

The Pink Sheets: A Better Option Than You Think

The Pink Sheets is an US based electronic inter-dealer quotation system published by Pink Sheets LLC a private company. Pink Sheets LLC is not registered with the SEC. It provides quotes and last-sale information for over-the-counter securities not listed on the OTCBB or one of the other over the counter quote systems (ie. Yellow Sheets for debt; Gray Market for one off trades). The Pink Sheets frequently appeals to small companies who want a trading market but do not at present meet the criteria required for trading on larger exchanges or quote systems -- in terms of capitalization, number of shareholders, or who desire to avoid the cost or ongoing compliance requirements associated with being a reporting issuer. The Pink Sheets also serves as an interim location at which to place shares of large but financially distressed companies that have been delisted from the larger exchanges, but do not immediately meet the requirements to list on the OTCBB.



The Pink Sheets offers issuers:

- **Visibility** in the US investment community, which in theory can increase an issuer's brand recognition and create demand for its products and services;
- **Market Transparency** through the availability of real-time market data, in the form of competing market-maker quotes and buy and sell prices;
- **Efficiency** in trading by providing broker-dealers with an electronic way system for trading OTC securities reducing costs in time and money; and
- **Liquidity** in terms of the ease with which an issuer's securities can be bought or sold in the market without unduly affecting the price of a stock.

A Pink Sheets quote may also help an issuer raise capital as the quote will provide private placement investors with a way of selling their investment in the future. In short, the Pink Sheets is a viable option for issuers who chose to gain the advantages of going public without incurring the costs of being a public company.

Since 1999 the Pink Sheets has been steadily improving its profile in the micro-cap, small-cap and ADR marketplace. It is about to go head to head with the OTC Bulletin Board in attracting and keeping issuers that have substantial operating businesses. The Pink Sheets will provide credible disclosure on these issuers to the public by identifying and quoting them on a new premium tier called the OTCQX. The Pink Sheets estimates that 20% of its current issuers meet the requirements necessary to trade on the OTCQX tier. The Pink Sheets may indeed prove a better option for TSX Venture companies looking to have a US quote given the changes that have been implemented over the years and the new changes now underway. Certainly it is worth a look as it is not the same old barren ground of forgotten and left to die issuers that it once was ten years ago. One could say the Pink Sheets is even becoming a sexy place to be with no need to be a US reporting issuer to get the benefits of a dual quote and the added benefit of the Pink Sheet quote acting as a signal of your quality to the US marketplace. This article covers the changes undertaken by the Pink Sheets in the last eight years to make it a better option for those issuers that wish to provide their shareholders with the liquidity and transparent disclosure of a US quote system but in a more flexible regulatory environment that is suitable to the needs of smaller and foreign issuers.

How Did the Pink Sheets Increase its Profile?

In the last eight years the Pink Sheets has received a substantial boost in its profile from two regulatory shifts as well as internal changes implemented by the management of Pink Sheets LLC.

VENTURE LAW CORPORATION

The first regulatory shift occurred in 1999 when NASD amended its eligibility rule 6530 to require all OTC Bulletin Board quoted companies to be reporting issuers under the *Securities and Exchange Act of 1934*. The phase in period for this new eligibility requirement began in July 1999 and ended in June 2000, and resulted in over 3,000 former OTCBB companies moving over to the Pink Sheets. The second regulatory shift was initiated by the Federal government in July 2002 and resulted in the implementation of new SEC and exchange rules. The *Sarbanes-Oxley Act of 2002* (“SOX”) increased the cost of regulatory compliance of reporting issuers considerably which resulted in 300 or more companies choosing to move to the Pink Sheets and over 150 companies to go private in the first two years of its implementation. Not all of the companies that have moved over to the Pink Sheets are gems, but a good number of them are solid and legitimate companies. The Pink Sheets received a positive boost in numbers and profile as a result of these two regulatory shifts.

The Pink Sheets also received a boost to its profile by internal changes implemented by management. The first being the implementation of a real time electronic quotation service in September 1999. No more one day lags or paper (the OTCBB still relies on the telephone to complete its trades). The Pink Sheets real-time Level Two feed was also made available to the public in May 2001. The next change undertaken was to setup a sophisticated website in June 2000 that now provides the public with access to quotes, performance charts, financial and other information about Pink Sheet quoted companies. These two changes increased the visibility of the Pink Sheet quoted companies and increased the level of transparency and efficiency of the trades being conducted on the Pink Sheets.

Management of the Pink Sheets also became active in soliciting the SEC to expand NASD’s short-interest-reporting rules to include over-the-counter (OTC) equity securities, including those quoted on Pink Sheets. As a result of these efforts new short-interest-reporting rules were made effective on July 3, 2006. The campaign to address the shorting issue in the OTC market positively increased the profile and legitimacy of the Pink Sheets among those investors, market participants and issuers participating in this market segment.

The Pink Sheets and Eligibility Requirements

The internal changes of the Pink Sheets over the last three years have included increasing the eligibility requirements for issuers looking to be quoted on the Pink Sheets. The changes have been a market driven “race to the top” to stifle the rogues and identify the cream. At one time all that was required to become quoted on the Pink Sheets was a market maker, 20 stockholders or more, current unaudited financial statements and a completed Form 15c-211. The Form 15c-211 was reviewed internally by Pink Sheets LLC. The Pink Sheets has moved well away from its original “open arms with a few adjustments” approach to a new bold disclosure system, which it hopes will buy it, and the securities it quotes, legitimacy with a broader base of the market. The changes are set out below to give you an idea of how the Pink Sheets has evolved and is evolving.

On February 15, 2005, the Pink Sheets made it mandatory for issuers to make their information publicly available on www.pinksheets.com if a company was quoted by a market maker on an unsolicited basis. To do this issuers were required to subscribe to the Pink Sheets News Service (set up fee \$500, annual fee \$1500) before they could provide their financial statements, basic information, and news releases to the Pink Sheets to meet this new requirement. They were also required to provide a lawyers opinion letter concerning their stock and information.

On November 9, 2005, the Pink Sheets made it a requirement for market makers to file a Form 15c-211 with NASD for clearance of companies for which they planned on making unsolicited quotes on the Pink Sheets. Prior to this date only solicited quotes required market makers submit a Form 15c-211 to NASD for clearance for trades on the Pink Sheets.

On February 6, 2006, the rules were changed again to limit the publication of unsolicited quotes to issuers who meet one of the following five conditions:

- The issuer of the securities is subject to Section 13 or 15(d) of the *Securities and Exchange Act of 1934*, is current in its filing obligations and has other seasoned securities currently trading on the NYSE, AMEX, NASDAQ, OTCBB or the Pink Sheets;
- The securities were delisted from NYSE, AMEX, NASDAQ or the OTCBB;
- The issuer is a bank, savings and loan, or insurance company and is current in its regulatory filing obligations;
- The securities were issued as part of a bankruptcy plan of reorganization; or
- The security being quoted is a foreign ordinary, which is listed on a foreign exchange, or an ADR representing such ordinaries.

The Next Chapter in Growth and Legitimacy for the Pink Sheets

On March 16, 2006, the Pink Sheets introduced its biggest change yet to the Pink Sheets and issuer eligibility. These changes will begin being implemented on May 5, 2007 with a full roll out being completed by August 1, 2007. The change being introduced is a tier structure with issuers being placed into one of eight categories. The top tiers are referred to as the “OTCQX”. The eight categories in theory are based on the level, quality and timeliness of an issuer's disclosure.. The OTCQX categories require issuers to submit an application directly to the Pink Sheets and hire a US resident attorney or US resident investment bank that has registered and paid a fee to Pink Sheets LLC to be a Designated Advisors for Disclosure (“DAD”) or Principle American Liaison (“PAL”). The basic categories are as follows:

- **OTCQX Premium tiers**
 - **PremierQX** - The highest tier for U.S. companies. Must meet the continuing financial requirements of Nasdaq Capital Market, provide credible disclosure to the marketplace, and nominate a DAD.
 - **PrimeQX** - Must have ongoing business operations, a \$0.25 initial bid price, provide credible disclosure to the marketplace, and nominate a DAD.
- **International OTCQX Premium Tiers**
 - **International PremierQX** - The highest tier for international companies. Must meet the financial requirements of the NYSE's Worldwide Listing standards, be listed on a qualified international stock exchange, provide home country disclosure to U.S. investors in English, and nominate a PAL.
 - **International PrimeQX** - Must be listed on a qualified international stock exchange, provide home country disclosure to U.S. investors in English, and nominate a PAL.
- **Current Information (icon: Pink Checkmark)** - Must either be registered with the SEC pursuant to 12(g) of the *1934 Act* and current in all electronic filings posted on the SEC's EDGAR system, OR if not registered with the SEC, must meet Pink Sheets Guidelines for Providing Adequate Current Information and have this confirmed by quarterly letters from an attorney, all of which must be posted on the Pink Sheets News Service and displayed on pinksheets.com*. Disclosure is deemed to be current if it is posted within 120 days of the fiscal year ended (annual reports) and within 60 days of the quarter ended (quarterly reports); interim material events should be disclosed on a timely basis.
 - * *Banks and Financial Institutions* - Companies that report to federal or state banking regulators or to insurance commissions will be placed in the Current Information category if they post onto Pink Sheets News Service the same information they supply to their regulator (for example, to the FDIC), in a timely manner. An attorney letter is not required.
 - * *Foreign Private Issuers* - Non-U.S. companies that do not furnish electronic reports on the SEC's EDGAR system and that are listed on a qualified international stock exchange will be placed in the Current Information category if they post onto Pink Sheets News Service the same disclosure that they supply to their home country exchange and to their shareholders, in a timely manner. The disclosure must be in English. No attorney letter is required.
- **Limited Information (icon: Yield Sign)** - SEC registered companies must have posted some disclosure on the SEC's Edgar system within the last six months. Non-SEC reporting companies must have, at a minimum, quarterly financial reports prepared in accordance with GAAP, including financial notes, and certifications by the CEO and CFO, posted either on Pink Sheets News Service or SEC's EDGAR system.

- **No Information (icon: Stop Sign)** - The company does not make disclosure publicly available, or its available disclosure is older than six months.
- **Caveat Emptor/Buyer Beware (icon: Skull & Crossbones)** - There is a public interest concern associated with this company, which may include a stock spam campaign or other questions concerning the security or issuer. During a spam campaign, companies that have not, at a minimum, qualified for the Current Information category will also have their company's quotes blocked on pinksheets.com.

Is the Pink Sheets Right for You?

Obviously, if you are currently a US reporting issuer and quoted on the OTCBB the Pink Sheets may not be for you even if you fit in their premium tiers. You would actually be adding costs by switching to the OTCQX as you would have to retain a DAD or PAL and subscribe to the Pink Sheets News Service (set up fee \$500, annual fee \$1500) in order to post your information on the Pink Sheets web site.

If, on the other hand, you are a TSX or TSX Venture listed company you may be interested in being quoted on the OTCQX premium tier. If so, you would first file a Rule 12g3-2b package with the SEC to avoid inadvertently triggering US registration requirements. You would then find a willing market maker, hire a PAL and subscribe to the Pink Sheets News Service.

If, as a TSX or TSX Venture listed company you wanted to bypass the yearly cost of a PAL and the Pink Sheet pink check market/current information category is sufficient for your needs, you only need to file a Rule 12g3-2B package with the SEC, find a willing market maker and subscribe to the Pink Sheet News Service.

Time will tell how the new Pink Sheet system will work. It used to be that the Pink Sheets had a nominal cost associated with being quoted as it was driven by the market makers. Now, US resident lawyers, US resident investment bankers and the Pink Sheets LLC will all be diving into the pockets of issuers whose stock is quoted on the Pink Sheets. (The market makers are barred by NASD rules from taking money from issuers they submit quotes for.) These costs may indeed improve the quality of the Pink Sheets and the companies quoted, or just be a new revenue streams for US resident lawyers and US resident investment bankers with little real value added.

April 26, 2007



Venture Law Corporation
618 - 688 West Hastings Street
Vancouver, BC V6B 1P1
Phone: 604-659-9188
Fax: 604-659-9178
acormick@venturelawcorp.com