

# New Over-The-Counter Bulletin Board Rules May Mean Three Strikes and You're Out to Some Issuers

By

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On November 16, 2005, the Securities and Exchange Commission (the "Commission") approved a proposed rule change to the National Association of Securities Dealers ("NASD") Rule 6530, (the "Eligibility Rule"). Under the rule change, Over-The-Counter Bulletin Board ("OTCBB") issuers that fail to file a "Periodic Report" (10-Q's, 10-K's, 10-QSB's and 10-KSB's) with the Commission on the due date of such report, or after such extension provided by the filing of a Form 12b-25, three (3) times in any 24-month period are removed from quotation on the OTCBB for a period of one (1) year following such removal. The new rule applies to any reporting period ending after October 1, 2005.

Pursuant to the Eligibility Rule, once Nasdaq learns that an OTCBB issuer is delinquent in filing a Periodic Report, it will append an "e" to the end of an issuer's trading symbol to alert both the issuer and the market that the issuer has not timely filed such Periodic Report. Typically, the issuer is then sent a notification letter from Nasdaq, which states that the issuer will be de-listed from the OTCBB if it does not file the Periodic Report within thirty (30) days from the date its symbol is appended with the "e" (the "Grace Period"). If after the expiration of the thirty (30) day grace period, the issuer fails to file the Periodic Report, the issuer's securities are de-listed from the OTCBB. The issuer is then required to have a market maker submit a new Form 211 and 211 Addendum to be re-listed on the OTCBB.

Nasdaq has reported that historically, approximately 80% of issuers achieve compliance within the grace period, while 20% of issuers fail to comply with the Eligibility Rule within the Grace Period and are de-listed. Specifically, over the two year period ending August 31, 2004, Nasdaq identified 3,000 instances of delinquent or other incomplete filings by OTCBB issuers. Additionally, of the 1,806 OTCBB issuers, 1,035 were late in filing their Periodic Report once during the two year period, 548 were delinquent twice and 223 were delinquent three or more times. As a result, NASD proposed the rule change to the Eligibility Rule to encourage issuers to file their Periodic Reports within the filing deadlines, which rule changes the Commission believes will help to prevent

fraudulent and manipulative acts and practices and to protect investors and the public interest.

Under the rule change to the Eligibility Rule, if an issuer has been late in filing a Periodic Report two (2) previous times during the prior 24-month period, and fails to timely file a third Periodic Report (after any extension provided by the filing of a Form 12b-25), the issuer is automatically removed from quotation on the OTCBB. While the issuer does not receive the advantage of the Grace Period, Nasdaq does provide issuers with seven (7) calendar days to request review of the de-listing by a hearings panel, prior to being de-listed pursuant to the Eligibility Rule.

If an issuer is removed from quotation on the OTCBB due to the new Eligibility Rule, such issuer will not be eligible for re-listing on the OTCBB until it has timely filed all Periodic Reports due for a one (1) year period (generally including the filing of one annual report and three quarterly reports). If at any time prior to being re-listed on the OTCBB, the issuer is late in filing a Periodic Report with the Commission, the one (1) year period restarts and the issuer must timely file all Periodic Reports for another one year period following the filing of the late report.

The Commission believes that the Eligibility Rule will help foster the timeliness of disclosure available to the public by OTCBB issuers.

The change in the Eligibility Rule applies to Periodic Reports for periods ending on or after October 1, 2005. The change in the Eligibility Rule does not look backward and does not include or effect any Periodic Reports filed late prior to the date the change in the Eligibility Rule took effect. For example, if an issuer had missed the filing date of its March 31, 2005 Quarterly Report on Form 10-QSB, had its trading symbol appended with an "e," but filed its March 31, 2005 Quarterly Report on Form 10-QSB within the Grace Period and prior to being de-listed from the OTCBB, such late filing would not count as one of the three (3) late filings for the purposes of the amended Eligibility Rule, as its reporting date was prior to the effective date of those periods covered by the

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amended Eligibility Rule, October 1, 2005.

The amendment to the Eligibility Rule will force OTCBB issuers to be more diligent in their efforts to complete and file their Periodic Reports within the Commission's filing requirements, or face de-listing from the OTCBB. In our experience as corporate counsel to various public companies, the biggest factor leading to late Periodic Report filings with the Commission is that the company's auditor does not receive the company's financial statements with sufficient time to conduct an audit or review such financial statements. As such, we suggest that all OTCBB issuers prepare their quarterly and annual financial statements as early as possible after the end of each quarterly and annual period, so that their auditors are provided ample time to complete an audit or review of such financial statements and to minimize the chance of something going wrong at the last minute of a Periodic Filing, which could result in an issuer being de-listed from the OTCBB pursuant to the amended Eligibility Rule. The probable results of a company's stock being de-listed from the OTCBB include the following:

- ◆ a decline in stock price,
- ◆ increased volatility, and
- ◆ a limited market for the company's securities.

Additionally, it is unlikely that companies who are de-listed from the OTCBB for their failure to comply with the amended Eligibility Rule will be able to timely file the required reports to be eligible to be re-listed on the OTCBB, as such companies have been unable to file their reports on time in the past. Additionally, a de-listing may reduce or eliminate a company's chances of raising capital. Once a company is de-listed, it is unlikely that the investment community and the company's shareholders will receive periodic reports containing financial results, as well as current public information about the company, until such time, if ever, as the company is able to correct the deficiencies in its controls and procedures which caused it to become de-listed in the first place.

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