exposure, and a higher valuation.

Both the NASDAQ and the AMEX offer several alternative listing standards. A company may be required to satisfy one or more conditions, including (i) a minimum amount of stockholders' equity (\$4 or \$5 million), (ii) an operating history of at least two years, (iii) a minimum market capitalization (\$50 or \$75 million); (iv) net income from continuing operations in the latest fiscal year or in two of the last three fiscal years of at least \$750,000; (v) a minimum market value of all the publicly held shares (\$3, \$5, \$15, or \$20 million), (vi) a public float of at least 500,000 or 1,000,000 shares; (vii) a minimum number of shareholders (300, 400, or 800) holding at least 100 shares; and (viii) a minimum bid price for the company's shares (\$2.00, 3.00, or 4.00 per share), depending on the alternative. Unfortunately, for many issuers that were recently shell companies, the requirements for listing on a senior securities exchange can be difficult to satisfy.

In addition, until recently, a move to a senior securities exchange by companies "going public" through a reverse merger with a Form 10 shell was somewhat challenging, since NASDAQ generally requires that a company have at least 300 shareholders and AMEX usually requires at least 400 shareholders for listing on those exchanges. Form 10 shells, by their nature, typically have significantly fewer shareholders even after the completion of a reverse merger.

A recently introduced process called a "WRASP" addresses this issue using a series of transactions that can take a non- trading Form 10 shell directly to a senior securities exchange completely bypassing the OTCBB. WRASPs now have been used by a handful of investment firms successfully. The first step involves a typical APO transaction in which a Form 10 shell is merged with an operating company, along with a concurrent PIPE financing in which the company typically raises between \$3 million and \$5 million. Shortly after the completion of the APO, the post- merger company files a registration statement with the SEC to register the PIPE investors' shares for resale, and simultaneously files a registration statement for the sale of shares of the post- merger company in a secondary public offering to over 400 shareholders, pursuant to which it raises additional funds of up to \$25 million and possibly more, depending

on the company's need for capital. Third, while the registration statements are pending, the company files a listing application with a senior securities exchange such as the NASDAQ or AMEX. When the registration statements are declared effective by the SEC, trading of the company's shares is initiated on the senior exchange as a result of sales by the company of its shares in the secondary offering and the resale of shares by the PIPE investors.

CONCLUSION

Being public provides a company with significant advantages, including the ability to raise growth capital, use stock as currency for acquisitions and employee recruitment and retention, greater public visibility, and liquidity for its investors, which frequently result in a higher valuation. As traditional IPOs are no longer available to a large cross section of companies desiring to be public, reverse mergers and APOs have emerged as alternatives to go public and to raise capital in the process. Companies have several options when it comes to reverse mergers, including whether to list on the OTCBB or one of the Pink OTC Markets, and whether to use a former operating shell company or a virgin shell. Ultimately, those choices and the strategy as to how to eventually move to a senior exchange, such as the NASDAQ or AMEX, are dependent on the specifics of the company and should be examined carefully, with assistance from the company's legal counsel and investment bankers.

Feldman LLP is a boutique law firm based in New York. Its attorneys specialize in corporate and securities law, including reverse mergers and other alternatives to traditional IPOs. Scott M. Miller, Senior Counsel to Feldman LLP, specializes in corporate and securities matters, including the representation of investment banks, broker-dealers, and issuers in public offerings, reverse mergers, PIPES, and private placement financing transactions.