

# Form 10 Shells: The New Sweetheart of US Investment Dealers

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**U.S.** investment dealers at one time focused almost exclusively on bringing issuers public through an initial public offering. They were not interested in alternative public offering methods. The introduction of SPACs, special public acquisition companies, by Early Bird Capital Inc. in August of 2003 marked the beginning of a change in how investment dealers viewed going public transactions. SPACs are blank check companies which are registered with the Securities and Exchange Commission ("SEC") and traded on the OTC BB or Amex after their initial public offering. The sole purpose of a SPAC is to identify and acquire an operating business through a merger, share exchange or other transaction. SPACs are structured similar to Rule 419 blank check companies with a couple of key differences which I will not go into in this article. The important thing to understand is that they are cashed up shell companies looking for an operating entity to acquire.



SPACs were hugely successful up until 2008 when they hit a number of problems as a result of the economy and the nature of their structure. Regardless of their current state, SPACs introduced the idea that alternative public offerings could be a successful tool in the hands of investment dealers.

## Form 10 Shell Companies

Form 10 shell companies, or virgin shells as they are sometimes referred to, are a different form of a blank check company. Form 10 shell companies are registered under the *Securities and Exchange Act of 1934* but do not trade. They traditionally have no cash, no debt, no business and a nominal number of shareholders. Like SPACs, their sole purpose is to identify and acquire an operating business through a merger, share exchange or other transaction. Unlike SPACs, however, Form 10 shell companies are not burdened with formal structures as how to go about identifying or closing a transaction.

There is always been a small part of the market which has utilized Form 10 shell companies as alternative going public vehicles. My first Form 10 reverse merger transaction was in 1998. Over the years securities laws and tax rules have affected market perception and deal structure of Form 10 transactions bringing them in and out of favour and usage. Form 10 shell companies have always been best suited to situations where the main parties to the transaction are market savvy or have professionals involved who know how to best structure and utilize this type of vehicle. They have never been and probably never will be turnkey shells like a legacy shells or SPACs .

Smaller market players started dabbling with utilizing Form 10 shells in the early part of 2000 as an alternative public offering vehicle. Over the years different twists have emerged in how Form 10 shell companies are utilized. Halter Financial Investments, LP., in Texas, one of the earliest adopters, has been involved in over a dozen Form 10 transactions. [WestPark Capital, Inc.](#), in California, has closed fifteen

Form 10 transactions. Roth Partners LLC, Cowen & Co., National Securities Corp., Rodman and Renshaw and other investment dealers have also become involved in Form 10 transactions. More than one investment dealer may be involved in a transaction as almost all Form 10 transactions include a financing (\$5-65 million) concurrent to the close of the acquisition of the operating entity.

### **Why Use a Form 10 Shell Company**

Investment dealers are interested in Form 10 shells for a number of reasons. They are clean with no prior business history, debt or potential litigation or improper trading issues unlike legacy or recently created trading shell companies. They tend to have only one or two shareholders who are sophisticated market players who are looking for the right deal and not just a quick sale of their shell. Unlike SPACs they can close a deal quickly with an operating company as no shareholder meeting is required as there are often only one or two shareholders of a Form 10 shell. Share structure issues and valuation are similarly easily managed. Institutional investors and hedge funds that are limited to investing only in public companies are freely able to invest in these vehicles as they meet the requirement of being a SEC reporting issuer.

The fact that Form 10 shells do not trade is not as big of an issue as you would suspect with investment dealers or management of the operating target company. New private placement investors and the shareholders of the target entity both receive restricted securities regardless if the shell company is trading or not. The fact that the Form 10 shell is not trading puts everyone on a trading field. By being non-trading, Form 10 shells eliminate the risk that the shell owners secretly hold "free-trading shares" in nominees' names or that someone unrelated to the new group will run a damaging stock promotion campaign before the securities of the new investors and shareholders are tradable. Form 10 shells also have no risk of disgruntled shell shareholders looking to sell as soon as possible, as everyone one involved in a Form 10 transaction is backing the business and management of the operating entity.

Operating entities also like this structure over a traditional initial public offering as they receive the cash they need up front rather than waiting for the initial public offering process to complete. There is no uncertainty that they will lose the market window and interest in their company during the registration process. The acquisition transaction and private placement financing transaction close concurrently. One does not happen without the other. During the registration process companies may conduct another private offering of securities as long as the investor was not solicited using the pending registration or directed to the company as a result of the pending registration

The majority of investors like this process as they often see a premium on their stock on filing the Form S-1 registration statement covering the resale of their stock. If you look at the WestPark deals you will see that the majority of their Rule 506 offerings were conducted at \$1 to \$1.50 a share. The resale and concurrent registered offerings were priced \$3.50 to \$5.50 or above per share.

### **The Form 10 Alternative Public Offering Process**

A Form 10 alternative public offering transaction has four main steps: (1) the acquisition of the operating entity; (2) completion of a concurrent private placement; (3) filing and clearing a resale registration statement with or without new registered offering; and (4) listing on exchange or application for an OTCBB quote. No shareholder meeting is required of the shell. A Form D, Form 8-K (super 8K); schedule 14F1, Form S-1 registration statement; and Form 424B3/424B4 prospectuses are the main documents filed

with the SEC as part of the transaction. All directors, officers and 10% holders also file all required insider reports with the SEC. A Super 8K contains Form 10 like disclosure of the operating entity acquired. The Super 8K on filing ends the issuer's status as a shell company. The application for listing on an exchange runs concurrent to the S-1 registration filing.

## **Twists to the Form 10 Going Public Transaction**

Halter Financial Investments, L.P., have the majority of their Form 10 shells go through a bankruptcy process before the alternative going public transaction. Section 1145(a) of the *US Bankruptcy Code* deems securities received in a bankruptcy proceeding, a "public offering" and therefore such securities are freely tradable (subject to a notice requirement). This step effectively allows them to bypass Rule 144's legend and resale restrictions and has allowed them to obtain a quote on the OTCBB for the securities of their Form 10 shells.

[WestPark Capital, Inc.](#) introduced a registered secondary offering immediately on the heels of clearing the Form S-1 registration covering the resale of the securities issued in the acquisition transaction and private placement. On review of the filings made in the Form 10 transactions involving WestPark you can see how their approach to these transactions has been fine tuned over the years.

Some issuers are electing to forgo filing a resale registration statement and instead are waiting out the mandatory one year hold period placed on their securities by Rule 144. The one year hold period runs from the date the issuer files the Super 8K. On conclusion of this hold period they then apply to trade their securities on a formal exchange or the OTCBB.

## **Closing Comments**

I expect more investment dealers will become Form 10 alternative public offering converts as they become comfortable with this process. Although it is not a structure for everyone it is a structure that works very well when professionals are involved who are familiar with the process. Form 10 shells by their very nature work to eliminate a majority of the risks associated with closing a SPAC transaction and the problems associated traditionally associated with shell deals in general.

**Notice:** This article is provided as a guideline for planning purposes only. You are advised to contact legal counsel prior to undertaking any resale of securities. Laws change and there are subtle nuisances to the rules that may apply in your particular circumstance.



**Venture Law Corporation**  
618 - 688 West Hastings Street  
Vancouver, BC V6B 1P1  
Phone: 604-659-9188  
Fax: 604-659-9178 [E-mail Us](#)