

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43907; File No. SR-NASD-01-01]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Amend NASD Rule 4330(f) To Require a Nasdaq Issuer To Apply for Initial Inclusion Following a Reverse Merger With a Non-Nasdaq Entity

January 30, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 9, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been 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 Substance of the Proposed Rule Change

Nasdaq has filed with the Commission a proposed rule change to amend NASD Rule 4330(f) to require a Nasdaq issuer to apply for initial inclusion following a reverse merger with a non-Nasdaq entity. Nasdaq also proposes to make conforming changes to IM-4300, Interpretive Material Regarding Future Priced Securities.³ Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in brackets.

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IM-4300. Interpretive Material Regarding Future Priced Securities

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[Change of Control and Change in Financial Structure] Reverse Merger

NASD Rule 4330(f) provides: [Nasdaq shall require a Nasdaq SmallCap Market issuer to comply with all applicable requirements for initial inclusion under this Rule 4300 Series and shall require a Nasdaq National Market issuer to comply with all applicable requirements for initial inclusion under the Rule 4300 Series and Rule 4400 Series in the event that such issuer enters into a merger, consolidation, or other type of acquisition with a non-Nasdaq entity (including domestic and foreign corporations and limited partnerships), which results in a change of control and either a change in business or change in the financial structure of the Nasdaq SmallCap Market or Nasdaq National Market issuer.]

An issuer must apply for initial inclusion following a transaction whereby the issuer combines with a non-Nasdaq entity, resulting in a change of control of the issuer and potentially allowing the non-Nasdaq entity to obtain a Nasdaq Listing (for purposes of this rule, such a transaction is referred to as a "Reverse Merger"). In determining whether a Reverse Merger has occurred, Nasdaq will consider all relevant factors including, but not limited to, changes in the management, board of directors, voting power, ownership, and financial structure of the issuer. Nasdaq will also consider the nature of the businesses and the relative size of the Nasdaq issuer and non-Nasdaq entity.

This provision, which applies regardless of whether the issuer obtains shareholder approval for the transaction, requires issuers to qualify under the initial inclusion standards following a Reverse M[m]erger [or consolidation that results in a change of control if there is also a change in either the business or the financial structure of the issuer].⁴ It is important for issuers to realize that in certain instances, the conversion of a Future Priced Security may implicate this provision. For example, if there is no limit on the number of common shares issuable upon conversion, or if the limit is set high enough, the exercise of conversion rights under a Future Priced Security could result in a [change of control in

a deemed] Reverse M[m]erger [or consolidation] with the holders of the Future Priced Securities. [In addition, the issuance of the Future Priced Security and the large increase in the number of common shares outstanding after conversion of the Future Priced Security may be viewed as a change in financial structure.] In such event, an issuer may be required to re-apply for initial inclusion and satisfy all initial inclusion requirements.

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Rule 4330. Suspension or Termination of Inclusion of a Security and Exceptions to Inclusion Criteria

(a)-(e) No change.

(f) [Securities issued in connection with the merger, consolidation, or other type of acquisition of at least one issuer of qualifying securities shall be promptly included in Nasdaq, provided that the conditions of Rule 4310(c) or rule 4320(e) for securities that have already been included are satisfied. Nasdaq shall require a Nasdaq SmallCap Market issuer to comply with all applicable requirements for initial inclusion under this Rule 4300 Series and shall require a Nasdaq National Market issuer to comply with all applicable requirements for initial inclusion under the Rule 4300 Series and Rule 4400 Series in the event that such issuer enters into a merger, consolidation, or other type of acquisition with a non-Nasdaq entity (including domestic and foreign corporations and limited partnerships), which results in a change of control and either a change in business or change in the financial structure of the Nasdaq SmallCap Market or Nasdaq National Market issuer.]

An issuer must apply for initial inclusion following a transaction whereby the issuer combines with a non-Nasdaq entity, resulting in a change of control of the issuer and potentially allowing the non-Nasdaq entity to obtain a Nasdaq Listing (for purposes of this rule, such a transaction is referred to as a "Reverse Merger"). In determining whether a Reverse Merger has occurred, Nasdaq will consider all relevant factors including, but not limited to, changes in the management, board of directors, voting power, ownership, and financial structure of the issuer. Nasdaq will also consider the nature of the businesses and the relative size of the Nasdaq issuer and non-Nasdaq entity.

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¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Future Priced Securities are private financing instruments which were created as an alternative means of quickly raising capital for issuers. A Future Priced Security is generally structured in the form of a convertible security and is often issued via a private placement. See IM-4300.

⁴ This provision is designed to address situations where a company attempts to obtain a "backdoor listing" on Nasdaq by merging with a Nasdaq issuer with minimal assets and/or operations.

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

The purpose of the proposed rule change is to amend NASD Rule 4330(f) (the "Rule") which provides, in pertinent part, that a Nasdaq issuer must comply with all applicable initial inclusion requirements under Nasdaq rules in the event that the issuer enters into a merger, consolidation, or other type of acquisition with a non-Nasdaq entity, which results in a change of control and either a change in business or a change in the financial structure of the Nasdaq issuer.

Nasdaq originally adopted the Rule in 1993 to address the trend of non-Nasdaq entities seeking a "backdoor listing" on Nasdaq through a business combination involving a Nasdaq issuer.⁵ In these combinations, a non-Nasdaq entity purchased a Nasdaq issuer in a transaction that resulted in the non-Nasdaq entity obtaining a Nasdaq listing without qualifying for initial listing or being subject to the background checks and scrutiny normally applied to issuers seeking initial listing.

Some issuers and their counsel have expressed uncertainty regarding the exact circumstances under which the Rule is applicable. Therefore, Nasdaq proposes to amend the Rule to more clearly define that it is intended to apply to business combinations between a Nasdaq issuer and a non-Nasdaq entity in which there is a change of control of the Nasdaq issuer⁶ and the potential for the non-Nasdaq entity to acquire a Nasdaq listing (for purposes of this rule, such a transaction is referred to as a "Reverse Merger"). To provide further clarification, the proposed Rule would also set forth a list of non-exclusive

⁵ See Securities Exchange Act Release No. 32264 (May 4, 1993), 58 FR 27760 (May 11, 1993) (ordering approving File No. SR-NASD-93-07).

⁶ It is not necessary to obtain a majority interest in order for a change of control to occur.

factors to be considered when determining whether a Reverse Merger has occurred. These factors include changes in the management, board of directors, voting power, ownership, and financial structure of the Nasdaq issuer. The nature of the businesses and the relative size of the Nasdaq issuer and non-Nasdaq entity would also constitute additional factors to be considered. Nasdaq believes that these proposed amendments will clarify the Rule for issuers while continuing to prevent "backdoor listings" on Nasdaq.

Nasdaq also proposes to make conforming changes to IM-4300, Interpretive Material Regarding Future Priced Securities.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with Section 15A(b)(6)⁷ of the Act, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, and to protect investors and the public interest. As noted above, the proposed rule change is aimed at clarifying NASD Rule 4330(f), which prevents non-Nasdaq entities from obtaining a "backdoor listing" on Nasdaq through a business combination involving a Nasdaq issuer.

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.

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

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 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 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 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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 inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-01-01 and should be submitted by February 28, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43911; Filed No. SR-PCX-00-46]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Prohibition of Harassment

January 31, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 13, 2000, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been

⁸ 17 CFR 200.30-3(a)(12)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁷ 15 U.S.C. 78o-3(b)(6).