Ellenoff Grossman & Schole LLP

370 Lexington Avenue
New York, NY 10017
Tel: (212) 370-1300
Facsimile: (212) 370-7889
bdaughney@egsllp.com

CLIENT ALERT

Update on NASD Rules 2710 and 2720 in the Private Placement, PIPE and Resale Registration Context

March 16, 2007

On March 13, 2007, two partners from our firm, Doug Ellenoff and Brian Daughney, met with several staff members of the NASD Corporate Finance Department ("CFD") in Washington, D.C. Our firm had requested the meeting with the CFD to discuss with them NASD Rules 2710 and 2720 in the context of private placements, PIPEs and resale registration statements. We had earlier provided the CFD with a memorandum detailing many of the problems experienced by our broker-dealer clients during the several years we have been advising them to make filings with the CFD. A copy of our original memorandum is attached hereto for your reference.

In our memorandum to the CFD, we highlighted several unresolved issues pertaining to the applicability of Rule 2710 to private placements and PIPEs which are followed by a resale registration statement. We also highlighted problems with the NASD's COBRADesk filing system and the disparate results that we have achieved for various clients over the last several years due to differing rule interpretations by individual members of CFD staff ("Staff").

Present at the meeting on behalf of the NASD were six senior members of the Staff. We also invited two attorneys from other law firms to attend in order to impart to the Staff that the problems with Rule 2710 and 2720 in the private placement and PIPE registration context are universal in nature.

We commenced the meeting by stressing to the Staff that our primary purpose in submitting the memorandum and seeking the meeting was to rationalize the 2710 process, to achieve more consistent and timely review of each filing and to attempt to obtain clarity – or at least more Staff consideration – of several problematic issues. Staff assured us that the CFD is sensitive to charges that its policies are not uniformly implemented or interpreted and that it is working toward clarity and rule

changes. With respect to specific changes to Rule 2710, Staff advised that it is revising its proposed rule changes in light of the SEC's comments to its April 2006 submissions and that the NASD would be re-submitting those revisions to the SEC in the next 30 to 60 days. Staff said it would internally consider several of our discussion points as it re-writes the proposals.

We also impressed upon the Staff that there remains continued industry confusion (and, in fact, hostility) about whether any filing is necessary at all for a PIPE transaction that is followed by a resale registration statement. Staff reluctantly acknowledged that many NASD member firms were not in compliance with Rule 2710, despite their belief that they had provided adequate public notices (in the forms of notices to members, rule proposals, etc.) about the requirement for filings and review. We also emphasized that much of the confusion in this area is the result of the use of the term "underwriting" throughout Rule 2710 and supporting literature in light of the fact that the resale registration statement following a private placement or PIPE is not underwritten. It should be noted that the Staff did make it clear that the CFD was now more involved with NASD enforcement of compliance with the filing requirements. We believe that once the new rules are adopted the Staff will be taking a much more aggressive posture to ensure compliance.

Summary

There is no doubt that the meeting caused the CFD to internally review its positions on several matters and to reflect further on our observations regarding untimely review of filings. While Staff did not agree with several of our discussion points, we did achieve positive movement in other areas. We believe that there will be more consistency to their approach to certain matters and hopefully improved processing of individual filings. Further, there is substantive value to meeting and knowing each of the CFD personnel on an individual level – most of whom we have been interacting with over the telephone for several years. Historically, the Staff has been reluctant to discuss policies and procedures related to Rule 2710 on any level. Despite years of requests for meetings, Staff has refused to meet with any outside counsel or NASD member firms to discuss CFD policies. Hopefully, our meeting with CFD staff will further open lines of communication in the future.

Further, we believe that we successfully (only time will tell, of course) impressed upon the Staff that when and if the new Rule 2710 proposals are filed with the SEC, the Staff needs to present to member firms an explanation in plain English that one intended effect of Rule 2710, as amended, is to clarify that 1) the CFD requires a filing, absent an exemption, for all resale registration statements and 2) non-cash compensation obtained by a member firm in a PIPE or private placement will be subject to review at the time of the resale registration.

We present below an overview of each of the discussion points from the meeting.

Discussion Points

1. Delays in Obtaining Clearance from CFD Staff.

In our memorandum and also in the meeting with the Staff, we emphasized to Staff that the review process was far too long. We advised that based upon our experience (and of the two other laws firms present), the review process for Rule 2710 filings following a PIPE was often longer than the review process in an IPO.

Staff partially conceded that sometimes the process was inefficient and recognized that the investors were the parties most harmed by this inefficiency. Also, this led to the "concession" by Staff that investors can sell their securities through any member firm which did not receive compensation from the issuer in the prior 180 days. Historically, Staff has been adamant that no sales could be made at any member firm until Staff had issued a clearance letter. Although we argued with Staff that this "concession" would require, at best, that the placement agent firm inform its client investors that they could sell their securities through another firm but not at the placement agent, and therefore was unfair to the firm that acted as placement agent, Staff was not willing to change this policy.

2. Standard of Total Compensation Applied to the Resale Registration.

We discussed with Staff the base standard that it uses for allowing a level of compensation. Although never officially stated in any public notice, Staff confirmed that its standard for total compensation is that no member firm can receive more than 8% total compensation in connection with the resale distribution. In most resale registration scenarios following the private placement or PIPE, the components of this 8% figure will be:

a. the agency resale commissions to be earned;

b. the value of any warrants received as a placement agent in the prior 180 days before filing;

c. any rights of first refusal; and

d. any other items of value (as defined under the rule).

3. Information Requirements Related to the Involvement of Other Member Firms or Associated Persons in an Issuer.

Often in the resale registration statement, more than one NASD member firm, or associated persons of other member firms, are included as selling shareholders. In addition, another member firm may have received some form of compensation from an issuer within 180 days prior to the registration statement. In the past, CFD has frequently asked the member firm which made the filing to obtain information from an issuer, namely whether any of its shareholders or any selling shareholders is affiliated with other member firms and whether any member firm has received compensation from the issuer in the prior 180 days. CFD also requests information about the intended selling distribution methods of these other firms or persons. These information requests often delay the process because the filing firm has to obtain the information from the issuer, who in turn tries to obtain the information from the selling shareholders. Although our firm's practice is to include in the selling shareholder questionnaires a question designed to obtain information about NASD affiliations, the information may not always be readily available.

At our meeting, Staff advised that it had agreed to change its policies in this regard. No longer would the filing firm be required to submit or obtain information about other member firms or associated persons. Further, Staff has now concluded that in a co-managed placement they will not inquire of the applicant the compensation of another participating firm. Of course, the co-placement agents may voluntarily make a joint filing, but it is not a requirement.

4. Filing Exception for Limited Resales.

As presently interpreted by Staff, a member firm must file under Rule 2710 following a PIPE if 1) any selling shareholder is going to resell any of the PIPE securities through the member firm or 2) the member firm or any affiliate of the member firm is named as a selling shareholder (often because it received warrants in the PIPE and the issuer is required to register the underlying shares). In NASD's proposed changes to Rule 2710 submitted to the SEC in April 2006, it had included a filing exception to Rule 2710 if certain conditions tied to the level of resales were satisfied. Staff confirmed that its new rule change proposals would contain a similar list of exceptions, which they outlined as follows:

a. the member firm did not receive any securities from the issuer and is not named as a selling shareholder (this condition would not be satisfied in most smallcap/OTC PIPE deals);

b. the resale registration statement is not the first "public offering" by the issuer (in effect, not the issuer's IPO); and

c. the number of resales which would be undertaken by the selling shareholders through the member firm did not exceed, in the aggregate, the volume limitations under Rule 144 (this condition would also not be satisfied in most smallcap/OTC or pink sheet PIPE deals).

Despite our comments regarding the arbitrariness of these conditions (it favors the bulge bracket type PIPE because most bulge bracket deals do not involve warrants to the placement agent and the Rule 144 volume limits are much higher), Staff did not believe it would be changing its position.

5. Warrant Calculation and Analysis used to Determine Compensation.

We discussed with Staff its positions and rule interpretations related to the compensation attributed to warrants received by a placement agent. Staff would not agree with our position that the warrants were issued for services rendered in the private placement or PIPE – not a public offering or distribution subject to the rule – and therefore should not be counted as compensation. Staff firmly believes that the PIPE contemplates the registration resale and therefore it is compensation received in connection with a distribution covered by Rule 2710 (the resale by the investors). Staff also stated that it could not change this rule and that any securities received within 180 days of the filing of the registration statement would be deemed compensation.

We also discussed with Staff the use by Staff of the market value of the issuer's common stock at the time of filing of the registration statement, instead of the completion of the private placement or PIPE, to value the warrant for compensation purposes. Under the current rule, for private placements or PIPEs for OTC or pink sheet issuers, Staff does not consider there to be a "bona fide independent market". Therefore, although the placement agent may receive warrants at the closing of the private placement or PIPE at the market price of the issuer's common stock, the "value" for 2710 purposes is not established until the resale registration statement is filed. So, for example, if between the date of the closing of the private placement or PIPE and the filing of the registration statement the issuer's common stock rises, the warrants will have a higher value in the compensation analysis.

We requested that Staff review this policy and, if possible, amend Rule 2710 to include an expanded or alternative definition of "bona fide independent market" to allow for the OTC or pink sheet listing of issuers. Staff was skeptical that the SEC would allow such a broad expansion; however, it did agree to

consider other possible alternatives that would recognize that the OTC and pink sheets are legitimate trading structures which could form the basis for valuing securities.

6. Valuation of "Tail" Rights or "Lost Profit" Rights.

We discussed with Staff a recent comment that Staff has been occasionally issuing related to "tail" rights or "lost profit" rights. Briefly, many placement agents in a private placement or PIPE include a provision in their agreements that states if the issuer goes back to the investors within a certain time frame for more money, then the placement agent is entitled to receive compensation for such additional investment – usually at the same rate as in the original private placement.

Recently, Staff has been declaring this right as unreasonable under Rule 2710 because Staff cannot value the right (unlike a right of first refusal, which has a value of 1% under the rule) and because the member firm is getting paid, in Staff's opinion, without providing any services.

We presented an argument to Staff that the value of these investors is a real value and the member firm should be able to protect its sources. Further, the right being protected is not a "tail fee" within the meaning of the rules. A "tail fee" is a fee which a member firm might receive in the event an original underwriting is not consummated. We argued that the right for additional compensation is for a future possible transaction that actually occurs. Further, the Rule 2710 filing is being made for the resale of securities by the PIPE investors, and this future right has nothing to do with the resale offering.

Staff agreed to undertake a review of this policy.

7. Filing under Rule 2710 is Required in connection with Agency Sales under a Resale Registration Statement.

Since we were meeting with Staff face to face, we decided to argue that under the existing language of Rule 2710, no filing is required for agency sales in a resale registration statement. Our argument was based upon the express existing language within Rule 2710 – it speaks in terms of underwritten offerings, not sales made on an agency basis. By way of example, "participation or participating in a public offering" does not currently include any reference to sales on an agency basis. We argued that when an investor from a private placement or PIPE transactions sell his securities through his account at the placement agent, it is not an underwritten offering and not "participation in a public offering". We further argued that the recent rule proposals submitted to the SEC by the NASD were at least an acknowledgement of our position.

Staff adamantly opposes this interpretation and stated that one of the reasons for its recent proposals to amend Rule 2710 was to make it <u>abundantly clear</u> that a filing will be required absent an exemption, not that the current rules do not require filings.

8. Requirement for Qualified Independent Underwriters.

In our experience there have been several recent occasions where a member firm has received warrants in an issuer (or shares of common stock) as compensation for a private placement or PIPE and potentially holds 10% of more of the issuer's securities. Staff has argued that under Rules 2710 and 2720, the resale registration statement is a distribution by a member firm of an affiliated entity, and

that under Rule 2720 the member firm is required to obtain a "qualified independent underwriter" ("QIU").

We discussed the inherent fallacy of Staff's position on this matter, and the improper manner in which Staff was determining the 10% ownership. We argued that the requirement for a QIU only applies to when a member firm is selling securities of an affiliate. The resale registration statement is a sale by investors of their securities and is not being made on an underwritten basis by the member firm.

Staff agreed that the concept of requiring a QUI in the resale registration situation was often not appropriate. Staff indicated that the concept of the QIU was being reconsidered by Staff and that the new rule proposals would address the issue.

Further, we argued that Staff was not following the traditional Section 13d standards for determining ownership. By way of example, we argued that if a member firm has received a warrant as compensation for 100,000 shares and the issuer has 1,000,000 shares outstanding, the member firm potentially owns 100,000 shares out of a total of 1,100,000 shares (which results in the placement agent owning 9.1% and therefore not requiring any QIU). Under the SEC's traditional Section 13d analysis, when computing ownership an investor is allowed to add into the outstanding shares the number of securities which would be obtained upon exercise of a convertible security. Staff, on the other hand, utilizes an analysis that results in the placement agent owning 100,000 shares out of 1,000,000 (which results in the placement agent owning 10% and requiring a QIU).

Staff agreed to revisit its use of a different ownership calculation standard. We are optimistic that Staff will adopt the Section 13d standard.

9. Miscellaneous Issues

We also asked that Staff consider further changes to Rule 2710 and the COBRADesk filing system, or at least address these issues more explicitly in public statements. The following items were discussed:

a. revising the COBRADesk system to include a separate filing scheme for resale registration statements which are not being underwritten;

b. revising the rule and the COBRADesk system to include specific language addressing agency sales and resale registration statements, especially when no traditional underwriting is involved;

c. when revisions to Rule 2710 are submitted to the SEC or approved, the NASD should issue a notice to members, and in that notice make it explicit that compensation received in private placements or PIPEs within 180 days prior to the filing of a resale registration statement will be subject to review.

We are optimistic that we have established an open dialogue with the CFD on these and related issues. Please contact members of our firm to discuss any other issues that you believe may require further or additional dialogue with the NASD. If you have any questions or require additional assistance please contact one of the undersigned at (212) 370-1300:

Brian C. Daughney	ext 109
Douglas Ellenoff	ext 108
Stuart Neuhauser	ext 132

Ellenoff Grossman & Schole LLP

370 Lexington Avenue
New York, NY 10017
Tel: (212) 370-1300
Facsimile: (212) 370-7889
bdaughney@egsllp.com

To: Mr. Bernard Thompson
NASD

From: Ellenoff Grossman & Schole LLP

Re: NASD Rules 2710 and 2720
COBRADesk Filing and Review Process

Date: January 5, 2007

We have prepared this Memorandum in response to your recent request that we provide your office with a more detailed analysis of issues and concerns that we have experienced during the last several years during the review process of our clients' filings under NASD Rules 2710 and 2720 following the filing of a resale registration statement. This discussion is related solely to the review process of COBRADesk filings for registration statements following completion of a private placement offering. In preparing this memorandum, we have consulted with several other law firms who are similarly actively engaged in Rule 2710 filings and solicited their concerns with the filing and review process.

Since 2003, our firm has been actively encouraging NASD member firms to comply with Rule 2710 as its related to the aforementioned registrations, having had numerous discussions directly with the NASD Corporate Finance Department about its emerging sensitivity to the increasing popularity of private placement financings into public companies (commonly referred to as "PIPES") and its interest at that time in "encouraging" member firms to make 2710 filings in connection with the resale registrations of those same financings. Our experience with the process (after numerous filings) would suggest that there may be relatively easy methods for simplifying much of the process while still addressing the substantive issues that the NASD staff appropriately raises.

There are other issues that we have identified which we are raising that may be more complicated to resolve but that we believe ought to be considered as well. Nearly four years after the NASD's initial push for members to file under Rule 2710, we believe that there still remains

significant confusion amongst member firms about their responsibilities under Rule 2710. Further, those that have followed our advice and complied have, in certain cases, had a dissatisfying experience, not as to the conclusions necessarily, but the process. Primarily, it is the length of time required to get a "no objections" letter from NASD Corporate Finance. The significant time delay involved does not only impact the NASD member firm which has made the filing, but directly and adversely impacts the investing public because the NASD staff forbids any sales until the no objections letter is issued. We believe that these same member firms will either elect to refrain from providing similar broker-dealer services to issuers in the future, thereby adversely affecting the capital raising markets, or choose not to be vocal proponents of further compliance for other professional colleagues with whom they are in contact (recognizing fully that it is compulsory).

For our discussion purposes, we have identified the following key issues (not listed in any order) in processing Rule 2710 filings on CobraDesk in connection with resale registrations and discuss them further below:

-- Need for timely and greater communication from NASD Corporate Finance Department staff.
-- Need for public notice of changes in the NASD's internal review policies.
-- Need for uniform application of the NASD rules and review policies among reviewers;
-- Need for application of the rules and review process to address the common structure of the typical "retail" PIPE resale registration;
-- Re-visit the requirement for QIU pursuant to the application of Rule 2720 in a PIPE registration; and
-- Achieving the goal of "no objections" ruling.

We have also attached, as per your request, a "timeline" which sets forth some recent examples of the prolonged Rule 2710 and COBRADesk review process that we have experienced with respect to our clients' filings. As you will note from the timeline sheet, from initial filing to final conclusion, there can be an extensive time delay in obtaining clearance.

Background to the COBRADesk Rule 2710 and 2720 Filing

We believe that it is instructive to describe what we believe to be a "model" of the typical transaction in which many small and mid size broker-dealers are involved and which leads to the frustration with the COBRADesk filing and review system under Rule 2710 and 2720. There are, of course, many variations of the model, but we believe for our discussion purposes the "facts" stated below are representative of the type of transaction which leads to our concerns with the COBRADesk process.

The broker-dealer is engaged as a placement agent or selling agent to assist a company to raise capital through a private placement. Most often the client company is a smallcap or microcap public company. We refer to this company as the "issuer". The issuer retains the broker-dealer member firm pursuant to a written engagement agreement which typically provides for cash compensation and some type of equity, usually in the form of warrants. The broker-dealer and the issuer negotiate the terms of this compensation prior to the commencement of the placement, based upon numerous factors, including the market for the issuer's securities.

The placement is commenced and the broker-dealer solicits its client base for interested investors. The offering period generally lasts from between 10 to 90 days. The investors often receive

two types of securities for their investment. The first type is usually shares of the issuer's common stock or promissory notes. The second type of security is warrants to purchase shares of the issuer's common stock.

In our experience, the terms of the warrants to be issued to the broker-dealer are based upon two factors, namely, the terms of the warrants to be issued to investors and the "then" market price of the issuer's common stock. Many of our clients negotiate that the warrants they receive will have the same terms as the warrants received by investors. So the terms of the broker dealer warrants are set prior to commencement of the placement.

The terms of the offerings also contemplate that within some time frame, usually 30 to 90 days, after the completion of the placement, the issuer will file a registration statement with the SEC causing the registration for the resale of the securities purchased by the investors in the placement. The securities received by the broker-dealer firm as compensation for the placement may be included in the registration as well. In many cases, the registration statement may receive "no review" from the SEC. If the registration does receive a review it may take between 30 and 90 days to get it "effective". At the time of the original placement or at the time of "effectiveness" of the resale registration, there is no arrangement or agreement between the issuer or the investors to sell their securities through the broker-dealer which completed the placement.

Of course, since many of the investors have accounts at the broker-dealer which completed the placement, they will in fact sell their shares on an agency basis through that same firm[1]. Based upon this reality, it is at this stage that the broker-dealer firms must address Rules 2710 and 2720--although as we have observed for most of our professional careers and confirmed by many other colleagues there has been limited compliance with this filing and virtually no enforcement of it by the NASD—except as we have observed, in extreme cases of some perceived outright fraud. In our practice, as counsel to the broker-dealer firm which completed the placement, we are often assigned with making the filings under Rule 2710.

Compliance with Rule 2710

Rule 2710 (b)(1) requires a filing as follows:

> No Member or person associated with a Member shall participate in any manner in any public offering of securities subject to this Rule, rule 2720 or Rule 2810 unless documents and information as specified herein relating to the offering have been filed with and reviewed by NASD.

The NASD Corporate Finance Staff has been unofficially interpreting Rule 2710 to mean that "participation in a public offering" includes the activities of the broker dealer acting on an agency basis when the investors from the private placement resell their securities following the effectiveness of the registration statement. It is only within the last proposed amendments to Rule 2710[2] that NASD has

[1] The NASD staff has also taken the position, although never explicitly communicated in any public notice to member firms, that the inclusion of a broker dealer firm's placement agent securities in a resale registration statement, in and of itself, requires that a filing be made under Rule 2710.

[2] The NASD filed a proposed rule change on April 28, 2008 with the SEC which included changes to Rule 2710. We note that the proposed rule changes were not contained in any Notice to Members and cannot be found on the SEC's website or the NASD website without an extensive search.

clarified in writing in a public document is intention to apply Rule 2710 to the agency resale process. Although staff believes its positions have been made public for some time, we are aware of many broker dealer firms who disagree with the NASD's position and continue to believe that it is not applicable to the model transaction. Further, we are aware of only three broker dealer firms which have ever received written inquiries from NASD regarding whether or not they have been making Rule 2710 COBRADesk filings. All of these broker dealers are located in the New York region.

We believe that more explicit statements from the NASD Corporate Finance Department notifying NASD member firms of the potential impact of Rule 2710 on otherwise unregulated private placements would do much to inform the member firms of these issues. We would suggest, for example, that when and if the most recent rule change proposals to Rule 2710 are adopted, a Notice to Members be issued explicitly explaining the impact.

Issues and Concerns

1. Need for more timely and greater communication

As the 2710 review process for a particular transaction progresses, it would be helpful for the submission counsel to be able to speak with the examiners on an informal basis to expedite responses as they address the details of the examiners' comments. There seems to be an unofficial position that examiners will not address comments issued by staff or possible responses to comments with the submitting party (usually the broker dealer law firm) and require all requests and proposed answers to comments be filed through COBRADesk. As a result, there is a seemingly endless comment and response period where a single phone call could instead resolve a point in sometimes as little as 10 minutes. When we have asked NASD staff at regional and national meetings whether there is a policy on communications which forbids telephone communications, it is stated that this is not an official policy. The inability to speak directly with staff effectively hinders and delays the review process. Given that the SEC review process involves extensive and frequent telephone communication, we question the efficacy of this "unofficial" policy.

Also, we believe it would be useful to have a senior Corporate Finance staff member available as an "attorney of the day" or "Staff Respondent" to quickly address issues and questions that arise regarding Rules 2710 and 2720.

Also related to the issue of a communication breakdown is that there is no provision of Rule 2710, 2720 or any Notice To Members or other public notice issued by NASD Corporate Finance which states that NASD Corporate Finance applies Rule 2710 to private placement offerings. There is no requirement for any review of any terms of a private placement offering under NASD Rules. In fact, it is important to note that both rules consistently refer to "underwriters" and the actual COBRADesk system also uses this term. Much of the confusion and frustration that we hear from our broker-dealer client base is centered on the use of this term. That is because the private placement transaction is not underwritten and the broker dealer firm is not an underwriter of the resale registration. Therefore, our clients do not understand why or how Rules 2710 and 2720 are applied to govern a private placement transaction which has already been completed. Because of the manner in which 2710 and 2720 are applied by the Corporate Finance Staff, these rules actually do impact the compensation received in a completed private placement offering. We would suggest, as noted in the forepart of this memorandum, that the new rule proposals or a Notice to Members issued at the time of

adoption be explicit in this regard to include notice that compensation received as part of a previously completed private placement can be impacted by Rule 2710.

2. Notice of change in the NASD's internal review policies

As counsel to many NASD member firms, we take pains to anticipate and address the requirements of the NASD staff. As a result, we review the provisions of approved agreements to cull or edit the language for use in subsequent transactions. However, because of apparent NASD Corporate Finance internal policy changes which are not disclosed to the NASD member firms, documents or language used in one deal which are then subsequently used in a structurally identical deal are rejected or deemed in violation of Rule 2710. Further, we have used identical language in a resale registration statement from a previously approved registration statement and not received clearance without more modifications. It would be helpful and save effort for all parties to have some vehicle for notice of a change in the review policies so that documents can be adapted consistent with NASD standards prior to submission. This would facilitate the review and completion process for all parties, and limit the amount of frustration and uncertainty.

3. Uniform application of the NASD rules and review policies

In an effort to address the comments and concerns of the examiners, we have found that some examiners will request that certain information within the COBRADesk system be "checked off", while other examiners will question why that information is checked off (e.g. Papilsky Rules, which are not applicable to resale registrations). It would be helpful to have a checklist of information required for each type of offering, e.g. initial public offerings, secondary offerings, resale registrations, etc.

In addition, as stated above the provisions of Rule 2710 are primarily geared toward public offerings, which involve underwriters. In regard to resale registrations, underwriter issues and concerns do not directly apply. The resale registrations for model transactions are never underwritten. As a result, the NASD examiners and submission counsel struggle to conform the rule to these types of deals with mixed results. A rule interpretation would be enormously useful to all parties for guidance in adapting the requirements to these examinations. For example, when preparing a filing on the COBRADesk system there is an initial query whether the transaction is an initial public offering. A negative indication often prompts a comment from the Staff to change the designation to an affirmative indication; the only recourse being to add language to the Filer Notepad section of COBRADesk explaining that the transaction is not an initial public offering, despite the indication. Further, the Supplemental screen of COBRADesk queries again whether the transaction is an initial public offering, any response other than an affirmatyive one prompting a Staff comment to alter to affirmative despite the resale nature of the transaction being reported.

4. The calculation of compensation pursuant to Rule 2710 does not contemplate the common structure of the PIPE resale registrations

As described in the model transaction, the broker-dealer firm obtains warrants when the private placement is completed. Rule 2710 (d)(3) states that these warrants are deemed received at completion of the private placement. For valuation purposes, the value is determined under Rule 2710 (e)(3), which ties the value of the warrants in part to:

(i) the market price per security on the date of acquisition, where a bona fide independent market exists for the security, or

(ii) the public offering price per security.

Our first concern in this area is the inconsistency of the valuation process. There is no interpretation of "bona fide independent market". As stated above, the broker dealer warrants generally have terms tied to the market price of the issuer's common stock when the private placement is negotiated by the issuer and the broker dealer on an arm's length good faith basis. Or, in an effort to protect the investors in the private placement, the broker-dealer agrees that its warrants will have the same terms as provided to the investors or a higher exercise price. On many occasions the NASD staff, however, later "values" the warrant on the "public offering price" of the security (the price of the issuer's common stock when the registration is filed) – which can be as much as 120 days after completion of the offering and even longer after the original offering terms were struck. Again, in a resale registration statement there is no "public offering price". The reselling investor can sell anytime at any price over an extended period of time for so long as the registration statement remains effective. So the broker dealer is deemed to receive compensation at a higher level than the parties ever contemplated, and is penalized for a higher issuer stock price which may have no relationship to the broker dealer. We suggest that there be a change in the rule to recognize the realities of the terms of the transaction, and remove the "bona fide market" clause. This will at least provide certainty to the parties beforehand and remove the drawn out negotiation process for one portion of the valuation process. We believe this change would also benefit NASD Corporate Finance for these same reasons, given the limited amount of resources that the department can expend with respect to any particular filing.

Additionally, unlike the more common SEC interpretation of Section 13d of the Securities and Exchange Act of 1934, pursuant to Rule 2710(a)(3), the placement agent's warrants are not included in the denominator when calculating their compensation value. As a result of this exclusion, the percentage of the placement agent's compensation appears to be artificially inflated as a percentage of the model transaction as a whole.

5. Requirement for QIU pursuant to the application of Rule 2720 in a PIPE

Pursuant to Rule 2720, if a member holds in excess of 10% of the issuer's securities (which is calculated differently from the method of determining "beneficial ownership" by the SEC (see the discussion above regarding Section 13(d)), it cannot "participate in the offering" unless it complies with Rule 2720. If the issuer is not listed on an exchange, or other exemptions do not apply, the member must retain a qualified independent underwriter ("QIU") to, among other things, conduct due diligence and opine that the price is fair. This interpretation conflicts with the model transaction. Again, in a model transaction, there is no underwriter. Moreover, the investors listed as selling shareholders in the registration statement can sell their securities anytime and at any price and through any broker dealer firm, or they may not sell for a long period of time. Because shares are sold at market in a resale shareholder registration, we have sought guidance from the NASD as to how a QIU could opine that the market price is fair. Further, who would be retaining a QUI? There is no underwriting involved in the resale registration statement. There is no underwriting agreement and no arrangement with the issuer or any investor for the resale of the securities.

The unintended effect of this interpretation and rule application is to prevent the investors from selling their securities because NASD staff will not allow sales by any NASD member firm until a "no

objections" letter is issued. This was not the bargained for terms of their decision to invest in the issuer some 120 days prior. NASD Corporate Finance has rejected our arguments that compliance with the requirements of Rule 2720 in this context is not possible. In light of this position from staff, we have requested guidance from NASD Corporate Finance for an example of another resale registration where a QIU was involved and have not received any such guidance to date. As a result, we cannot provide guidance to our NASD member firms in this area. The effect is to reduce the capital raising activities of the broker dealer firms. Similarly, investors will refuse to provide capital to issuers because of the inability to know when their securities can be resold.

6. Achieving the goal of "no objections" ruling

Our goal is to conclude each COBRADesk 2710 review with an issuance of a "no objections" letter from NASD Corporate Finance. Recently, we have noted that examiners are increasingly rendering an opinion of "conditional no objections", which requires the subsequent filing of selected dealer agreements. However, these agreements are not applicable to the PIPE model registrations. Again, despite staff's acknowledgement that there is no underwriting involved, staff sometimes issues these types of letters. Further, there is no reference in Rule 2710, including the proposed amendments to any "conditional no objection" letter. So despite having received a no objections letter in a similar prior transaction, using almost identical disclosure, we are forced to advise our broker-dealer clients that this "conditional no objections" letter appears to be a new policy. As with other issues stated throughout this memorandum a more explicit policy set forth in a Notice to Members would be very helpful.

Conclusion

We are providing our analysis mindful of and respectful of the NASD's regulatory role in protecting the investment community at large and recognizing that there may be many other elements to the decision making process. Given the several years of filings at this point and the new clarifying rule in this area, we would encourage the NASD to further review and analyze the process for complying with Rule 2710. We are available for additional discussions and/or to meet in person, as you may deem worthwhile. If the NASD deems it appropriate, there are several other practitioners that we are familiar with at counterpart law firms (including several, like ours, with national practices which are not isolated to one NASD region), who we believe would further confirm our concerns based upon their experiences.

We would appreciate the opportunity to discuss these concerns and issues in a direct meeting with your office and members of the Corporate Finance Department. As stated in the forepart to this memorandum our goal is to help solve issues and concerns that we have encountered in the system, not to point fingers or criticize any of the participants. Please contact any of the persons listed below in our office:

Douglas Ellenoff, Esq	ext 108
Brian C. Daughney, Esq.	ext 109
Stuart Neuhauser	ext 132

ELLENOFF GROSSMAN & SCHOLE LLP

TIME LINE FOR 2710 FILINGS FOR RESALE REGISTRATIONS

Name of Issuer	**EGS File* Date**	**NASD Review Period (# of days)**	**NASD Comment Date**	**NASD Comment**	**Review Process (initial filing to approval)**
Acorn Factor, Inc.	12/1/06	27	12/28/06	Defer	Open
World Waste Technologies, Inc.	8/9/06 10/24/06	12 ???	8/21/06 Pending	Unreasonable	Open
Neuralstem, Inc.	6/21/06 9/6/06 11/9/06	26 35 29	7/17/06 10/9/06 12/8/06 12/8/06	Defer Defer No objections Conditional no objections	170 days
Avalon Energy Corp.	7/20/06 9/7/06 12/7/06	21 53 38	8/10/06 10/30/06 12/7/06	Unreasonable Unreasonable Conditional no objections	140 days
Rim Semiconductor Co.	6/1/06 8/18/06 9/8/06 11/10/06	13 9 24	6/14/06 8/29/06 12/4/06	Unreasonable Defer Conditional no objections	186 days
Sense Holdings, Inc.	6/28/06 7/31/06 10/16/06	14 21	7/12/06 8/21/06 10/12/06	Unreasonable Defer Conditional no objections	110 days

ELLENOFF GROSSMAN & SCHOLE LLP

TIME LINE FOR 2710 FILINGS FOR RESALE REGISTRATIONS

Name of Issuer	**EGS File* Date**	**NASD Review Period (# of days)**	**NASD Comment Date**	**NASD Comment**	**Review Process (initial filing to approval)**
ARTISTdirect, Inc.	2/23/06 5/3/06 9/11/06 9/15/06	29 61 3	3/14/06 7/3/06 9/5/06 9/14/06	Defer Status request Status request Conditional no objections	204 days
Ashlin Development Corp.	2/15/06 7/6/06 9/12/06	28 29	3/15/06 5/15/06 8/14/06	Defer Status request No objections	209 days
The Sagemark Companies Ltd.	3/18/05 5/6/05 8/24/05 9/27/05 1/26/06	19 77 117	4/6/05 7/22/05 5/23/06	Unreasonable Unreasonable No objections	65 days
Power Efficiency Corporation	11/15/05 1/3/06	21 43	12/6/05 2/15/06	Defer 415 takedown – no objections	92 days
AVP, Inc.	5/3/05 7/13/06	21 139	5/24/05 11/29/05 12/8/05	Defer Defer Conditional no objections	219 days
Cell Power Technologies	12/7/04 2/8/05 7/7/05 9/29/05 10/19/05	34 112 71 42	1/10/05 5/31/05 6/8/05 9/16/05 11/30/05	Defer Status request Defer Defer No objections	358 days

ELLENOFF GROSSMAN & SCHOLE LLP

TIME LINE FOR 2710 FILINGS FOR RESALE REGISTRATIONS

Name of Issuer	**EGS File* Date**	**NASD Review Period (# of days)**	**NASD Comment Date**	**NASD Comment**	**Review Process (initial filing to approval)**
IR BioSciences Holdings, Inc.	12/27/04 4/8/05	32 61	1/28/05 3/30/05 6/8/05 11/18/05	Defer Status request Status request No objections	326 days
Key Hospitality Corporation	5/18/05 8/1/05 8/23/05	49 58	7/6/05 10/20/05	Unreasonable No objections	155 days
Sense Holdings, Inc.	11/17/04 12/2/04	13 189	11/30/04 6/9/05 6/9/05	Defer Conditional no objection 415 takedown-no objections	204 days
Orange Hospitality, Inc.	11/23/04 12/22/04 1/24/05	 7	 1/31/05	 No objections	69 days
Hyperspace Communica-tions, Inc.	5/12/04 7/7/04 9/7/04 9/20/04	13 19 8 7	5/25/04 7/26/04 9/15/04 9/27/04	 Unreasonable Unreasonable No objections	138 days
Newtek Business Services, Inc.	5/21/04 6/17/04	19 29	6/9/04 7/16/04	Unreasonable No objections	56 days