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VERTICALNET INC  
Form PRER14A  
March 31, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

SCHEDULE 14A

(RULE 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE SECURITIES EXCHANGE ACT OF 1934 (AMENDMENT NO. 1)

Filed by the registrant

Filed by a party other than the registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, For Use of the Commission only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Section 240.14a-12

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**VERTICALNET, INC.**

(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.  
(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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(5) Total fee paid:

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Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Date Filed:

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD MAY 19, 2006

To Our Shareholders:

The 2006 annual meeting of shareholders of Verticalnet, Inc. will be held at the office of Morgan, Lewis & Bockius LLP, 1701 Market Street, Philadelphia, PA 19103 on May 19, 2006, beginning at 10:00 a.m. local time. At the meeting, you will be asked to act on the following matters:

- (1) Election of two directors;
- (2) To consider and vote upon an amendment to our Amended and Restated Articles of Incorporation to effect a reverse stock split of our outstanding common stock at an exchange ratio of not less than 1-for-3 and not more than 1-for-7, and authorize our Board of Directors to implement the reverse stock split within this range at any time prior to the 2007 annual meeting of shareholders by filing an amendment to our Amended and Restated Articles of Incorporation;
- (3) To consider and vote upon the approval to issue shares of our common stock pursuant to our \$6.6 million Senior Secured Convertible Promissory Notes in an aggregate amount exceeding 19.99% of our outstanding shares of common stock;
- (4) To consider and vote upon the approval of the Verticalnet, Inc. 2006 Omnibus Equity Compensation Plan;
- (5) To consider and vote upon an amendment to our Amended and Restated Articles of Incorporation to increase the number of authorized shares of our common stock to 150,000,000 shares; and

(6) Any other matters that properly come before the meeting.

All holders of record of shares of Verticalnet's common stock at the close of business on March 1, 2006 are entitled to vote at the meeting or any postponements or adjournments of the meeting.

YOUR VOTE IS IMPORTANT. PLEASE READ THE PROXY STATEMENT AND THE VOTING INSTRUCTIONS ON THE PROXY CARD AND THEN VOTE EITHER BY MAIL BY COMPLETING THE PROXY CARD AND RETURNING IT OR BY TELEPHONE BY FOLLOWING THE VOTING INSTRUCTIONS PRINTED ON THE PROXY CARD SENT TO YOU.

By order of the Board of Directors,

Christopher G. Kuhn

Vice President, General Counsel and Secretary

, 2006

Malvern, Pennsylvania

400 CHESTER FIELD PARKWAY  
MALVERN, PENNSYLVANIA 19355

**PROXY STATEMENT**

This proxy statement contains information related to the annual meeting of shareholders of Verticalnet, Inc. to be held on May 19, 2006 (the Annual Meeting), beginning at 10:00 a.m. local time, at the offices of Morgan, Lewis & Bockius LLP, 1701 Market Street, Philadelphia, PA 19103 and any postponements or adjournments thereof. Verticalnet first mailed these proxy materials to shareholders on or about April 10, 2006.

**ABOUT THE ANNUAL MEETING**

***What is the purpose of the Annual Meeting?***

At the Annual Meeting, shareholders will act upon the matters listed in the Notice of Annual Meeting and any other matters that properly come before the meeting. In addition, the management team will report on the performance of Verticalnet during 2005 and respond to questions from shareholders.

***Who can vote at the meeting?***

All shareholders of record at the close of business on March 1, 2006, or the record date, are entitled to vote at the Annual Meeting and any postponements or adjournments of the meeting.

***What are the voting rights of the holders of the common stock?***

Holders of our common stock will vote on all matters to be acted upon at the Annual Meeting. Each outstanding share of common stock will be entitled to one vote on each matter to be voted upon at the Annual Meeting.

***Who can attend the Annual Meeting?***

All shareholders as of the record date, or their duly appointed proxies, may attend the Annual Meeting. Each shareholder may be asked to present valid picture identification, such as a driver's license or passport. If you hold your shares through a broker or other nominee, you must bring a copy of a brokerage statement reflecting your stock ownership as of the record date. Everyone must check in at the registration desk at the meeting.

***How do I vote?***

You may attend the Annual Meeting and vote in person. Alternatively, you may vote your shares by proxy by:

mail, or

telephone

To vote by mail, simply mark, sign and date your proxy card and return it in the postage-paid envelope provided for receipt by us prior to May 18, 2006 (proxy cards received after 11:59 p.m., May 18, 2006 will not be counted). The enclosed proxy card contains instructions for telephone voting, which is available to shareholders 24 hours a day, 7 days a week until 10:00 a.m., Malvern, Pennsylvania time on May 18, 2006.

Please note that if your shares are held in street name, you must check the proxy card or contact your broker or nominee to determine if you will be able to vote by telephone. If you want to vote in person at the Annual Meeting and you hold Verticalnet common stock in street name, you must obtain a proxy card from your broker and bring that proxy card to the Annual Meeting, together with a copy of a brokerage statement reflecting your stock ownership as of the record date.

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Please also note that by casting your vote by proxy in any of the ways listed above, you are authorizing the individuals listed on the proxy card to vote your shares in accordance with your instructions.

***Is my vote confidential?***

Yes. Proxy cards, ballots and voting tabulations that identify shareholders are kept confidential except in certain circumstances where it is important to protect the interests of Verticalnet and its shareholders.

***What if I do not indicate my preference on the proxy card?***

If you do not indicate how you would like your shares to be voted with respect to a particular proposal, your shares will be voted FOR the election of the nominated slate of directors. As to other matters as may properly come before the meeting (or any adjournments or postponements thereof), the proxy holders will vote as recommended by the Board of Directors. If no such recommendation is made, the proxy holders will be authorized to vote upon such matters in their own discretion.

***Can I change my vote after I return my proxy card?***

Yes. Even after you have submitted your proxy, you may change your vote at any time before the proxy is exercised by filing with the Secretary of Verticalnet either a notice of revocation or a duly executed proxy bearing a later date. The powers of the proxy holders will be suspended if you attend the Annual Meeting in person and request to recast your vote. Attendance at the Annual Meeting will not, by itself, revoke a previously granted proxy.

***What constitutes a quorum?***

As of the record date, Verticalnet had 51,508,660 shares of its common stock outstanding. The presence at the Annual Meeting, in person or by proxy, of the holders entitled to cast at least a majority of votes which all shareholders are entitled to cast as of the record date will constitute a quorum. Broker non-votes, abstentions and votes withheld count as shares present at the Annual Meeting for purposes of a quorum. With respect to Proposal No. 3, however, a different standard will constitute a quorum for that proposal. See *Approval to Issue Shares of Our Common Stock Exceeding 19.99% of Our Outstanding Shares of Common Stock* on page 15 of this proxy statement.

***What are the recommendations of the Board of Directors?***

Unless you instruct otherwise on your proxy card, the persons named as proxy holders on the proxy card will vote in accordance with the recommendations of the Board of Directors. The Board of Directors recommends a vote

FOR the election of the nominated slate of directors;

FOR an amendment to our Amended and Restated Articles of Incorporation to effect a reverse stock split of our outstanding common stock at an exchange ratio of not less than 1-for-3 and not more than 1-for-7, and authorize our Board of Directors to implement the reverse stock split within this range at any time prior to the 2007 annual meeting of shareholders by filing an amendment to our Amended and Restated Articles of Incorporation;

FOR the approval to issue shares of our common stock pursuant to our \$6.6 million Senior Secured Convertible Promissory Notes in an aggregate amount exceeding 19.99% of our outstanding shares of common stock;

FOR the approval of the Verticalnet, Inc. 2006 Omnibus Equity Compensation Plan; and

FOR an amendment to our Amended and Restated Articles of Incorporation to increase the number of authorized shares of our common stock to 150,000,000 shares.

The proxy holders will vote as recommended by the Board of Directors with respect to any other matter that properly comes before the Annual Meeting. If the Board of Directors gives no recommendation on any such matter, the proxy holders will vote in their own discretion.

***What vote is required to approve each proposal?***

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*Election of Directors.* The affirmative vote of a plurality of the votes cast at the Annual Meeting is required for the election of directors. A properly executed proxy marked **WITHHOLD** authority with respect to the election

of one or more directors will not be voted with respect to the director or directors indicated, although it will be counted for purposes of determining whether there is a quorum. Thus, the two candidates with the most affirmative votes will be elected at the Annual Meeting.

*Approval to Issue of Shares of Our Common Stock Exceeding 19.99% of Our Outstanding Shares of Common Stock.* The affirmative vote of a majority of the votes cast by all the shareholders entitled to vote for this proposal, excluding the shares previously issued under our \$6.6 million Senior Secured Convertible Promissory Notes, as amended (the Notes), is required to approve the issuance of shares of our common stock pursuant to the Notes in an aggregate amount exceeding 19.99% of our outstanding stock on the date the Notes were sold. A properly executed proxy marked ABSTAIN with respect to this proposal will be counted for purposes of determining whether a quorum exists. However, under Pennsylvania law, a proxy marked ABSTAIN is not considered a vote cast. Accordingly, an abstention will have no effect on the approval of this proposal. Pursuant to applicable rules of The Nasdaq Stock Market and the terms of the Notes and the Note and Warrant Purchase Agreement between Verticalnet and the holders of the Notes, dated as of August 16, 2005, as amended, the holders of shares of our common stock previously issued pursuant to the Notes are not entitled to cast votes on this proposal with respect to such shares and such shares will not be counted for purposes of determining whether a quorum exists with respect to this proposal.

*Other Proposals.* For the other proposals, including an amendment to our Amended and Restated Articles of Incorporation to effect a reverse stock split at the discretion of our Board of Directors, the approval of the Verticalnet, Inc. 2006 Omnibus Equity Compensation Plan, an amendment to our Amended and Restated Articles of Incorporation to increase the number of authorized shares of common stock, and each other proposal that may be properly brought before the meeting, the affirmative vote of a majority of the votes cast by all the shareholders entitled to vote for the proposal will be required for approval. A properly executed proxy marked ABSTAIN with respect to any such matter will be counted for purposes of determining whether there is a quorum. However, under Pennsylvania law, a proxy marked ABSTAIN is not considered a vote cast. Accordingly, an abstention will have no effect on the approval of these proposals.

*Broker Non-Votes.* If you hold your shares in street name through a broker or other nominee, your broker or nominee may not be permitted to exercise voting discretion with respect to some of the matters to be acted upon. Under the rules that govern brokers who are voting with respect to shares held in street name, brokers have the discretion to vote such shares on routine matters, but not on non-routine matters. Routine matters include the election of directors. Non-routine matters include matters such as amendments to stock plans. Therefore, if you do not give your broker or nominee specific instructions, your shares may not be voted on non-routine matters and will not be counted in the voting results. Shares represented by such broker non-votes will be counted in determining whether there is a quorum. Broker non-votes will not be counted toward a nominee's total of affirmative votes in the election of directors and will have no effect on the approval of the other proposals.

***Who conducts the proxy solicitation and how much will it cost?***

Verticalnet is soliciting the proxies and will bear the cost of the solicitation. Verticalnet has retained Georgeson Shareholder to aid in the solicitation. For these services, Verticalnet will pay Georgeson Shareholder a fee of \$6,500 and reimburse it for out-of-pocket disbursements and expenses. Verticalnet may ask its officers and other employees, without compensation other than their regular compensation, to solicit proxies by further mailing or personal conversations, or by telephone, facsimile, Internet or other means of electronic transmission. Verticalnet will also, if asked, reimburse brokerage firms and others for their reasonable expenses in forwarding solicitation material to the beneficial owners of the common stock.

**INFORMATIONAL NOTE REGARDING PRIOR STOCK SPLITS**

Information in this proxy statement has been adjusted to reflect three separate stock splits of our common stock. A two-for-one stock split was effected on August 20, 1999 and another two-for-one stock split was effected on March 31, 2000. A one-for-ten reverse stock split was effected on July 15, 2002. All references to shares and per share amounts have been adjusted retroactively for these splits.



**PROPOSAL NO. 1 ELECTION OF DIRECTORS**

The Board of Directors is currently divided into three classes; two classes consist of three members and one class has two members. Each class has a three-year term. The classes expire in successive years.

The Board of Directors proposes that each of the nominees identified below, all of whom are currently serving as directors, be re-elected into the class listed below for a new term expiring at the annual meeting in the year listed below and until their successors are duly elected and qualified.

Name	Nominee For:		Current Director In:	
	Class	Term Expiring	Class	Term Expiring
Mark L. Walsh	I	2009	I	2006
Darryl E. Wash	I	2009	I	2006

Each of the nominees has consented to serve for the term indicated above. If any of them become unavailable to serve as a director prior to the end of their current term, the Board of Directors may designate a substitute nominee. In that case, the persons named as proxies will vote for the substitute nominee designated by the Board of Directors.

There are currently two vacancies in our Class I Directors. These vacancies were created by the resignations of Walter W. Buckley, III and Robert F. Bernstock. The nominating and corporate governance committee has not sought to identify candidates for nomination to fill these vacancies. As such, after the Annual Meeting two vacancies will remain on the Board of Directors in Class I whose term will expire in 2009. Under the terms of our Amended and Restated Articles of Incorporation and bylaws, the Board of Directors may fill these vacancies at any time.

**The Board of Directors Recommends That You Vote FOR Each of the Following Class I Director Nominees:**

**MARK L. WALSH**, 50, has served as a director since August 1997. He is the managing partner of Ruxton Associates, a private equity and investment firm he founded in April 2002. He was CEO of Air America Radio from November 2003 until April 2004. He also served as head of Internet operations for the John Kerry Presidential Campaign from June 2003 through September 2003, and as Chief Technology Advisor to the Democratic National Committee from December 2001 until September 2002. He served as Chairman of the Verticalnet Board of Directors from July 2000 until February 2002. Prior to that, he served as President and Chief Executive Officer of Verticalnet from August 1997 to July 2000. Before joining Verticalnet, he was a Senior Vice President and corporate officer at America Online, Inc. from 1995 to 1997. He founded and managed AOL Enterprise, the business-to-business division of AOL. Prior to his position with AOL, Mr. Walsh was the President of GENie, General Electric's online service. He currently serves on a number of private company and non-profit boards of directors and advisors. He received his MBA from Harvard Business School and B.A. from Union College.

**DARRYL E. WASH**, 40, has served as a director since August 2004. Mr. Wash co-founded Ascend Venture Group, LLC in January 2000 and has served as its Managing Partner since January 2000. Ascend is a private investment firm specializing in the education and applied technology industries. Prior to founding Ascend, he served as a Managing Director of Peter J. Solomon Company, a New York-based private investment bank focused in the retail, communications, and education markets, from April 1995 to January 2000. Prior to that, Mr. Wash was employed in the Investment Banking Division of Goldman, Sachs & Co. from June 1991 to March 1995. Currently, Mr. Wash serves as a director of several Ascend portfolio companies as well as the National Association of Investment Companies. Mr. Wash received a B.A. in Economics from the University of California at Berkeley and an MBA from Stanford University.

**Incumbent Directors**

The following persons are serving as Class II directors, whose terms expire in 2007:

**JEFFREY C. BALLOWE**, 50, has served as a director since July 1998. Mr. Ballowe is retired from Ziff-Davis, Inc. where he was President, Interactive Media and Development Group. Before leaving Ziff Davis at the end of 1997, Mr. Ballowe led the launches of five magazines, ZDNet on the Web, ZDTV (now TechTV), and the initial

ZD/Softbank investment in Yahoo!, Inc. Currently he serves as a director of Onvia. He is the co-founder and past President of the not-for-profit Electronic Literature Organization and a former member of the Board of Directors of Trustees of Lawrence University. He has an MBA from the University of Chicago, an M.A. in French from the University of Wisconsin-Madison, and a B.A. from Lawrence University.

**MICHAEL J. HAGAN**, 42, co-founded Verticalnet in 1995 and served as a director since 1995 and as Chairman of the Board of Directors from February 2002 to May 2005. Mr. Hagan has been Chairman and Chief Executive Officer of NutriSystem, Inc. since December 2002. Prior to that, he served as our President and Chief Executive Officer from January 2001 until February 2002, and Executive Vice President and Chief Operating Officer from January 2000 to January 2001. Prior to our founding, Mr. Hagan was Vice President and Senior Manager at Merrill Lynch Asset Management from 1990 to 1995. Currently he serves as a trustee of American Financial Realty Trust and Saint Joseph's University. Mr. Hagan received a B.S. from St. Joseph's University and was formerly a Certified Public Accountant.

**GREGORY G. SCHOTT**, 40, has served as a director since August 2003 and as Chairman of the Board of Directors since May 2005. Mr. Schott served as Senior Vice President of Marketing for Agile Software Corporation from 2001 to 2002. From 1999 to 2001, Mr. Schott served as Vice President of Business Development for Agile. From 1997 to 1999, Mr. Schott served as Vice President of Marketing at Digital Generation Systems, Inc., a provider of digital distribution systems to the broadcast advertising industry. From 1996 to 1997, Mr. Schott served as Vice President of Operations, from 1995 to 1996 as Director of Business Development and from 1994 to 1995 as Director of Operations, all at Digital Generation Systems. From 1991 to 1994, Mr. Schott served as a management consultant at The Boston Consulting Group. Mr. Schott received a B.S. in Mechanical Engineering from North Carolina State University and an MBA from Stanford University.

The following persons are serving as Class III directors, whose terms expire in 2008:

**NATHANAEL V. LENTZ**, 43, has served as our President and Chief Executive Officer and a director since November 2002. He was our Senior Vice President of Strategy and Marketing from August 2000 to November 2002, during which time he had responsibility for guiding our transition from an operator of Internet-marketplaces to a provider of supply management solutions. Prior to that, Mr. Lentz was a Vice President and Partner of Mercer Management Consulting, where he was employed from September 1991 to May 1998 and January 1999 to August 2000. While at Mercer, Mr. Lentz managed the San Francisco office and was a leader in their Global Process Industries and E-Commerce Practices. From May 1998 to November 1998, he was employed as Vice President of Strategic Development at CMC Industries, an electronic manufacturing services company located in Santa Clara, CA. Mr. Lentz received his MBA from Stanford University where he was an Arjay Miller scholar and a B.A. from Brown University.

**VINCENT J. MILANO**, 42, has served as a director since August 2003. Mr. Milano is serving, since January 2006, as Chief Operating Officer, as well as, since November 1997, Vice President, Chief Financial Officer of ViroPharma Incorporated. In addition, Mr. Milano has served as Vice President, Finance & Administration of ViroPharma since February 1997, as Treasurer since July 1996, and as Executive Director, Finance & Administration from April 1996 until February 1997. From 1985 until he joined ViroPharma, Mr. Milano was with KPMG LLP, most recently as a Senior Manager. Mr. Milano received his B.S. in Accounting from Rider College.

**JOHN N. NICKOLAS**, 39, has served as a director since February 2003. Mr. Nickolas has been Director, Finance & Accounting with The Philadelphia Phillies since July 2003. Prior to joining The Philadelphia Phillies, Mr. Nickolas had been a managing director with Internet Capital Group, Inc. since January 1999. During his tenure at Internet Capital Group, Mr. Nickolas served in a variety of roles including Chief Financial Officer of ICG Europe Ltd., a wholly owned subsidiary, and as a board member and Chief Financial Officer of Logistics.com, an Internet Capital Group partner company that was sold in December 2002. Prior to joining Internet Capital Group, Mr. Nickolas served in various financial positions with Safeguard Scientifics, Inc. from 1994 through 1998, most recently as Corporate Controller. Prior to joining Safeguard, Mr. Nickolas was an audit manager in the Philadelphia office of KPMG LLP. Mr. Nickolas graduated summa cum laude with a B.S. in Accounting from West Chester University.

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## Compensation of Directors

In November 2004, the Board of Directors adopted a policy regarding compensation to the members of the Board of Directors. Verticalnet pays its non-employee directors \$10,000 once a year for regular service on the Board of Directors in the form of a grant of restricted stock units ( RSUs ). The number of RSUs granted is determined by dividing \$10,000 by the closing price of Verticalnet common stock on the date of grant, which is typically the date of the annual meeting of shareholders. The RSUs have an exercise price of \$0.01 which is payable by the grantee upon distribution of the shares represented by the RSUs, and typically vest 25% each quarter after the date of grant. On March 2, 2006, the Board of Directors determined that the grant of RSUs to the Board of Directors for 2006 would not be made until the annual grant date for 2007, provided that a present member of the Board of Directors must be on the Board of Directors on the date of the annual grant for 2007 to receive the RSU grant.

Additionally, each non-employee director receives an initial grant of 30,000 options upon joining the Board of Directors and an annual grant of 20,000 options granted on the date of the annual meeting of shareholders. The exercise price of the options is the closing price of Verticalnet common stock on the date of grant. The options are generally non-qualified stock options and 100% of the options vest in one year from the date of grant. Options have a maximum term of ten years, except that a director has 90 days to exercise after leaving the Board of Directors. For fiscal 2005, Verticalnet granted 20,000 options and 14,085 RSUs to its non-employee directors. On March 2, 2006, the members of the Board of Directors determined that the annual grant of options for 2006 will have an exercise price equal to the greater of: (i) the fair market value of a share of our common stock on the date of such grant, or (ii) \$0.70 per share.

Verticalnet pays the chair of the audit committee \$5,000 and members of its audit committee \$3,500 for each fiscal quarter that they serve on the committee. Verticalnet pays the members of its compensation and nominating and corporate governance committees \$1,500 for each fiscal quarter that they serve on the respective committee. In addition, members of the Board of Directors are reimbursed for expenses they incur in attending meetings.

## Board of Directors and Committees

The Board of Directors is currently composed of Messrs. Schott, Ballowe, Hagan, Lentz, Milano, Nickolas, Walsh and Wash. Mr. Schott is the Chairman of the Board of Directors. The Board of Directors has determined that as of the Annual Meeting, all directors, other than Mr. Lentz, will be independent directors as that term is defined by the applicable listing standards of The Nasdaq Stock Market. The independent directors met regularly in executive sessions outside of the presence of directors who are not independent.

The Board of Directors met nine times during 2005. Four of the meetings were regular meetings and the other five were special meetings. Pursuant to our Corporate Governance Guidelines, all directors are encouraged to attend annual and special meetings of shareholders. Messrs. Lentz and Nickolas were in attendance at our 2005 annual meeting of shareholders. The Board of Directors has established the following standing committees:

*Audit Committee.* The principal purposes of the audit committee of the Board of Directors (the Audit Committee ) are to oversee our processes of accounting, auditing, financial reporting, internal controls and legal compliance functions, including without limitation, oversight of (i) the processes to insure the integrity of our consolidated financial statements; (ii) our compliance with legal and regulatory requirements; (iii) our independent registered public accounting firm s qualifications and independence; and (iv) the performance of our independent registered public accounting firm. In discharging its duties, the Audit Committee:

selects our independent registered public accounting firm and approves in advance any audit or non-audit service provided to us by our independent registered public accounting firm;

reviews and discusses consolidated financial statements with management and our independent registered public accounting firm;

reviews with management and our independent registered public accounting firm matters relating to our internal accounting controls, internal audit program, accounting practices and procedures, the scope and procedures of the outside audit, the independence of the independent registered public accounting firm and other matters relating to our financial condition;

reviews with management our disclosure controls and procedures;

reviews with management and our independent registered public accounting firm our compliance with applicable law and regulatory requirements;

reviews transactions that involve a potential conflict of interest; and

reviews our annual report on Form 10-K and our quarterly reports on Form 10-Q for filing with the Securities and Exchange Commission (the SEC).

The Audit Committee acts pursuant to a written charter, a copy of which is attached to this proxy statement as Annex 1 and is also posted on the Corporate Governance section of our website, [www.verticalnet.com](http://www.verticalnet.com).

The Audit Committee is currently composed of Messrs. Milano, Ballowe and Schott, each of whom the Board of Directors has determined is independent, as that term is defined by applicable listing standards of The Nasdaq Stock Market. Mr. Milano is the Chairman of the Audit Committee. The Board of Directors has determined that Mr. Milano qualifies as an audit committee financial expert as defined under Item 401(h)(2) of Regulation S-K of the Securities Exchange Act of 1934, as amended. In 2005, the Audit Committee met nine times.

*Compensation Committee.* The compensation committee of the Board of Directors (the Compensation Committee) is charged with reviewing Verticalnet's general compensation policies; reviewing, approving, recommending and administering Verticalnet's incentive compensation and stock option plans; and approving certain employment arrangements. The Compensation Committee acts pursuant to a written charter, a copy of which is posted on the Corporate Governance section of our website, [www.verticalnet.com](http://www.verticalnet.com).

The Compensation Committee was comprised of Messrs. Buckley, Ballowe and Schott until September 12, 2005, when Mr. Buckley resigned as a director. From September 12, 2005 until November 10, 2005, the Compensation Committee consisted of Messrs. Ballowe and Schott. Since November 10, 2005, the Compensation Committee has been comprised of Messrs. Ballowe, Schott and Wash, each of whom the Board of Directors has determined is independent, as that term is defined by applicable listing standards of The Nasdaq Stock Market. Mr. Ballowe is the Chairman of the Compensation Committee. In 2005, the Compensation Committee met nine times.

*Nominating and Corporate Governance Committee.* The nominating and corporate governance committee of the Board of Directors (the Nominating and Corporate Governance Committee) is responsible for identifying and recommending the director nominees to be selected by the Board of Directors for each annual meeting of shareholders; implementing the Board of Directors' criteria for selecting new directors; developing, reviewing and recommending to the Board of Directors a set of corporate governance policies applicable to Verticalnet; and providing oversight for the evaluation of the performance of the Board of Directors. The Nominating and Corporate Governance Committee acts pursuant to a written charter, a copy of which is posted on the Corporate Governance section of our website, [www.verticalnet.com](http://www.verticalnet.com).

The Nominating and Corporate Governance Committee was composed of Messrs. Nickolas, Buckley and Milano until September 12, 2005, when Mr. Buckley resigned as a director. From September 12, 2005 until November 10, 2005, the Compensation Committee consisted of Messrs. Nickolas and Milano. Since November 10, 2005, the Nominating and Corporate Governance Committee has been composed of Messrs. Nickolas, Milano and Wash, each of whom the Board of Directors has determined is independent, as that term is defined by applicable listing standards of The Nasdaq Stock Market. Mr. Nickolas is the Chairman of the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee met two times in 2005.

#### **Director Candidates**

Shareholders may recommend director candidates for inclusion by the Board of Directors in the slate of nominees which the Board of Directors recommends to shareholders for election. The qualifications of recommended candidates will be reviewed by the Nominating and Corporate Governance Committee. If the Board of Directors determines to nominate a shareholder-recommended candidate and recommends his or her election as a director by the shareholders, his or her name will be included in Verticalnet's proxy card for the shareholder meeting at which his or her election is recommended.

Shareholders may recommend individuals to the Nominating and Corporate Governance Committee for consideration as potential director candidates by submitting their names and background to Mr. Nickolas, Chairman of the Nominating and Corporate Governance Committee, at the address set forth below under Shareholder Communications. The Nominating and Corporate Governance Committee will consider a recommendation only if appropriate biographical information and background material is provided on a timely basis. The process followed by the Nominating and Corporate Governance Committee to identify and evaluate candidates includes requests to Board of Directors and others for recommendations, meetings from time to time to evaluate biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Nominating and Corporate Governance Committee and the Board of Directors. The Nominating and Corporate Governance Committee is authorized to retain advisers and consultants and to compensate them for their services. The Nominating and Corporate Governance Committee did not retain any such advisers or consultants during 2005.

Assuming that appropriate biographical and background material is provided for candidates recommended by shareholders, the Nominating and Corporate Governance Committee will evaluate those candidates by following substantially the same process, and applying substantially the same criteria, as for candidates submitted by Board of Directors members or by other persons. In considering whether to recommend any candidate for inclusion in the Board of Directors' slate of recommended director nominees, including candidates recommended by shareholders, the Nominating and Corporate Governance Committee will apply the criteria which are set forth in our Corporate Governance Guidelines. These criteria include the candidate's integrity, business acumen, age, experience, diligence, conflicts of interest and the ability to act in the interests of all shareholders. The Nominating and Corporate Governance Committee does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees. We believe that the backgrounds and qualifications of the directors, considered as a group, should provide a significant composite mix of experience, knowledge and abilities that will allow the Board of Directors to fulfill its responsibilities.

Shareholders also have the right to nominate director candidates themselves, without any prior review or recommendation by the Nominating and Corporate Governance Committee or the Board of Directors, by the procedures set forth herein under Shareholder Proposals for the 2007 Annual Meeting.

**PROPOSAL NO. 2 APPROVAL OF AN AMENDMENT TO OUR AMENDED AND RESTATED ARTICLES OF INCORPORATION TO EFFECT A REVERSE STOCK SPLIT OF OUR OUTSTANDING COMMON STOCK AT AN EXCHANGE RATIO OF NOT LESS THAN 1-FOR-3 AND NOT MORE THAN 1-FOR-7, AND AUTHORIZE OUR BOARD OF DIRECTORS TO IMPLEMENT THE REVERSE STOCK SPLIT WITHIN THIS RANGE AT ANY TIME PRIOR TO THE 2007 ANNUAL MEETING OF SHAREHOLDERS BY FILING AN AMENDMENT TO OUR AMENDED AND RESTATED ARTICLES OF INCORPORATION**

**Overview**

The Board of Directors has unanimously adopted a resolution approving, subject to approval by our shareholders, a proposed amendment to our Amended and Restated Articles of Incorporation to effect a reverse stock split of our outstanding shares of common stock, at an exchange ratio of not less than 1-for-3 and not more than 1-for-7, at the discretion of the Board of Directors. Shareholder approval of this proposal will authorize the Board of Directors, in its discretion, to effect a reverse stock split, and if so, at which exchange ratio within the approved range, at any time prior to our 2007 annual shareholders meeting. The Board of Directors believes that approval of a proposal granting this discretion to the Board of Directors to effect a reverse stock split and to determine the exchange ratio, as opposed to approval of an immediate reverse stock split at a specific ratio, will provide the Board of Directors with maximum flexibility to react to current market conditions and to therefore achieve the purposes of the reverse stock split, if implemented, and to act in the best interests of the Company and our shareholders.

To effect the reverse stock split, our Board of Directors would file an amendment to our Amended and Restated Articles of Incorporation with the Pennsylvania Secretary of State. The form of amendment to our Amended and Restated Articles of Incorporation to effect the proposed reverse stock split is attached to this proxy statement as Annex 2. If the Board of Directors elects to implement a reverse stock split approved by our shareholders, then the number of issued and outstanding shares of our common stock would be reduced in accordance with the exchange ratio for the selected reverse stock split. The number of shares of our common stock between and including three and seven would be combined into and become one share of common stock. The par value of our common stock would remain unchanged at \$0.01 per share. The reverse stock split would become effective upon the filing of the amendment to our Amended and Restated Articles of Incorporation with the Pennsylvania Secretary of State. The Board of Directors may elect not to implement a reverse stock split at its sole discretion, even if the proposal to grant the Board of Directors the discretion to effect a reverse stock split is approved by our shareholders.

Our Board of Directors has approved the proposed grant of discretion to effect a reverse stock split. By approving the proposal, however, our shareholders will give our Board of Directors maximum flexibility to determine the best stock split ratio.

**Purposes of the Proposed Reverse Stock Split**

Our Board of Directors believes that we should maintain the right to implement a reverse stock split for the following reasons:

To enhance the acceptability and marketability of our common stock to the financial community and the investing public;

To enable us to use the reverse stock split as may be required to maintain, and our Board of Directors believes it is in our and our shareholders' best interests to maintain, the listing of our common stock on the Nasdaq Capital Market; and

To reduce the number of outstanding shares of our common stock to a number that is more comparable with those of similar technology and software companies.

Our common stock is currently listed on the Nasdaq Capital Market. A continued listing on the Nasdaq Capital Market requires us to meet certain qualitative standards, including maintaining a certain number of independent Board of Directors members and independent Audit Committee members, and certain quantitative standards,



including that we maintain \$2.5 million in shareholders' equity and that the closing price of our common stock not be less than \$1.00 per share for 30 consecutive trading days. Since March 14, 2005, our stock has closed below \$1.00 per share. On April 27, 2005, we received written notification from the staff (the "Staff") of The Nasdaq Stock Market that the bid price of our common stock for 30 consecutive trading days had closed below the minimum \$1.00 per share required for continued listing under Nasdaq Marketplace Rule 4310(c)(4) (the "Rule"). Pursuant to Nasdaq Marketplace Rule 4310(c)(8)(D), we were provided an initial period of 180 calendar days, or until October 24, 2005, to regain compliance.

On October 26, 2005, we received a second notice from The Nasdaq Stock Market stating that the Staff had determined that we had not regained compliance with the Rule, although we met all of the Nasdaq Capital Market initial listing criteria, except for the bid price requirement. Because we met the initial listing criteria, the Staff notified us that we had been granted an additional 180 calendar day compliance period, or until April 24, 2006, to regain compliance with the minimum bid price rule. The notice states that the Staff will provide written notification that we have achieved compliance with the Rule if at any time before April 24, 2006, the bid price of our common stock closes at \$1.00 per share or more for a minimum of ten consecutive business days, although the notice also states that the Staff has the discretion to require compliance for a period in excess of ten consecutive business days, but generally no more than 20 consecutive business days, under certain circumstances. If we fail to regain compliance by April 24, 2006, the Staff will provide written notice that our securities will be delisted. At that time, we may appeal the Staff's determination to delist our securities to a Listing Qualifications Panel.

Our Board of Directors believes that listing on the Nasdaq Capital Market is the preferred listing market for our common stock. As of March 1, 2006, we met all qualitative and, except for the minimum bid requirement, all quantitative standards for initial and continuing listing of our common stock on the Nasdaq Capital Market. Thus, if the reverse stock split is approved by our shareholders and implemented by our Board of Directors, we expect to satisfy the \$1.00 per share minimum bid price requirement for continued listing under the Rule. Management and our Board of Directors believe that the implementation of the reverse stock split may be in the best interests of our Company and our shareholders.

#### **Enhanced Marketability**

Our Board of Directors believes that the reverse stock split should also enhance the acceptability and marketability of our common stock to the financial community and the investing public and may mitigate any reluctance on the part of brokers and investors to trade in our common stock. Many institutional investors have policies prohibiting them from holding lower-priced stocks in their own portfolios, which reduces the number of potential buyers of our common stock. In addition, analysts at many leading brokerage firms are reluctant to recommend lower-priced stocks to their clients or monitor the activity of lower-priced stock. A variety of brokerage house policies and practices also tend to discourage individual brokers within those firms from dealing in lower-priced stocks. Some of those policies and practices pertain to the payment of brokers' commissions and to time-consuming procedures that function to make the handling of lower-priced stocks unattractive to brokers from an economic standpoint. Additionally, because brokers' commissions on lower-priced stocks generally represent a higher percentage of the stock price than commissions on higher-priced stocks, the current share price of our common stock can result in an individual stockholder paying transaction costs that represent a higher percentage of total share value than would be the case if our share price were substantially higher. This factor may also limit the willingness of institutions to purchase our stock.

Our common stock has been trading below \$1.00 per share since March 2005. With the shares trading in such a range, small moves in absolute terms in the price-per-share of our common stock translate into disproportionately large swings in the price on a percentage basis, and these swings tend to bear little relationship to our financial condition and results of operations.

In our Board of Directors' view, these factors have contributed to an unjustified, relatively low level of interest in our Company on the part of investment analysts, brokers and professionals and individual investors, which tends to depress the market for our common stock. Our Board of Directors has thus proposed having the discretion to effect a reverse stock split as a means of increasing the per share market price of our common stock.



**Factors Influencing the Board of Directors Discretion In Implementing the Reverse Stock Split**

The Board of Directors intends to implement a reverse stock split if it believes that this action is in the best interests of our Company and our shareholders. Such determination shall be based upon certain factors, including but not limited to: existing and expected marketability and liquidity of our common stock, The Nasdaq Stock Market's listing requirements, prevailing market conditions, and the likely effect on the market price of our common stock.

In determining the reverse stock split ratio, the Board of Directors will consider numerous factors, including the historical and projected performance of our common stock, our projected performance, prevailing market and industry conditions and general economic trends, and will place emphasis on the expected closing price of our common stock over the short and longer period following the effectiveness of the reverse stock split with a view to enabling us to meet, for the foreseeable future, the Nasdaq Capital Market's minimum bid price requirement for continued listing.

No further action on the part of our shareholders would be required to either effect or abandon the reverse stock split. Notwithstanding approval of the reverse stock split proposal by the shareholders, our Board of Directors may, in its sole discretion, determine to delay the effectiveness of the reverse stock split up until the 2007 annual meeting of our shareholders.

**Potential Effects of the Proposed Reverse Stock Split**

The immediate effect of a reverse stock split would be to reduce the number of shares of our outstanding common stock and to increase the trading price of our common stock. However, we cannot predict the effect of any reverse stock split upon the market price of our common stock, and the history of reverse stock splits for companies in similar circumstances sometimes improves stock performance and sometimes does not. We cannot assure you that the trading price of our common stock after the reverse stock split will rise in proportion to the reduction in the number of shares of our common stock outstanding as a result of the reverse stock split. Also, we cannot assure you that a reverse stock split would lead to a sustained increase in the trading price of our common stock, that the trading price would remain above the thresholds required by the Nasdaq Capital Market or that we will be able to continue to meet the other continued listing requirements of the Nasdaq Capital Market. The trading price of our common stock may change due to a variety of other factors, including our operating results and other factors related to our business and general market conditions.

As a summary and for illustrative purposes only, the following table reflects the approximate number of shares of our common stock that would be outstanding as a result of the potential reverse stock split ratios within the range based on 51,508,660 shares of our common stock outstanding as of the record date, without accounting for fractional shares, which will be rounded up to the nearest whole share:

<b>Proposed reverse stock split</b>	<b>Percentage reduction</b>	<b>Shares to be outstanding</b>
1-for-3	67%	17,169,553
1-for-4	75%	12,877,165
1-for-5	80%	10,301,732
1-for-6	83%	8,584,777
1-for-7	86%	7,358,380

The resulting decrease in the number of shares of our common stock outstanding could potentially impact the liquidity of our common stock on the Nasdaq Capital Market, especially in the case of larger block trades.

**Effects on Ownership by Individual Shareholders**

Shareholders should recognize that if a reverse stock split is effected, they will own a smaller number of shares than they currently own (approximately equal to the number of shares owned immediately prior to the reverse stock split divided by three, four, five, six or seven, depending on which split ratio is implemented and after giving effect to the rounding up of fractional shares to the nearest whole share, as described below). The reverse



stock split would not affect any shareholder's percentage ownership interests in Verticalnet or proportionate voting power, except to the extent that interests in fractional shares would be rounded up to the nearest whole share.

#### **Effect on Convertible Notes, Options, Warrants and Other Securities**

In addition, we would adjust all outstanding convertible notes, options, warrants and other securities entitling their holders to purchase or obtain shares of our common stock as a result of the reverse stock split, as required by the terms of these securities. In particular, we would reduce the conversion price for each convertible note in accordance with its terms and based on the exchange ratio of the reverse stock split. We would also increase the exercise price of options, warrants and other securities in accordance with the terms of each instrument and based on the exchange ratio of the reverse stock split. Also, we would reduce the number of shares reserved for issuance under our existing stock option and employee stock purchase plans proportionately based on the exchange ratio of the reverse stock split. A reverse stock split would not affect any of the rights currently accruing to holders of our common stock, convertible notes, options, warrants or other securities convertible into our common stock.

#### **Other Effects on Outstanding Shares**

If our Board of Directors implements a reverse stock split, then the rights and preferences of the outstanding shares of our common stock would remain the same after the reverse stock split. Each share of our common stock issued pursuant to the reverse stock split would be fully paid and nonassessable.

While we expect that the reverse stock split will result in an increase in the market price of our common stock, the reverse stock split may not increase the market price of our common stock in proportion to the reduction in the number of shares of our common stock outstanding or result in a permanent increase in the market price (which depends on many factors, including our performance, prospects and other factors that may be unrelated to the number of shares outstanding).

If a reverse stock split is effected and the market price of our common stock declines, the percentage decline as an absolute number and as a percentage of our overall market capitalization may be greater than would occur in the absence of a reverse stock split. Furthermore, the liquidity of our common stock could be adversely affected by the reduced number of shares that would be outstanding after the reverse stock split. In addition, the reverse stock split will likely increase the number of our shareholders who own odd-lots (less than 100 shares). Shareholders who hold odd-lots typically will experience an increase in the cost of selling their shares, as well as potentially greater difficulty in effecting such sales. Brokerage commissions and other costs of transactions in odd-lots are generally higher than the costs of transactions in round-lot even multiples of 100 shares.

Our common stock is currently registered under Section 12(g) of the Securities Exchange Act of 1934. As a result, we are subject to the periodic reporting and other requirements of the Securities Exchange Act. The proposed reverse stock split would not affect the registration of our common stock under the Securities Exchange Act.

#### **Authorized Shares of Common Stock**

If we implement the reverse stock split, we would also reduce the number of authorized shares of our common stock as designated by our Amended and Restated Articles of Incorporation. The number of issued and outstanding shares of common stock and the number of shares remaining available for issuance under our authorized pool of common stock would decrease proportionately. However, our Board of Directors has also approved a proposal to amend our Amended and Restated Articles of Incorporation to increase the number of authorized shares of common stock to 150,000,000 shares, subject to shareholder approval. See Proposal No. 5 on page 25 of this proxy statement.

Even if Proposal No. 5 is not approved by our shareholders, we would still have a number of additional shares of common stock available for issuance from time to time for corporate purposes such as raising additional capital, acquisitions of companies or assets and sales of stock or securities convertible into common stock. However, we believe that the availability of the additional shares provides us with the flexibility to meet business needs as they arise, to take advantage of favorable opportunities and to respond to a changing corporate environment.

### **Procedure for Effecting the Proposed Reverse Stock Split and Exchange of Stock Certificates**

If our shareholders approve the proposed amendment to our Amended and Restated Articles of Incorporation, our Board of Directors may elect whether or not to declare a reverse stock split, as well as the specific exchange ratio, at any time before our 2007 annual shareholders meeting. The reverse stock split would be implemented by filing the appropriate amendment to our Amended and Restated Articles of Incorporation with the Pennsylvania Secretary of State, and the reverse stock split would become effective on the date the filing is accepted by the Pennsylvania Secretary of State.

As of the effective date of the reverse stock split, each certificate representing shares of our common stock before the reverse stock split would be deemed, for all corporate purposes, to evidence ownership of the reduced number of shares of our common stock resulting from the reverse stock split, except that holders of unexchanged certificates would not be entitled to receive any dividends or other distributions payable by Verticalnet after the effective date until they surrender their old stock certificates for exchange. All shares underlying convertible notes, options, warrants and other securities would also be automatically adjusted on the effective date.

Our transfer agent would act as the exchange agent for purposes of implementing the exchange of stock certificates. As soon as practicable after the effective date, shareholders and holders of securities convertible into our common stock would be notified of the effectiveness of the reverse stock split. Shareholders of record would receive a letter of transmittal requesting them to surrender their stock certificates for stock certificates reflecting the adjusted number of shares as a result of the reverse stock split. Persons who hold their shares in brokerage accounts or street name would not be required to take any further actions to effect the exchange of their certificates. No new certificates would be issued to a shareholder until the shareholder has surrendered the shareholder's outstanding certificate(s) together with the properly completed and executed letter of transmittal to the exchange agent. Until surrender, each certificate representing shares before the reverse stock split would continue to be valid and would represent the adjusted number of shares based on the exchange ratio of the reverse stock split, rounded up to the nearest whole share. **SHAREHOLDERS SHOULD NOT DESTROY ANY STOCK CERTIFICATE AND SHOULD NOT SUBMIT ANY CERTIFICATES UNTIL REQUESTED TO DO SO.**

### **Fractional Shares**

We would not issue fractional shares in connection with the reverse stock split. Instead, any fractional share resulting from the reverse stock split would be rounded up to the nearest whole share and no cash payment will be made in respect to such rounding.

### **No Appraisal Rights**

No appraisal rights are available under the Pennsylvania Business Corporation Law or under our Amended and Restated Articles of Incorporation or bylaws to any shareholder who dissents from this proposal. There may exist other rights or actions under state law for shareholders who are aggrieved by reverse stock splits generally.

### **Accounting Consequences**

The par value of our common stock would remain unchanged at \$0.01 per share after the reverse stock split. Also, our capital account would remain unchanged, and we do not anticipate that any significant accounting consequences would arise as a result of the reverse stock split.

### **Federal Income Tax Consequences**

The following is a summary of material federal income tax consequences of the reverse stock split and does not purport to be complete. It does not discuss any state, local, foreign or minimum income or other tax consequences. Also, it does not address the tax consequences to holders that are subject to special tax rules, including banks, insurance companies, regulated investment companies, personal holding companies, foreign entities, nonresident alien individuals, broker-dealers and tax-exempt entities. We have based this discussion on the provisions of the United States federal income tax law as of the date of this proxy statement, which are subject to change retroactively as well as prospectively. This summary also assumes that shareholders hold the shares as a capital asset, as defined in the Internal Revenue Code of 1986 (the Code) (generally, property held

for investment). The tax treatment of a shareholder may vary depending upon the particular facts and circumstances of the shareholder. We urge each shareholder to consult with the shareholder's own tax advisor with respect to the consequences of the reverse stock split.

The reverse stock split is intended to constitute a reorganization within the meaning of Section 368 of the Code. Assuming the reverse stock split qualifies as a reorganization, the following tax consequences generally will result:

No gain or loss will be recognized by Verticalnet as a result of the reverse stock split.

A holder of the pre-reverse stock split shares who receives only post-reverse stock split shares, in exchange for his or her shares, generally will not recognize gain or loss on the reverse stock split, the aggregate tax basis of the post-reverse stock split shares received will be equal to the aggregate tax basis of the pre-reverse stock split shares exchanged therefore, and the holding period of the post-reverse stock split shares received will include the holding period of the pre-reverse stock split shares exchanged.

Our beliefs regarding the tax consequence of the reverse stock split are not binding upon the Internal Revenue Service or the courts, and there can be no assurance that the Internal Revenue Service or the courts will accept the positions expressed above. The state and local tax consequences of the reverse stock split may vary significantly as to each shareholder, depending upon the state in which he or she resides.

#### **Votes Required for Approval of Proposal No. 2**

The affirmative vote of a majority of the votes cast by all the shareholders entitled to vote for this proposal will be required for approval. A properly executed proxy marked "ABSTAIN" with respect to this proposal will be counted for purposes of determining whether there is a quorum. However, under Pennsylvania law, a proxy marked "ABSTAIN" is not considered a vote cast. Accordingly, an abstention will have no effect on the approval of this proposal.

#### **Annex Relating to Proposal No. 2.**

The form of an amendment to our Amended and Restated Articles of Incorporation is attached to this proxy statement as Annex 2.

#### **Recommendation of the Board of Directors**

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE **FOR** AN AMENDMENT TO OUR AMENDED AND RESTATED ARTICLES OF INCORPORATION TO EFFECT A REVERSE STOCK SPLIT OF OUR OUTSTANDING COMMON STOCK AT AN EXCHANGE RATIO OF NOT LESS THAN 1-FOR-3 AND NOT MORE THAN 1-FOR-7, AND AUTHORIZE OUR BOARD OF DIRECTORS TO IMPLEMENT THE REVERSE STOCK SPLIT WITHIN THIS RANGE AT ANY TIME PRIOR TO THE 2007 ANNUAL MEETING OF SHAREHOLDERS BY FILING AN AMENDMENT TO OUR AMENDED AND RESTATED ARTICLES OF INCORPORATION.

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**PROPOSAL NO. 3 APPROVAL TO ISSUE SHARES OF OUR COMMON STOCK PURSUANT  
TO OUR \$6.6 MILLION SENIOR SECURED CONVERTIBLE PROMISSORY NOTES IN AN  
AGGREGATE AMOUNT EXCEEDING 19.99% OF OUR OUTSTANDING SHARES OF  
COMMON STOCK**

**Overview**

On August 16, 2005, we issued various independent institutional investors (the Investors) senior secured convertible promissory notes in the aggregate principal amount of \$6.6 million and warrants to purchase an aggregate of 4,719,000 shares of our common stock (the Warrants) for an aggregate purchase price of \$6.6 million. The Notes and Warrants were sold pursuant to a Note and Warrant Purchase Agreement dated as of August 16, 2005, as amended between us and the Investors (the Purchase Agreement). We also issued the placement agent for the transaction a warrant to purchase 141,429 shares of our common stock having the same terms and conditions as the Warrants issued to the Investors.

**Note and Warrant Purchase Agreement**

Under the Purchase Agreement, we agreed with the Investors that: (i) we will maintain at least \$1.5 million in our bank accounts while the Notes are outstanding; (ii) at our next annual meeting of shareholders, we will solicit shareholder approval of the issuance of shares of our common stock pursuant to the Notes in excess of 9,468,758 shares, such amount representing 19.99% of the aggregate number of shares of our common stock outstanding immediately prior to the sale of the Notes (the Shareholder Proposal); (iii) the Investors will have rights of first refusal on future financings within 14 months after the effective date of the registration statement registering the shares of our common stock for resale issued pursuant to the Notes and upon exercise of the Warrants; (iv) we will be restricted from issuing certain types of debt and equity instruments while the Notes are outstanding; and (v) all of our officers and directors who hold shares of our common stock will vote in favor of the Shareholder Proposal.

Pursuant to the Purchase Agreement, if our shareholders do not approve the Shareholder Proposal at this Annual Meeting, then as long as the Notes remain outstanding we are required to cause a shareholders' meeting to be held every six months, at our expense, seeking approval of the Shareholder Proposal.

**Senior Secured Convertible Promissory Notes**

The following discussion includes a summary of the Notes, a form of which Note along with a form of Amendment No. 1 to Note are attached to this proxy statement as Annexes 3 and 4. The summary is qualified in its entirety by reference to the attached documents. Shareholders are urged to read the form of Note and form of Amendment No. 1 to Note for a more complete description of the terms and conditions of the Notes.

The Notes are convertible in whole or in part into shares of our common stock, at the option of the Investors, at a conversion price of \$0.70 per share (the Conversion Price), subject to adjustment upon certain conditions. The Conversion Price for the Notes is subject to anti-dilution provisions in connection with certain future issuances of our securities as well as for adjustments for stock splits and the like. Specifically, if we issue shares of our common stock at a price below \$0.70 per share, the Conversion Price will adjust to the same price as the shares of our common stock issued below \$0.70 per share. The anti-dilution provisions above do not apply to certain excluded issuances, including the issuance of securities upon conversion of the Notes or the exercise of the Warrants, as payment of principal or interest on the Notes, pursuant to certain underwritten public offerings, pursuant to certain acquisitions by us, upon the conversion or exercise of existing convertible securities or in connection with our existing stock option plans.

The Notes mature on July 2, 2007 (the Maturity Date) and accrue interest at 9% per annum from the issue date. Interest is payable monthly, in arrears, beginning December 2005 until the earlier of the Maturity Date or the date of conversion of the Notes (the Conversion Date). Principal payments equal to 1/20th of the original principal amount of each Note are payable beginning in December 2005 and on the first business day of each month thereafter through July 2007 or the Conversion Date, whichever is sooner. If an Investor converts a portion of its Note such that the remaining principal amount of the Note is less than 1/20th of the original principal amount of the Note, the remaining principal amount of such Note is then payable in full on the next monthly principal payment date.

At our discretion, we may pay the monthly principal and interest payments in cash, shares of our common stock or a combination of cash and common stock, subject to certain limitations set forth in the Notes. If the closing bid price of our common stock for the 20 trading days prior to the date we elect to pay in shares of our common stock is at least 115% of the Conversion Price, the conversion price used for payments of principal and interest in shares of our common stock will be \$0.70 per share. If the closing bid price is less than 115% of the Conversion Price for such period, the conversion price will be equal to 85% of the average of the five lowest daily volume weighted average prices for the ten trading days prior to the date we elect to pay in shares of our common stock.

The Notes provide that if we are acquired or upon the occurrence of certain other events, which include the failure to make a timely payment, the failure to maintain the listing of our common stock on a satisfactory exchange or market, or the suspension of effectiveness of a registration statement registering the shares of our common stock underlying the Notes, the Investors may require us to prepay the Notes at 110% of the remaining principal amount of the Notes.

### **Warrants**

The Warrants have an exercise price of \$0.77 per share, and contain anti-dilution provisions that are similar to those contained in the Notes. Similar to the anti-dilution provisions contained in the Notes, if we issue shares of our common stock at a price below \$0.77 per share, the exercise price of the Warrants will adjust to the same price as the stock issued below \$0.77 per share. However, under no circumstances will the exercise price adjust to less than the closing bid price of our common stock on August 15, 2005 as a result of our issuing stock below \$0.77 per share. The Warrants are exercisable after six months from August 16, 2005 until August 16, 2010. The term of the Warrants can be extended by the Investors for the number of days that the shares of our common stock underlying the Warrants are not saleable as a result of the suspension of trading of our common stock on an applicable trading market and if the Investors are not permitted to use the prospectus included in the registration statement for the resale of the shares.

### **Reasons for Shareholder Approval**

Our common stock is listed on the Nasdaq Capital Market, and, as a result, we are subject to the rules of The Nasdaq Stock Market. Nasdaq Marketplace Rule 4350(i)(1)(D) requires Nasdaq-listed companies to obtain shareholder approval prior to the issuance of securities under certain circumstances, including a transaction involving the sale and issuance of common stock (or securities convertible into or exercisable for common stock) at a price below the book value or market value of the common stock, where the amount of stock being issued is equal to 20% or more of the issuer's common stock outstanding before such issuance.

On August 15, 2005, the last trading day prior to the date the Notes were sold, the closing bid price of our common stock on the Nasdaq Capital Market was \$0.70 per share. Assuming no adjustments are made to the Conversion Price of the Notes, the common stock issuable as payment of principal and interest on the Notes or upon the conversion of the Notes would be not be issued at a price that is below the book value or market value of the common stock as of the date we sold the Notes and the applicable Nasdaq Marketplace Rules would not be implicated by such issuances. However, in order for the Conversion Price to be equal to \$0.70 per share in connection with our decision to pay principal or interest on the Notes in stock, the closing bid price of our common stock for the 20 trading days prior to the date we elect to pay in shares of our common stock must be at least 115% of the Conversion Price. If the closing bid price is less than 115% of the Conversion Price for such period, the Conversion Price will be equal to 85% of the average of the five lowest daily volume weighted average prices for the 10 trading days prior to the date we elect to pay in shares of our common stock. As of March 1, 2006, all of the shares we have issued as payment of principal and interest on the Notes have been issued at a Conversion Price below \$0.70 per share. In addition, certain future issuances of our equity securities may cause anti-dilution adjustments to the Conversion Price of the Notes such that the Conversion Price of the Notes could be less than the greater of the market value and the book value of our common stock as of the date we sold the Notes.

Immediately prior to the sale of the Notes under the Purchase Agreement, 47,367,473 shares of our common stock were outstanding. As of March 1, 2006, an aggregate of 3,951,789 shares of our common stock had been

issued upon conversion of the Notes or as payment of principal and interest due on the Notes. In addition, as of March 1, 2006, an aggregate of 7,097,071 additional shares of common stock are issuable if the Investors elect to convert the remaining outstanding principal amount of the Notes, which was \$4,967,950 as of such date. Therefore, assuming no adjustments to the Conversion Price, as of March 1, 2006, the total number of shares of common stock issuable upon conversion of the Notes, when aggregated with the 3,951,789 shares previously issued upon conversion or as payment of principal and interest on the Notes, equals 11,048,860 or 23.33% of the shares outstanding immediately prior to the sale of the Notes and Warrants and exceeds the 19.99% threshold by 1,580,102 shares. In addition, an indeterminate number of shares of common stock could be issued as future payment of principal and interest on the Notes because the Conversion Price for such issuances varies with the price of our shares. An indeterminate number of shares of common stock could also be issued upon conversion of the Notes or as payment of principal and interest on the Notes because of the potential anti-dilution adjustments to the Conversion Price. Accordingly, under Nasdaq Marketplace Rule 4350(i)(1)(D) and pursuant to the terms of the Purchase Agreement and the Notes, we are required to obtain shareholder approval before we can issue shares of our common stock in excess of 9,468,758 shares.

In addition, Nasdaq Marketplace Rule 4350(i)(1)(B) requires shareholder approval in connection with the issuance or potential issuance of securities that will result in a change of control of an issuer. In determining whether shareholder approval would be required, Nasdaq looks to the hypothetical maximum number of shares that could potentially be issued and the minimum price per share for which such shares could potentially be issued. While we do not believe that the issuance of the shares of our common stock pursuant to the terms of Notes and upon exercise of the Warrants will result in a change of control, and therefore we do not believe that Rule 4350(i)(1)(B) applies to this issuance, a substantial adjustment to the Conversion Price of the Notes could result in a sufficient number of shares of our common stock issued under the Notes and upon exercise of the Warrants to constitute a change in control. Accordingly, we are seeking shareholder approval at this time in advance of any such issuance of common stock.

Absent shareholder approval of this Proposal No. 3, we will not be able to issue shares of our common stock pursuant to the Notes to the extent such issuance, when combined with the shares of our common stock previously issued under the Notes, would exceed 9,468,758 shares, or 19.99% of our outstanding stock as of the date the Notes were sold. Any amount of the Notes that the Investors are unable to convert in excess of the 19.99% threshold will remain a cash liability, due and payable on the earlier of the Maturity Date or the Conversion Date. In that event, we may be required to raise additional funds in order to meet this obligation. We may not be able to raise sufficient funds at that time, and, even if we are able to raise sufficient funds, the terms of such financing may not be favorable to us.

As of March 1, 2006, the total number of shares of common stock issuable upon conversion of the Notes, when aggregated with the shares previously issued upon conversion or as payment of principal and interest on the Notes, exceeds the 19.99% threshold by 1,580,102 shares. Thus, assuming a conversion of all outstanding Notes on March 1, 2006, absent shareholder approval of this Proposal No. 3, the Investors would have been unable to convert approximately \$1,106,071 aggregate principal amount of the Notes. Furthermore, having reached the 9,468,758 share threshold, we would be required to make all future payments on the Notes in cash.

Having to make payments on the Notes in cash where it would otherwise be optimal for us to satisfy these obligations with the delivery of shares of our common stock could leave us with limited working capital to operate our business. If we have limited working capital to operate our business, we may be forced to seek additional financing on terms which could materially and adversely affect the interests of our shareholders at that time. Furthermore, if this Proposal No. 3 is not approved by the shareholders at the Annual Meeting, we will be required to cause a shareholders meeting to be held every six months, at our expense, seeking approval of the Shareholder Proposal.

We granted the Investors registration rights with respect to the shares of our common stock issuable under the Notes or upon exercise of the Warrants. In connection with the closing of the transaction under the Purchase Agreement, we filed a registration statement on Form S-3 with the SEC which was declared effective by the SEC on October 7, 2005. That registration statement covers the resale of the shares of our common stock that are



issuable under the Notes and upon exercise of the Warrants. If the shareholders approve this Proposal No. 3, we may be obligated to file an additional registration statement covering the resale of the shares of our common stock that exceed the 9,468,758 share threshold that are issuable pursuant to the Notes.

If this Proposal No. 3 is approved and a future dilutive transaction were to occur, the Conversion Price of the Notes would be adjusted and, as a result, the issuance of common stock upon a future conversion of the Notes could potentially result in substantial dilution to the voting interests of our existing shareholders and those shareholders will own a smaller percentage of the our outstanding common stock as a result of such issuance.