

IPARTY CORP  
Form DEF 14A  
April 24, 2012

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**



**SCHEDULE 14A**

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Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant   
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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
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iParty Corp.  
(Name of Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

- No fee required.
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  - (1) Amount Previously Paid:
  - (2) Form, Schedule or Registration Statement No.:
  - (3) Filing Party:
  - (4) Date Filed:

**iParty Corp.**

**270 Bridge Street, Suite 301**

**Dedham, MA 02026**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

The 2012 Annual Meeting of Stockholders of iParty Corp. will be held as follows:

**Date:** Wednesday, June 6, 2012

**Time:** 11:00 a.m., local time

**Place:** Posternak Blankstein & Lund LLP

Prudential Tower

800 Boylston Street, 33rd Floor

Boston, MA 02199

**Matters to be voted on:**

1. The election of four directors to serve until the 2013 Annual Meeting of Stockholders;
2. Approval of an amendment to iParty's Restated Certificate of Incorporation to effect a reverse stock split, pursuant to which the existing shares of iParty's common stock would be combined into new shares of iParty common stock at an exchange ratio ranging between one-for-five and one-for-twenty, with the exchange ratio to be determined by the Board of Directors (the **Reverse Stock Split**);
3. Ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 29, 2012; and
4. Any other matters properly brought before the annual meeting or any adjournment thereof.

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The Board of Directors has fixed the close of business on April 10, 2012 as the record date for determining stockholders entitled to notice of and to vote at the annual meeting. Representation in person or by proxy of at least a majority of all outstanding shares of each class of stock entitled to vote at the meeting is required to constitute a quorum. Accordingly, it is important that your shares be represented at the annual meeting. The list of stockholders entitled to vote at the annual meeting will be available for examination by any stockholder at our offices at 270 Bridge Street, Suite 301, Dedham, MA 02026 for ten (10) days prior to June 6, 2012. Enclosed with the proxy statement for the meeting, you will find a copy of our Annual Report on Form 10-K for fiscal 2011.

**Your vote at the meeting is very important to us regardless of the number of shares you own. Please vote your shares, whether or not you plan to attend the meeting, by completing the enclosed proxy card and returning it to us in the enclosed envelope. Should you want to change your vote prior to the annual meeting you may do so in accordance with the instructions contained in the accompanying proxy statement.**

By Order of the Board of Directors,

DAVID ROBERTSON  
*Secretary*

*This notice, proxy statement, and form of proxy are being distributed on or about April 24, 2012.*

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**iParty Corp.**

**270 Bridge Street, Suite 301**

**Dedham, MA 02026**

**PROXY STATEMENT**

**for Annual Meeting of Stockholders to Be Held on June 6, 2012**

**GENERAL INFORMATION**

Our Board of Directors (the **Board**) is furnishing you this proxy statement to solicit proxies on its behalf to be voted at the Annual Meeting of Stockholders of iParty Corp. (**iParty** or the **Company**). The meeting will be held at the offices of Posternak Blankstein & Lund LLP, at the Prudential Tower, 33rd Floor, 800 Boylston Street, Boston MA, 02199, on June 6, 2012, at 11:00 a.m., local time. The proxies also may be voted at any adjournments or postponements of the meeting.

The mailing address of our principal executive offices is iParty Corp., 270 Bridge Street, Suite 301, Dedham, MA, 02026. We are first furnishing the proxy materials to stockholders on or about April 24, 2012.

All properly executed written proxies that are delivered pursuant to this solicitation will be voted at the meeting in accordance with the directions given in the proxy, unless the proxy is revoked prior to completion of voting at the meeting.

Only owners of record of shares of common stock, Series B convertible preferred stock (**Series B Preferred Stock**), Series C convertible preferred stock (**Series C Preferred Stock**), Series D convertible preferred stock (**Series D Preferred Stock**), Series E convertible preferred stock (**Series E Preferred Stock**) and Series F convertible preferred stock (**Series F Preferred Stock**) and together with the Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock, the **Convertible Preferred Stock** of the Company at the close of business on April 10, 2012, the record date, are entitled to notice of and to vote at the meeting, or at any adjournments or postponements of the meeting.

**QUESTIONS AND ANSWERS ABOUT THE MEETING AND VOTING**

**What is this document?** This is the Notice of our 2012 Annual Meeting of Stockholders of iParty Corp. (**iParty** or the **Company**), and our Proxy Statement which provides important information for your use in voting your shares of our common stock, or our various series of Convertible Preferred Stock, at the annual meeting.



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**Who can vote?** You can vote your shares of common stock or your shares of Convertible Preferred Stock if our records show that you owned the shares at the close of business on April 10, 2012, which is the record date for the annual meeting. As of the record date, shares representing a total of 38,783,358 votes are eligible to vote at the meeting.

**Common Stock.** You are permitted one vote for each share of common stock you owned at the close of business on April 10, 2012, including (i) shares held in your name as a stockholder of record, and (ii) shares held in **street name** for you as the beneficial owner through a broker, trustee, or other nominee, such as a bank. Thus, as of April 10, 2012, there were 24,418,284 votes eligible to vote at the meeting associated with shares of common stock. The enclosed proxy card shows the number of shares you can vote.

**Convertible Preferred Stock.** Except as otherwise required by Delaware General Corporation Law, the Convertible Preferred Stock is entitled to vote together with the common stock on all matters to which the common stock is entitled to vote. When the Convertible Preferred Stock votes together with the common stock as one class, you are permitted one vote for each whole number of shares of our common stock into which the shares of Convertible Preferred Stock are convertible. Thus, as of April 10, 2012, the number of votes eligible to vote at the meeting were 5,455,554 votes associated with 419,658 shares of Series B Preferred Stock (you are permitted thirteen (13) votes for each share of Series B Preferred Stock), 1,300,000 votes associated with 100,000 shares of Series C

Preferred Stock (you are permitted thirteen (13) votes for each share of Series C Preferred Stock), 3,500,000 votes associated with 250,000 shares of Series D Preferred Stock (you are permitted fourteen (14) votes for each share of Series D Preferred Stock), 2,966,660 votes associated with 296,666 shares of Series E Preferred Stock (you are permitted ten (10) votes for each share of Series E Preferred Stock), and 1,142,860 votes associated with 114,286 shares of Series F Preferred Stock (you are permitted ten (10) votes for each share of Series F Preferred Stock).

In each such case, the number of votes is calculated based on the number of shares you owned at the close of business on April 10, 2012, including shares held in your name as a stockholder of record and shares held in **street name** for you as the beneficial owner through a broker, trustee, or other nominee, such as a bank. The enclosed proxy card shows the number of shares you can vote.

***Special Voting Rights of Series C and Series D Preferred Stock with Respect to Election of Directors.*** So long as at least fifty percent (50%) of the initially issued shares of Series C Preferred Stock remains outstanding, the holders of the Series C Preferred Stock are entitled to vote alone for the election of a Series C Director. So long as at least fifty percent (50%), of the initially issued shares of Series D Preferred Stock remains outstanding, the holders of the Series D Preferred Stock are entitled to vote alone for the election of a Series D Director. The holders of the Series C and Series D Preferred Stock have each informed us that they will not be nominating directors for election at the annual meeting this year.

***Special Voting Rights of the Convertible Preferred Stock.*** Under the various Certificates of Designations, each series of Convertible Preferred Stock has a separate class vote in the following instances:

- The creation and issuance of any series of preferred stock or other security which is senior as to liquidation and or dividend rights to such Convertible Preferred Stock; and
- An action that repeals, amends, or otherwise changes the Certificate of Designation or Certificate of Incorporation in a manner that would alter or change the powers, preferences, rights, privileges, restrictions and conditions of the particular class of Convertible Preferred Stock to adversely affect such class.

Unless otherwise specified in the Certificates of Designations, when voting as a separate class, you are permitted one vote for each share of Convertible Preferred Stock you owned at the close of business on April 10, 2012, including (i) shares held in your name as a stockholder of record, and (ii) shares held in **street name** for you as the beneficial owner through a broker, trustee, or other nominee, such as a bank.

**How do I vote by proxy?** Follow the instructions on the enclosed proxy card to vote on each proposal to be considered at the annual meeting. Sign and date the proxy card and mail it back in the enclosed envelope. The proxy holders named on the proxy card will vote your shares as you instruct. If you sign and return the proxy card but do not vote on a proposal, the proxy holders will vote for you on that proposal. Unless you instruct otherwise, the proxy holders will vote in accordance with the Board of Directors' recommendation below.

**What is the purpose of the Reverse Stock Split?** The primary purpose of the Reverse Stock Split is to increase proportionately the per share trading price of iParty's common stock. iParty's common stock is listed on the NYSE Amex. Under the NYSE Amex's listing standards, if the exchange considers iParty's common stock to be a low priced stock, iParty's common stock could be subject to a delisting notification. The

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exchange considers a low priced stock to be stock selling for a substantial period of time at a low price. Our common stock has not traded above \$1 per share since February 2005, and our price per share has ranged over the last year from a low of \$.11 per share to a high of \$.29 per share during the one year period ended April 10, 2012. If we were to receive a formal delisting notification letter from the NYSE Amex, to regain compliance we would need to effect a reverse stock split, which would require us to convene a special meeting of stockholders. Given the time and expense associated with convening a special meeting of stockholders, the Board of Directors has determined that it is most efficient to seek stockholder approval of the Reverse Stock Split at this Annual Meeting to avoid having to convene a special meeting at a later date.

We also believe that the increased market price of our common stock expected as a result of implementing a Reverse Stock Split may improve the marketability and liquidity of our common stock and

encourage interest and trading in our common stock. Because of the trading volatility often associated with low-priced stocks, many brokerage houses and institutional investors have internal policies and practices that either prohibit them from investing in low-priced stocks or tend to discourage individual brokers from recommending low-priced stocks to their customers. Some of those policies and practices may function to make the processing of trades in low-priced stocks economically unattractive to brokers. Moreover, because brokers' commissions on low-priced stocks generally represent a higher percentage of the stock price than commissions on higher-priced stocks, the current average price per share of common stock can result in individual stockholders paying transaction costs representing a higher percentage of their total share value than would be the case if the share price were substantially higher. Although it should be noted that the liquidity of our common stock may be harmed by the Reverse Stock Split given the reduced number of shares that would be outstanding after the Reverse Stock Split, our Board of Directors is hopeful that the anticipated higher market price will offset, to some extent, the negative effects on the liquidity and marketability of our common stock inherent in some of the policies and practices of institutional investors and brokerage houses described above.

**What effect will the Reverse Stock Split have on me?** On the date the amendment to our Restated Certificate of Incorporation effectuating the Reverse Stock Split is filed with the Secretary of State of the State of Delaware, referred to in this proxy statement as the effective date, the existing outstanding shares of our common stock would be combined into new shares of our common stock at an exchange ratio ranging from one-for-five to one-for-twenty, with the specific exchange ratio to be determined by us. This means that you would receive one new share of our common stock for each five to twenty shares of common stock that you currently hold, depending on the exchange ratio we determine. In addition, the conversion price of our Convertible Preferred Stock would be adjusted proportionally in accordance with the determined exchange ratio. Our Board of Directors believes that stockholder approval granting us discretion to set the actual exchange ratio within the range from one-for-five to one-for-twenty, rather than stockholder approval of a specified exchange ratio, provides us with maximum flexibility to react to then-current market conditions and volatility in the market price of our common stock in order to set an exchange ratio that is intended to result in a stock price in excess of \$1.00 per share with the intention of avoiding being considered a low-priced stock under NYSE Amex rules and therefore stockholder approval granting this discretion is in the best interests of iParty and its stockholders. However, there can be no assurance that the Reverse Stock Split will result in our common stock trading above \$1.00 per share or avoid being considered a low priced stock in the future or maintain compliance with the other quantitative and qualitative requirements under the NYSE Amex listing standards. The Reverse Stock Split would affect all stockholders uniformly and would not affect any stockholder's percentage ownership interest in iParty, except to the extent that the Reverse Stock Split would result in some of our stockholders owning a fractional share. You would receive cash in lieu of any fractional share that would otherwise be issuable.

**Am I entitled to appraisal rights from the Reverse Stock Split?** No. Under the Delaware General Corporation Law, stockholders are not entitled to appraisal rights with respect to the proposed amendment to our Restated Certificate of Incorporation to effect the Reverse Stock Split and we will not independently provide our stockholders with any such right.

**What are the federal income tax consequences of the Reverse Stock Split?** We expect that our stockholders generally will not recognize tax gain or loss as a result of the Reverse Stock Split. However, gain or loss will be recognized on the small amount of cash received in lieu of any fractional shares. Moreover, the tax consequences to each stockholder will depend on his or her particular situation. For further information, see the discussion on page 16 under the heading **Federal Income Tax Consequences of the Reverse Stock Split**.

**Can our Board of Directors abandon the Reverse Stock Split?** Our Board of Directors reserves the right, in its discretion, to abandon the Reverse Stock Split at any time prior to filing the amendment to our Restated Certificate of Incorporation with the Secretary of State of the State of Delaware.

**How does the Board of Directors recommend that I vote on the proposals?** The Board of Directors recommends that you vote:

**FOR** the election of all four nominees to serve as directors until the 2013 Annual Meeting of Stockholders;



**FOR** the approval of an amendment to iParty's Restated Certificate of Incorporation to effect a reverse stock split, pursuant to which the existing shares of iParty's common stock would be combined into new shares of iParty common stock at an exchange ratio ranging between one-for-five and one-for-twenty, with the exchange ratio to be determined by iParty's Board of Directors;

**FOR** the ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 29, 2012.

**What if other matters come up at the meeting?** The matters described in this proxy statement are the only matters we know that will be voted on at the meeting. If other matters are properly presented at the meeting, the proxy holders will vote your shares in their discretion.

**Can I change my vote after I return my proxy card?** Yes. At any time before the annual meeting, you can change your vote either by sending our Chief Financial Officer, David E. Robertson, a written notice revoking your proxy card or by signing, dating, and returning to us a new proxy card. We will honor the proxy card with the latest date.

**Can I vote in person at the meeting rather than by completing the proxy card?** Although we encourage you to complete and return the proxy card even if you plan to attend the meeting to ensure that your vote is counted, you can always vote your shares in person at the meeting. If you are not a record holder, but hold your shares through a broker, trustee or other nominee, such as a bank, and wish to vote your shares in person at the annual meeting, please contact such nominee for instructions on how to vote your shares at the meeting.

**Who will count the votes?** The votes cast by holders of shares of our common stock and our Convertible Preferred Stock will be counted, tabulated and certified by the transfer agent and registrar of our Common Stock and Series B Preferred Stock, Continental Stock Transfer & Trust Co. David E. Robertson, our Chief Financial Officer, will serve as the inspector of elections at the annual meeting.

**Will my vote be kept confidential?** Yes, your vote will be kept confidential and we will not disclose your vote other than to allow the inspector of elections to certify the results of the vote, unless (1) required to do so by law (including in connection with the pursuit or defense of a legal or administrative action or proceeding), (2) a stockholder makes a written comment on the proxy card or otherwise communicates his or her vote to management, or (3) there is a contested election for the Board of Directors. The inspector of elections will forward any written comments that you make on the proxy card to our Board of Directors and Chief Executive Officer without providing your name, unless you expressly request disclosure on your proxy card.

**What do I do if I am a beneficial owner and my shares are held in street name?** If your shares are held in the name of your broker, a bank, or other nominee, that party will give you instructions for voting your shares, which should be enclosed with this document.

**What constitutes a quorum?** In order for business to be conducted at the meeting, a quorum must be present. The presence, in person or by proxy, of the holders of a majority of the outstanding shares of each class of stock entitled to vote at the annual meeting is necessary to constitute a quorum at the annual meeting.

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Shares of common stock and Convertible Preferred Stock represented in person or by proxy (including broker non-votes, if any, and shares that abstain or do not vote with respect to one or more of the matters to be voted upon) will be counted for the purpose of determining whether a quorum exists. Broker non-votes are those shares that are held in street name by a broker, bank, or other nominee that indicates on its proxy that it does not have discretionary authority to vote on a particular matter.

If a quorum is not present, the meeting will be adjourned until a quorum is obtained. Under our by-laws, notice need not be given of any such adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting, our stockholders may transact any business that might have been transacted at the original meeting. If the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, our by-laws require that a notice of the adjourned meeting be given to each stockholder of record entitled to vote at the meeting.

**What is the voting requirement to approve each proposal?** In the election of directors, the persons receiving the greatest number of **FOR** votes at the meeting will be elected.

The proposal to authorize the Reverse Stock Split requires the affirmative vote of a majority of the outstanding shares of our common stock and Convertible Preferred Stock, voting together as a single class, on an as converted basis.

The proposal to ratify the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 29, 2012 requires the affirmative vote of a majority of the votes cast at the meeting by the holders of outstanding shares of all classes of our stock entitled to vote thereon who are present at the meeting either in person or by proxy.

Votes withheld for a particular director nominee will have no effect on the outcome of the election of directors. Abstentions and broker non-votes, if any, will have the same effect as a NO vote with respect to the approval of the Reverse Stock Split. Neither abstentions nor broker non-votes, if any, will have an effect on the voting for the ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm.

**What are broker non-votes ?** If you hold shares beneficially in street name and do not provide your broker with voting instructions, your shares may constitute **broker non-votes**. Generally, broker non-votes occur on a matter when a broker is not permitted to vote on that matter without instructions from you, as the beneficial owner. Brokers, banks and other nominees may not be able to use their discretionary authority for the matters involving the election of directors and the Reverse Stock Split; however they may be able to use their discretionary authority for the matter involving the ratification of our independent registered public accounting firm for the fiscal year ended December 29, 2012.

**Where can I find the voting results?** We will announce the results of the voting at the annual meeting and report the voting results in a Current Report on Form 8-K (the **8-K**) filing which we are required to file with the Securities and Exchange Commission (**SEC**) within four business days after our Annual Meeting of Stockholders. The results will be contained in the 8-K, which will be available via Internet on the SEC's website, [www.sec.gov](http://www.sec.gov) and on the Investor Relations page of our website at [www.iparty.com](http://www.iparty.com).

**Who pays for this proxy solicitation?** We do. In addition to sending you these materials, one of our officers, directors or employees may contact you by telephone, by mail, or in person. None of these persons will receive any extra compensation for doing this.

**How and when may I submit a stockholder proposal for consideration at next year's annual meeting of stockholders or to recommend nominees to serve as directors?** You may submit proposals, including director nominations, for consideration at future stockholder meetings.

**Stockholder Proposals:** If you are interested in submitting a proposal for inclusion in our proxy statement for next year's annual meeting, or would like to recommend a nominee for director, we must receive your written proposal at our principal executive offices no later than December 25, 2012, which is the 120th calendar day before the one-year anniversary of the proxy statement we are releasing to our stockholders for this year's annual meeting. If the date of next year's annual meeting (or special meeting in lieu of the annual meeting) is moved more than 30 days before or after the anniversary date of this year's meeting, the deadline for inclusion of proposals in our proxy statement will instead be a reasonable time before we begin to print and mail our proxy materials next year. Such proposals also will need to comply with SEC regulations under Rule 14a-8 (Shareholder Proposals) regarding the inclusion of stockholder proposals in company-sponsored proxy materials. Any



proposals should be addressed to:

iParty Corp.  
270 Bridge Street, Suite 301  
Dedham, MA 02026  
ATTN: David E. Robertson, Chief Financial Officer  
Fax: (781) 326-7143

Except in the case of proposals made in accordance with SEC Rule 14a-8 (Shareholder Proposals), the Company's proxy holders are allowed to use their discretionary voting authority on stockholder proposals that the Company did not receive written notice of at least 45 days prior to the anniversary of the date on which the Company first mailed its proxy materials for its immediately preceding annual meeting of stockholders, which for the 2013 Annual Meeting of Stockholders is March 10, 2013.

**Copy of By-Law Provisions:** You may contact our Chief Financial Officer (Mr. Robertson) at our principal executive offices for a copy of the relevant by-law provisions regarding the requirements for making stockholder proposals. Our by-laws also are available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com).

**How may I communicate with the board of directors or the non-management directors on the board of directors?** You may submit an e-mail to our Board of Directors at [bod@iparty.com](mailto:bod@iparty.com). All directors have access to this e-mail address. Communications intended for our non-management independent directors should be directed to the attention of Frank Haydu, the Chairman of our Audit Committee, at [fwh23@yahoo.com](mailto:fwh23@yahoo.com). You may report your concerns anonymously or confidentially.

**Does iParty have a policy regarding the attendance of directors at the meeting?** Our by-laws do not mandate that members of the Board of Directors attend the annual meeting of stockholders and we have no separate policy regarding such attendance.

**How many directors attended last year's annual meeting?** All of our directors were present in person at last year's annual meeting.

**Does iParty have a code of conduct applicable to all directors, officers, and employees?** Yes. In accordance with Section 406 of the Sarbanes-Oxley Act, Item 406 of SEC Regulation S-K, and Section 807 of the enhanced corporate governance rules of the NYSE Amex, we have adopted a code of business conduct and ethics that is applicable to all our directors, officers and employees and is available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com). Our written code of business conduct and ethics provides for an enforcement mechanism and requires that waiver of its provisions for any of our directors or officers must be approved by our Board of Directors. We are required to disclose any such waivers on the Investor Relations page of our corporate website at [www.iparty.com](http://www.iparty.com).

**Where can I see the Company's corporate documents and SEC filings?** iParty's website contains its by-laws, the Board Committee charters, corporate governance guidelines, code of business conduct and ethics and the Company's SEC filings. To view the by-laws, the Board's Committee charters, corporate governance guidelines, or code of business conduct and ethics, go to [www.iparty.com](http://www.iparty.com), and click on Investor Relations. To view iParty's SEC filings, including Forms 3, 4, and 5 filed by the Company's directors and executive officers, go to [www.iparty.com](http://www.iparty.com), click on Investor Relations and then click on SEC Filings.

iParty will also promptly deliver free of charge, upon request, a copy of the Company's Restated Certificate of Incorporation, by-laws, Board Committee charters, corporate governance guidelines or the code of business conduct and ethics to any stockholder requesting a copy. Requests for these documents may be made in the same manner as requests for a copy of iParty's Annual Report on Form 10-K.

**How can I obtain an annual report on Form 10-K?** A copy of our Annual Report on Form 10-K for the year ended December 31, 2011 (the **2011 Annual Report on Form 10-K** ) is enclosed with this proxy statement. Stockholders may request another free copy of our proxy statement and our 2011 Annual Report on Form 10-K by email to [investorrelations@iparty.com](mailto:investorrelations@iparty.com), by toll free telephone at 888-290-2945, or by making a written or oral request to:

iParty Corp.

270 Bridge Street, Suite 301

Dedham, MA 02026

ATTN: David E. Robertson, Chief Financial Officer

Telephone: (781) 329-3952

Our proxy statement and Annual Report on Form 10-K for fiscal 2011 are also available on the Investor Relations page of our website at [www.iparty.com](http://www.iparty.com), as noted below, and the SEC's website at [www.sec.gov](http://www.sec.gov).

**Where can I get directions to the meeting?** The meeting will be held in the offices of Posternak Blankstein & Lund LLP on the 33rd floor of the Prudential Tower, 800 Boylston Street, Boston, MA. Directions to the meeting location are available at [www.pbl.com](http://www.pbl.com).

**Who should I contact if I have any questions?** If you have any questions about the annual meeting or any matters relating to this proxy statement, please contact David E. Robertson, our Chief Financial Officer, at the address and telephone number above.

#### **Important Notice of Internet Availability of Proxy Materials for the Annual Meeting**

This proxy statement and our 2011 Annual Report are available at [www.iparty.com/proxy](http://www.iparty.com/proxy). This web page does not have cookies that identify visitors to the web page.

**ITEMS TO BE ACTED ON AT THE MEETING**

**PROPOSAL NO. 1**

**ELECTION OF DIRECTORS**

Our entire Board of Directors, to consist of four (4) members, will be elected at the meeting. Each nominee for director currently serves on our Board of Directors. The directors elected will hold office until their successors are elected and qualified, which should occur at the next annual meeting or special meeting in lieu thereof, in accordance with our by-laws.

We have no reason to believe that any of the nominees listed below will not be a candidate or will be unable to serve as a director. However, in the event any nominee is not a candidate or is unable or unwilling to serve as a director at the time of the election, the Board of Directors (on recommendation of the Nominating Committee) may either propose to reduce the number of directors or propose a substitute nominee.

Under the Certificate of Designations-Series C, for so long as at least 50% of the initially issued shares of Series C Preferred Stock remain outstanding, the holders of the Series C Preferred Stock have the exclusive right, voting separately as a class, to elect one director of the Company (the **Series C Director** ). The holders of the Series C Preferred Stock have not elected to designate a Series C Director at the 2012 Annual Meeting of Stockholders.

Under the Certificate of Designations-Series D, for so long as at least 50% of the initially issued shares of Series D Preferred Stock remain outstanding, the holders of the Series D Preferred Stock have the exclusive right, voting separately as a class, to elect one director of the Company (the **Series D Director** ). The holders of the Series D Preferred Stock have not elected to designate a Series D Director at the 2012 Annual Meeting of Stockholders.

**The Board recommends that you vote FOR each of the following nominees:**

- Sal V. Perisano
- Daniel I. DeWolf
- Frank W. Haydu III
- Joseph S. Vassalluzzo

Biographical information about each of these nominees can be found on pages 21 through 22 of this proxy statement.

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Unless you specify otherwise, the Board intends the accompanying proxy to be voted for these nominees. Thus, unless you withhold authority or your proxy contains contrary instructions, a properly signed and dated proxy will be voted **FOR** the election of these nominees. ~~Notes withheld~~ will not affect the outcome of the voting with respect to the election of any nominee.

**PROPOSAL NO. 2**

**AMENDMENT OF iPARTY'S RESTATED CERTIFICATE OF INCORPORATION TO EFFECT A REVERSE STOCK SPLIT OF ITS OUTSTANDING COMMON STOCK**

**General**

We are asking our stockholders to approve an amendment to iParty's Restated Certificate of Incorporation in the form set forth in **Exhibit A** to this Proxy Statement (the **Amendment**) providing for a reverse stock split of iParty's outstanding common stock (the **Reverse Stock Split** or **reverse split**), which the Board of Directors, in its discretion, would be authorized to implement at any time prior to our 2013 Annual Meeting of Stockholders, with an exchange ratio ranging from one-for-five to one-for-twenty (each an **Exchange Ratio** and collectively, the **Exchange Ratios**).

A vote **FOR** Proposal No. 2 will constitute your approval of the Amendment and the authorization of the Board of Directors, in its discretion, to effect a Reverse Stock Split at one of the Exchange Ratios. This means that if the Reverse Stock Split is effected, you would receive one new share of our common stock for each five to twenty shares of common stock that you currently hold, depending on the exchange ratio we determine. In addition, under our Restated Certificate of Incorporation, each of the series of Convertible Preferred Stock would receive a corresponding adjustment in their conversion ratios to reflect the Reverse Stock Split.

If stockholders approve Proposal No. 2, the Board of Directors will have the authority, but not the obligation, to effect the Reverse Stock Split at any time prior to the date of the 2013 Annual Meeting of Stockholders, without further approval or authorization of stockholders. If the Board of Directors elects to effect a Reverse Stock Split pursuant to one of the Exchange Ratios, the Board of Directors will be deemed to have abandoned its authorization related to the other Exchange Ratios.

If Proposal No. 2 is approved by the stockholders, the Reverse Stock Split will be effected, if at all, only upon a determination by the Board of Directors that implementing a Reverse Stock Split is in the best interests of iParty and its stockholders. The determination as to whether the Reverse Stock Split will be effected and, if so, pursuant to which Exchange Ratio, will be based upon those market or business factors deemed relevant by the Board of Directors at that time, including, but not limited to:

- existing and expected marketability and liquidity of iParty's common stock;
- prevailing stock market conditions;
- business developments affecting iParty;
- iParty's actual or forecasted results of operations;
- listing standards under NYSE Amex; and

- the likely effect on the market price of iParty's common stock.

Our Board of Directors believes that stockholder approval granting us discretion to set the actual exchange ratio within the range of the Exchange Ratios, rather than stockholder approval of a specified exchange ratio, provides us with maximum flexibility to react to then-current market conditions and volatility in the market price of our common stock in order to set an exchange ratio that is intended to result in a stock price in excess of \$1.00 per share to avoid being considered a low priced stock by the NYSE Amex, and therefore, is in the best interests of iParty and its stockholders. However, there can be no assurance that the Reverse Stock Split will result in our common stock trading above \$1.00 for any significant period of time. If the Board of Directors determines to implement the Reverse Stock Split, we intend to issue a press release announcing the terms and effective date of the Reverse Stock Split before we file the Amendment with the Secretary of State of the State of Delaware.

On April 6, 2012, the Board of Directors adopted resolutions declaring advisable and approving the Amendment, subject to stockholder approval, and authorizing any other action that the Board of Directors may deem necessary to implement the Reverse Stock Split, without further approval or authorization of stockholders, at any time prior to the date of the 2013 Annual Meeting of Stockholders. Under iParty's Restated Certificate of Incorporation, approval of the Amendment requires the affirmative vote of a majority of the outstanding shares of

our common stock and Convertible Preferred Stock entitled to vote on the matter, voting together as a single class on an as converted basis.

### **Purpose of the Reverse Stock Split**

The primary purpose of the Reverse Stock Split is to increase proportionately the per share trading price of our Common Stock. Our Common Stock is listed on the NYSE Amex. Under the NYSE Amex's listing standards, if the exchange considers our Common Stock to be a low-priced stock, our Common Stock could be subject to a delisting notification. The exchange considers a low-priced stock to be stock selling for a substantial period of time at a low price. Our common stock has not traded above \$1 per share since February 2005, and our price per share has ranged from a low of \$.11 per share to a high of \$.29 per share for the twelve month period ended April 10, 2012. If we were to receive a formal delisting notification letter from the NYSE Amex, to regain compliance we would need to effect a reverse stock split, which would require us to convene a special meeting of stockholders. Given the time and expense associated with convening a special meeting of stockholders, the Board of Directors has determined that it is most efficient to seek stockholder approval of a potential future Reverse Stock Split at this Annual Meeting to avoid having to convene a special meeting at a later date.

As noted above, if we were to receive a delisting notice and we were unable to regain compliance in the appropriate time, we could be subject to delisting. Delisting could have a material adverse effect on our business, liquidity and on the trading of our Common Stock. If our Common Stock were delisted, our Common Stock could trade on the OTC Bulletin Board or on the OTC markets or pink sheets maintained by the OTC Markets Group. However, such alternates are generally considered to be less efficient markets. Further, delisting from the NYSE Amex could also have other negative effects, including potential loss of confidence by customers, suppliers and employees.

We also believe that the increased market price of our Common Stock expected as a result of implementing the Reverse Stock Split may improve the marketability and liquidity of our Common Stock and encourage interest and trading in our Common Stock. Because of the trading volatility often associated with low-priced stocks, many brokerage houses and institutional investors have internal policies and practices that either prohibit them from investing in low-priced stocks or tend to discourage individual brokers from recommending low-priced stocks to their customers. Some of those policies and practices may function to make the processing of trades in low-priced stocks economically unattractive to brokers. Moreover, because brokers' commissions on low-priced stocks generally represent a higher percentage of the stock price than commissions on higher-priced stocks, the current average price per share of common stock can result in individual stockholders paying transaction costs representing a higher percentage of their total share value than would be the case if the share price were substantially higher. Although it should be noted that the liquidity of our Common Stock may be harmed by the Reverse Stock Split given the reduced number of shares that would be outstanding after the Reverse Stock Split, our Board of Directors is hopeful that the anticipated higher market price will offset, to some extent, the negative effects on the liquidity and marketability of our Common Stock inherent in some of the policies and practices of institutional investors and brokerage houses described above.

### **Board Discretion to Implement the Reverse Stock Split**

If Proposal No. 2 is approved by our stockholders, the Reverse Stock Split will be effected, if at all, only upon a determination by the Board of Directors that the Reverse Stock Split is in the best interests of iParty and its stockholders. The Board of Directors' determination as to whether the Reverse Stock Split will be effected and, if so, at which Exchange Ratio, will be based upon certain factors, including existing and expected marketability and liquidity of our Common Stock, prevailing stock market conditions, business developments affecting us, actual or forecasted results of operations and the likely effect on the market price of our Common Stock, and the listing standards of the NYSE Amex. If the Board does not act to implement the Reverse Stock Split prior to the date of the 2013 Annual Meeting of Stockholders, the authorization granted by stockholders pursuant to this Proposal No. 2 would be deemed abandoned and without any further effect. In that case, the Board of Directors may again seek stockholder approval at a future date for the Reverse Stock Split if it deems it to be advisable.





### Effect of the Reverse Stock Split

If approved by our stockholders and implemented by the Board of Directors, as of the effective time of the Amendment, each issued and outstanding share of our Common Stock would immediately and automatically be reclassified and reduced into a fewer number of shares of our Common Stock, depending upon the Exchange Ratio selected by the Board of Directors, which could range between one-for-five and one-for-twenty.

Except to the extent that the Reverse Stock Split would result in any stockholder receiving cash in lieu of fractional shares described below, the Reverse Stock Split will not:

- affect any stockholder's percentage ownership interest in us;
- affect any stockholder's proportionate voting power;
- substantially affect the voting rights or other privileges of any stockholder, unless the stockholder holds fewer than the number of shares selected among the Exchange Ratios, in which case, depending upon the Exchange Ratio, such stockholder would receive cash for all of his or her Common Stock held before the Reverse Stock Split and would cease to be an iParty stockholder following the Reverse Stock Split; or
- alter the relative rights of common stockholders, Convertible Preferred Stockholders, warrant holders or holders of equity compensation plan awards.

Depending upon the Exchange Ratio selected by the Board of Directors, the principal effects of the Reverse Stock Split are:

- the number of shares of Common Stock issued and outstanding will be reduced by a factor ranging between five and twenty;
- the per share exercise price will be increased by a factor between five and twenty, and the number of shares issuable upon exercise shall be decreased by the same factor, for all outstanding options, warrants and other convertible or exercisable equity instruments entitling the holders to purchase shares of our common stock;
- the number of shares authorized and reserved for issuance under our existing equity compensation plans will be reduced proportionately; and
- The conversion rates for holders of our Convertible Preferred Stock will be adjusted proportionately.

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The following table contains approximate information relating to our Common Stock, Convertible Preferred Stock, our outstanding warrants and outstanding options under our 1998 Plan and 2009 Plan, under various proposed options:

	<b>Pre Reverse Split</b>	<b>1for 5</b>	<b>1 for 7</b>	<b>1 for 10</b>	<b>1 for 15</b>	<b>1 for 20</b>
<b>Authorized Common Stock</b>	150,000,000	150,000,000	150,000,000	150,000,000	150,000,000	150,000,000
<b>Outstanding Common Stock</b>	24,418,284	4,883,610	3,487,783	2,441,761	1,627,416	1,220,792
<b>Reserved for issuance under 1998 Plan and 2009 Plan</b>	8,033,794	1,606,750	1,147,593	803,369	535,492	401,676
<b>Reserved for Issuance Under Warrants</b>	100,000	20,000	14,285	10,000	6,666	5,000
<b>Reserved for issuance under Series B</b>	5,621,739	1,124,329	803,073	562,142	374,752	281,049
<b>Reserved for issuance under Series C</b>	1,315,800	263,160	187,971	131,580	87,720	65,790
<b>Reserved for issuance under Series D</b>	3,516,250	703,250	502,321	351,625	234,416	175,812
<b>Reserved for issuance under Series E</b>	3,073,163	614,632	439,022	307,316	204,877	153,657
<b>Reserved for issuance under Series F</b>	1,184,803	236,960	169,257	118,480	78,986	59,240

If the Reverse Stock Split is implemented, the Amendment will not reduce the number of shares of our Common Stock or Preferred Stock authorized under our Restated Certificate of Incorporation.

Our Common Stock is currently registered under Section 12(b) of the Securities Exchange Act of 1934, as amended, and we are subject to the periodic reporting and other requirements thereof. We presently do not have any intent to seek any change in our status as a reporting company under the Securities Exchange Act of 1934, as amended either before or after the Reverse Stock Split, if implemented, and the Reverse Stock Split, if implemented, will not result in a going private transaction.

### Fractional Shares

Stockholders will not receive fractional shares in connection with the Reverse Stock Split. Instead, stockholders otherwise entitled to fractional shares will receive a cash payment in lieu thereof in an amount equal to the average closing sales price of our common stock as reported on the NYSE Amex for the four trading days preceding the effective date of the Reverse Stock Split multiplied by the amount of fractional shares they hold. Stockholders will not be entitled to receive interest for the period of time between the effective date of the Reverse Stock Split and the date the stockholder receives his or her cash payment. The proceeds will be subject to certain taxes as discussed below.

Stockholders holding fewer than the chosen Exchange Ratio will receive only cash in lieu of fractional shares and will no longer hold any shares of our Common Stock as of the effective time of the Amendment. For example, if the Board of Directors effected a one-for-twenty split, and you held nineteen shares of our Common Stock immediately prior to the effective date of the Amendment, you will no longer hold any shares of iParty Common Stock and you will receive only cash for the value of the nineteen shares of our Common Stock you



held immediately prior to the effective date of the Amendment. Assuming the same one-for-twenty Reverse Stock Split, if you held twenty-three shares of our Common Stock immediately prior to the effective date of the Amendment, you would receive one new share of our Common Stock and cash in lieu of fractional shares for the three shares of our Common Stock that you held immediately prior to the effective date of the Amendment.

#### **Effective Time and Implementation of the Reverse Stock Split**

The effective time for the Reverse Stock Split will be the date on which we file the Amendment with the office of the Secretary of State of the State of Delaware or such later date and time as specified in the Amendment, provided that the effective date must precede the date of the 2013 Annual Meeting of Stockholders.

As soon as practicable after the filing of the Amendment, we intend to notify stockholders and request that they surrender to our transfer agent their certificates representing shares of pre-reverse split iParty Common Stock, so that certificates representing the applicable number of shares of post-reverse split common stock, together with any cash payment in lieu of fractional shares, may be issued in exchange therefor. We expect to adopt a new stock certificate in connection with any implementation of the Reverse Stock Split.

**STOCKHOLDERS SHOULD NOT DESTROY ANY STOCK CERTIFICATE(S) AND SHOULD NOT SUBMIT ANY STOCK CERTIFICATE(S) UNTIL REQUESTED TO DO SO.**

#### **Accounting Matters**

The Reverse Stock Split will not affect the par value of a share of our Common Stock. However, at the effective time of the Reverse Stock Split, the stated capital attributable to common stock on our balance sheet will be reduced proportionately based on the Exchange Ratio (including a retroactive adjustment of prior periods), and the additional paid-in capital account will be credited with the amount by which the stated capital is reduced. Reported per share net income or loss would be expected to be proportionally higher because there will be fewer shares of our Common Stock outstanding.

#### **No Appraisal Rights**

Under the Delaware General Corporation Law, our stockholders are not entitled to appraisal rights with respect to the Reverse Stock Split.

#### **Certain Risks Associated with the Reverse Stock Split**

Before voting on this Proposal No. 2, you should consider the following risks associated with the implementation of the Reverse Stock Split:

- The price per share of our Common Stock after the Reverse Stock Split may not reflect the Exchange Ratio implemented by the Board of Directors and the price per share following the effective time of the Reverse Stock Split may not be maintained for any period of time following the Reverse Stock Split. For example, based on the closing price of our Common Stock on April 10, 2012 of \$0.17 per share, if the Reverse Stock Split was implemented at an Exchange Ratio of 1-for-20, there can be no assurance that the post-split trading price of iParty's common stock would be \$3.40, or even that it would remain above the pre-split trading price. Accordingly, the total market capitalization of our Common Stock following a Reverse Stock Split may be lower than before the Reverse Stock Split.
- Following the Reverse Stock Split, we may still run the risk of being considered a low priced stock under the listing standards of the NYSE Amex, which could cause the Company to be delisted.
- Effecting the Reverse Stock Split may not attract institutional or other potential investors, or result in a sustained market price that is high enough to overcome the investor policies and practices, and other issues relating to investing in lower priced stock described in **Purpose of the Reverse Stock Split** above.

- The trading liquidity of our Common Stock could be adversely affected by the reduced number of shares outstanding after the Reverse Stock Split.

- If a Reverse Stock Split is implemented by the Board, some stockholders may consequently own less than 100 shares of our Common Stock. A purchase or sale of less than 100 shares (an **odd lot** transaction) may result in incrementally higher trading costs through certain brokers, particularly full service brokers. Therefore, those stockholders who own fewer than 100 shares following the Reverse Stock Split may be required to pay higher transaction costs if they should then determine to sell their shares of iParty common stock.

### **Federal Income Tax Consequences of the Reverse Stock Split**

A summary of the federal income tax consequences of the proposed Reverse Stock Split to individual stockholders is set forth below. It is based upon present federal income tax law, which is subject to change, possibly with retroactive effect. The discussion is not intended to be, nor should it be relied on as, a comprehensive analysis of the tax issues arising from or relating to the proposed Reverse Stock Split. In addition, we have not requested and will not seek an opinion of counsel or a ruling from the Internal Revenue Service regarding the federal income tax consequences of the proposed Reverse Stock Split. Accordingly, stockholders are advised to consult their own tax advisors for more detailed information regarding the effects of the proposed Reverse Stock Split on them under applicable federal, state, local and foreign income tax laws.

- We believe that the Reverse Stock Split will be a tax-free recapitalization for federal income tax purposes. Accordingly, except with respect to any cash received in lieu of fractional shares, a stockholder will not recognize any gain or loss as a result of the receipt of the post-reverse split common stock pursuant to the Reverse Stock Split.

- The shares of post-reverse split common stock in the hands of a stockholder will have an aggregate basis for computing gain or loss equal to the aggregate basis of the shares of pre-reverse split common stock held by that stockholder immediately prior to the Reverse Stock Split, reduced by the basis allocable to any fractional shares which the stockholder is treated as having sold for cash, as discussed in the fifth bullet below.

- A stockholder's holding period for the post-reverse split common stock will include the holding period of the pre-reverse split common stock exchanged.

- Stockholders who receive cash for all of their holdings (as a result of owning fewer than the number in the Exchange Ratio selected by the Board of Directors) and who are not related to any person or entity that holds our Common Stock immediately after the Reverse Stock Split, will recognize a gain or loss for federal income tax purposes equal to the difference between the cash received and their basis in the pre-reverse split common stock. Such gain or loss will generally be a capital gain or loss if the stock was held as a capital asset, and such capital gain or loss will be a long-term gain or loss to the extent that the stockholder's holding period exceeds 12 months.

- Although the tax consequences to stockholders who receive cash for fractional shares are not entirely certain, these stockholders likely will be treated for federal income tax purposes as having sold their fractional shares and will recognize gain or loss in an amount equal to the difference between the cash received and the portion of their basis for the pre-reverse split common stock that is allocated to the fractional

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shares. It is possible that such stockholders will be treated as receiving dividend income to the extent of their ratable share of our current and accumulated earnings and profits (if any) and then a tax-free return of capital to the extent of their aggregate adjusted tax basis in their iParty shares, with any remaining amount of cash received being treated as capital gain.

- Stockholders who receive cash will be required to provide their social security or other taxpayer identification numbers (or, in some instances, additional information) in connection with the Reverse Stock Split to avoid backup withholding requirements that might otherwise apply. Failure to provide such information may result in backup withholding at a rate of 28%.



**Recommendation of the Board of Directors**

The Board of Directors recommends that you vote **FOR** the amendment to our Restated Certificate of Incorporation to effect the Reverse Stock Split in accordance with this Proposal No. 2. Unless you specify otherwise, the Board intends the accompanying proxy to be voted for this Proposal No. 2.

**PROPOSAL NO. 3**

**TO RATIFY THE SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Our Audit Committee has selected the independent registered public accounting firm of Ernst & Young LLP ( **E&Y** ) to examine and audit our financial statements for the year ending December 29, 2012. A resolution to ratify this selection will be presented at the meeting.

Stockholder ratification of the selection of E&Y is not required under our by-laws or Delaware General Corporation law. Although not required to do so, the Board is submitting the selection of E&Y for ratification by iParty's stockholders for their views, as a matter of good corporate governance. If the stockholders do not ratify the selection, the Audit Committee will consider the engagement of other independent auditors and whether to retain E&Y for the audit of our financial statements for the year ending December 29, 2012, but may ultimately determine to retain E&Y. However, the Audit Committee retains the ultimate discretion to appoint or terminate the appointment of our independent registered public accounting firm, irrespective of the outcome of this Proposal No. 3. E&Y has been our independent auditor for over eight years, including for fiscal year 2011.

We expect that one or more representatives of E&Y will be present at the annual meeting. They will be afforded an opportunity to make a statement at the annual meeting if they desire to do so and to respond to appropriate questions by stockholders.

E&Y has advised us that it has no direct, nor any indirect, financial interest in iParty or any of its subsidiaries.

This Proposal No. 3 to ratify the selection of E&Y as our independent registered public accounting firm for fiscal 2012 requires the affirmative vote of a majority of the votes cast at the meeting by the holders of outstanding shares of all classes of our stock entitled to vote thereon who are present at the meeting either in person or by proxy.

The Board recommends that you vote **FOR** this Proposal No. 3 to ratify the selection of Ernst & Young LLP.

Unless you specify otherwise, the Board intends the accompanying proxy to be voted for this Proposal No. 3.

Information about the fees and services we paid to E&Y in 2010 and 2011 is contained on page 36 of this proxy statement.

**OWNERSHIP OF IPARTY STOCK**

The following table shows the number of shares of our common stock and each series of our Convertible Preferred stock beneficially owned as of April 10, 2012 by:

- each person or entity that we believe beneficially owns more than 5% of our common stock or any series of our Convertible Preferred Stock,
- each director and nominee for director,
- each executive officer shown in the summary compensation table on **page 29** below, and
- all executive officers and directors as a group.

Name of Beneficial Owner (1)	Common Stock		Series of Convertible Preferred Stock	Convertible Preferred Stock	
	Number of Shares (2)	Percent of Class		Number of Shares	Percent of Class
<u>5% Stockholders</u>					
Estate of Robert H. Lessin (deceased)	10,579,243(3)	32.5%	Series B	137,500	32.8%
c/o Eric Rosenthal, CPA			Series D	250,000	100.0%
Press Shonig Rosenthal			Series E	266,666	89.9%
500 Bi County Road, Suite 201					
Farmingdale NY 11735					
Roccia Partners, L.P.	2,995,431(4)	11.1%	Series B	179,610	42.8%
c/o Lorenzo Roccia			Series E	30,000	10.1%
220 East 67th Street					
New York, NY 10021					
Naida S. Wharton	2,474,100(5)	10.1%			
c/o Eric Rosenthal, CPA					
Press Shonig Rosenthal					
500 Bi County Road, Suite 201					
Farmingdale NY 11735					
Boston Millennia Partners, LP	1,315,800(6)	5.1%	Series C	100,000	100.0%

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30 Rowes Wharf, Suite 500					
Boston, MA 02110					
Peter S. Lynch	1,453,841(7)	6.0%			
82 Devonshire Street, S4					
Boston MA 02109					
Patriot Capital Limited	1,184,803(8)	4.6%	Series F	114,286	100.0%
c/o Stephen Rasch					
Loeb, Block and Partners LLP					
505 Park Avenue					
New York, NY 10022					
<u>Directors, Nominees for Director, and</u>					
<u>Executive Officers</u>					
Sal V. Perisano	4,248,222(9)	15.6%			
Dorice P. Dionne	4,248,222(10)	15.6%			
David Robertson	461,117(11)	1.9%			
Daniel I. DeWolf	463,750(12)	1.9%			
Joseph S. Vassaluzzo	710,665(13)	2.9%			
Frank W. Haydu III	393,750(14)	1.6%			
All executive officers and directors as a group (6 persons)	6,277,504	21.8%			

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(1) Unless otherwise indicated, all addresses are c/o iParty Corp., 270 Bridge Street, Suite 301, Dedham, MA 02026.

(2) The number of shares beneficially owned by each entity, person, director, nominee for director, or named executive officer is determined under SEC rules, particularly Rule 13d-3, and the information is not necessarily indicative of beneficial ownership for any other purpose. Under such rules, each entity or individual is considered the beneficial owner of any shares as to which they have the sole or shared voting power or investment power. Such persons and entities are also deemed under the same rules to beneficially own any shares that they have the right to acquire within sixty (60) days of April 10, 2012 (i.e., June 9, 2012) through the conversion of convertible preferred stock, the exercise of stock options or warrants or other similar rights. This stock ownership information is based upon information furnished to us by the persons named in the table or as set forth in the Company's stock ledger. The percentage of class of common stock and Convertible Preferred Stock is calculated in accordance with Rule 13d-3 and (i) for the common stock, is based on 24,418,284 shares of common stock outstanding as of April 10, 2012 plus, as to each holder thereof and no other person, the number of shares (if any) that the person has the right to acquire on or prior to June 9, 2012, through the exercise of stock options or warrants or other similar rights and the conversion of Convertible Preferred Stock and (ii) for each series of Convertible Preferred Stock, is based on 419,658 shares of Series B Preferred Stock, 100,000 shares of Series C Preferred Stock, 250,000 shares of Series D Preferred Stock, 296,666 shares of Series E Preferred Stock, and 114,286 shares of Series F Preferred Stock, in each case outstanding as of April 10, 2012, plus as to each holder of such series of Convertible Preferred Stock thereof and no other person, the number of shares (if any) that the person has the right to acquire on or prior to June 9, 2012 of such series, through the exercise of options, warrants or other similar rights. Unless otherwise set forth herein, each holder has sole voting and investment power over such shares.

(3) The Estate of Mr. Lessin beneficially owns: (1) 2,474,100 shares of common stock, (2) 50,000 shares of common stock that may be acquired upon the exercise of presently exercisable options, (3) 1,776,500 shares of common stock that may be acquired upon the conversion of 137,500 shares of presently convertible Series B Preferred Stock, (4) 3,516,250 shares of Common Stock which may be acquired upon the conversion of 250,000 shares of presently convertible Series D Preferred Stock, and (5) 2,762,393 shares of Common Stock which may be acquired upon the conversion of 266,666 shares of presently convertible Series E Preferred Stock. Sandy Minardo is executrix for the estate of Mr. Lessin and has sole voting and dispositive power with respect to the shares held by the Estate of Mr. Lessin. The figure listed in the table does not include any shares reflected as owned by Ms. Wharton, who was formerly Mr. Lessin's spouse (see footnote (5) below).

(4) The figure in the table for Roccia Partners, L.P. includes 2,320,561 shares of common stock, which may be acquired upon the conversion of 179,610 shares of presently convertible Series B Preferred Stock held in the name of Roccia Partners, L.P. The figure also includes (1) 364,100 shares of common stock held in the name of Roccia Venture Partners, L.P. and (2) 310,770 shares of common stock, which may be acquired upon the conversion of 30,000 shares of presently convertible Series E Preferred Stock held in the name of Roccia Venture Partners, L.P.

(5) Ms. Wharton beneficially owns 2,474,100 shares of common stock.

(6) The figure in the table for Boston Millennia Partners, LP includes 1,315,800 shares of common stock that may be acquired upon the conversion of 100,000 shares of presently convertible Series C Preferred Stock owned by Boston Millennia Partners, LP and an affiliated entity.

(7) Mr. Lynch has the sole power to vote and dispose of 473,724 shares of our common stock and the shared power to vote and dispose of 980,117 shares of our common stock.

(8) The figure in the table for Patriot Capital Limited includes 1,184,803 shares of common stock, which may be acquired upon the conversion of 114,286 shares of presently convertible Series F Preferred Stock.

(9) Mr. Perisano beneficially owns 1,352,129 shares of common stock, of which 352,129 shares are jointly held with his wife, Ms. Dionne. Mr. Perisano also holds options for 3,538,581 shares, of which 2,359,113 shares are granted to Mr. Perisano and 1,179,468 shares are granted to Ms. Dionne. Options for 2,896,093 shares of common stock are presently exercisable or will be exercisable within 60 days of April 10, 2012, of which 1,910,713 are exercisable by Mr. Perisano and 985,380 are exercisable by Ms. Dionne.

(10) Ms. Dionne beneficially owns 1,352,129 shares of common stock, of which 352,129 shares are jointly held with her husband, Mr. Perisano. Ms. Dionne also holds options for 3,538,581 shares, of which 1,179,468 shares are granted to Ms. Dionne and 2,359,113 shares are granted to Mr. Perisano. Options for 2,896,093 shares of common stock are presently exercisable or will be exercisable within 60 days of April 10, 2012, of which 985,380 are exercisable by Ms. Dionne and 1,910,713 are exercisable by Mr. Perisano.

(11) Mr. Robertson holds options for 605,000 shares, of which 461,117 are presently exercisable or will be exercisable within 60 days of April 10, 2012.

(12) Mr. DeWolf beneficially owns 85,000 shares of common stock. The owner of record of 10,000 shares of those shares of common stock is Pine Street Ventures LLC, a Delaware limited liability company. The beneficial owners of Pine Street Ventures are Mr. DeWolf's children. Mr. DeWolf controls sole voting power. The owner of record of the other 75,000 shares of common stock is Dawntreader Chestnut Advisors, LLC. The beneficial owners of Dawntreader Chestnut Advisors, LLC are Mr. DeWolf's spouse and a trust for the benefit of his spouse and children. Mr. DeWolf controls sole voting power. Mr. DeWolf also holds options for the purchase of 385,000 shares, of which 378,750 are presently exercisable or will be exercisable within 60 days of April 10, 2012.

(13) Mr. Vassalluzzo beneficially owns 351,915 shares of common stock and holds options for 365,000 shares, 358,750 which are presently exercisable or will be exercisable within 60 days of April 10, 2012.

(14) Mr. Haydu beneficially owns 65,000 shares of common stock and holds options for 335,000 shares, of which 328,750 are presently exercisable or will be exercisable within 60 days of April 10, 2012.

#### BOARD OF DIRECTORS AND CORPORATE GOVERNANCE MATTERS

The following table sets forth the name and age of each of our directors, his position with us, and the period during which he has served as a director. Each of our currently serving directors is a nominee for reelection as a director at the meeting.

Name	Age	Position	Director Since
Sal V. Perisano	61	Chairman of the Board, Chief Executive Officer	1998
Daniel I. DeWolf	55	Director	2003
Frank W. Haydu III	64	Director	2003
Joseph S. Vassalluzzo	64	Director	2004

*Sal V. Perisano*, age 61, has served as a director of iParty since 1998 and its Chief Executive Officer since 1999. Mr. Perisano served as Chairman of the Board and President of The Big Party Corporation from 1992 to 1998, and continued serving as a director until 2000. In 1981, he co-founded Videosmith, which became a leading video retailer in the Boston area. In 1989, Videosmith was sold to a publicly traded company called Xtravision PLC, which owned 250 stores throughout the U.K. and Ireland. Mr. Perisano stayed on as a director and was later named Chief Executive Officer of the parent company, which was subsequently acquired by Blockbuster Video. Mr. Perisano holds a bachelor's

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degree from Boston College and a master's degree from Harvard University. Mr. Perisano is married to Ms. Dorice Dionne, who is employed by iParty as its Senior Vice President, Merchandising and Marketing.

*Daniel I. DeWolf*, age 55, has served as a director of iParty since 2003. In March 2004, Mr. DeWolf is a member of the corporate practice in the New York office and Co-Chair of the Ventures and Emerging Company Group of the law firm of Mintz, Levin, Cohen, Ferris, Glovsky, and Popeo PC. Mr. DeWolf is also a Managing Director of Dawntreader Ventures, an early stage venture capital firm, and an adjunct professor at the New York University Law School, where he teaches venture capital law. From 1999 to 2003, Mr. DeWolf was Director of Venture Capital Funds for SoundView Technology Group. Prior to joining SoundView, Mr. DeWolf was Of Counsel with the law firm of Cahmy, Karlinsky & Stein LLP ( **CKS** ) in New York City. Mr. DeWolf established the Corporate and Securities Practice Group at CKS in 1994



and was the head of that firm's New Media and E-Law Group. Mr. DeWolf has over 25 years of corporate transactional experience and has been an advisor to many early and developmental stage companies. Mr. DeWolf is a graduate of the University of Pennsylvania as well as the University of Pennsylvania School of Law. Mr. DeWolf currently serves as a director of various privately-held companies, including HNW, Inc., Tutor.com, and Visible World. The Company believes that Mr. DeWolf's diversified background in capital finance and legal and regulatory matters give him the qualities and skills to serve as a director.

*Frank W. Haydu III*, age 64, has served as a director of iParty and Chairman of our Audit Committee since November 2003. Mr. Haydu is a professional director and consultant to public and private businesses. Mr. Haydu currently serves as a director and Chairman of the Board of Zalicus, Inc., a public company, and several private companies. From 2001 until 2005, Mr. Haydu served as a Managing Director of Valuation Perspectives, Inc., a financial services consulting practice, and from 2005 until 2009, he served in a consulting capacity at Source Precision Medicine, a life sciences medical supplier. Mr. Haydu holds a Bachelor of Arts degree in economics from Muhlenberg College. The Company believes that Mr. Haydu's broad based experience in business and finance, including his extensive background in business consulting and management, gives him the qualities and skills to serve as a director.

*Joseph S. Vassalluzzo*, age 64, has served as a director of iParty since 2004. Since February 2006, he has served as the Non-executive Chairman of Federal Realty Investment Trust, a publicly held REIT, and a member of its Nominating and Corporate Governance Committee and Compensation Committee. From 2000 to 2005, Mr. Vassalluzzo served as Vice Chairman of Staples, Inc., in which capacity he was responsible for Staples' store growth, both domestic and abroad, oversaw Staples' corporate environmental initiatives and legal department, and was responsible for its merger and acquisition activities worldwide. He first joined Staples, Inc. in 1989 as its Executive Vice President, Growth & Support Services. He was named Executive Vice President, Global Growth and Development of Staples, Inc. in 1993, was promoted to President, Staples Realty & Development in 1997, and was further promoted to Vice Chairman of Staples, Inc. in 2000. Before joining Staples, Mr. Vassalluzzo held executive positions at American Stores Co., Acme Supermarkets, Mobil Corp. and Amerada Hess Corp. Mr. Vassalluzzo currently serves as an independent director, member of the Nominating and Corporate Governance Committee, member of the Compensation Committee, and Non-executive Chairman of the Board of Federal Realty Investment Trust, a publicly-held REIT. He also serves as an independent director, member of the Finance Committee, Chairman of the Compensation Committee and Non-executive Lead Director of Life Time Fitness, Inc. Previously, Mr. Vassalluzzo served as an independent director and member of the Compensation, Audit and Real Estate Committees of Commerce Bancorp., Inc. Mr. Vassalluzzo holds a B.S. degree in Marketing from Pennsylvania State University and an M.B.A. from Temple University. The Company believes that Mr. Vassalluzzo's broad based experience in business, including his extensive experience in retail businesses, such as his tenure as Vice Chairman of Staples, Inc., and in real estate matters, gives him the qualities to serve as a director of the Company.

## **Director Independence**

Our Board of Directors has determined that each of our director-nominees is an **independent** director as defined under applicable rules of the SEC and NYSE Amex, except for Mr. Perisano, who serves as our Chief Executive Officer. In making this determination for Mr. Vassalluzzo, the Board also considered his consulting arrangement with the Company and the fact that the Company leases 8,500 square feet of retail space from Federal Realty Investment Trust, of which Mr. Vassalluzzo is Non-executive Chairman. As a result, the Board of Directors has determined that a majority of the director-nominees are **independent** under applicable rules of the SEC and NYSE Amex. Mr. Schindler, who served as a director until his retirement on June 10, 2011, was also an **independent** director as defined under applicable rules of the SEC and NYSE Amex.

## **Board Diversity**

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Our Corporate Governance Guidelines provide that our Nominating Committee is to take into account such factors as diversity, age and skills such as understanding of the retail industry, finance, accounting, marketing, technology, and other knowledge needed on the Board. The Nominating Committee utilizes a broad meaning of diversity to include factors such as geographic, background, experience, skills, accomplishments, financial expertise, professional interests, personal qualities and other traits. The Committee implements that policy, and assesses its effectiveness, by examining the diversity of all of the directors on the Board when it selects nominees for directors.

The diversity of directors is one of the factors that the Nominating Committee considers, along with the other selection criteria described above.

### **Board Leadership and Risk Management**

The Board of Directors believes that Mr. Perisano's service as both Chairman of the Board and CEO is in the best interest of the Company and its stockholders. In managing the day-to-day operations of the Company, Mr. Perisano possesses detailed and extensive knowledge of the issues, opportunities and challenges facing the Company and its businesses. This knowledge helps Mr. Perisano develop agendas that focus on and ensure that the critical issues and matters are brought before the Board in a timely and thorough manner. The Company also believes that during the recent economic turmoil it has been beneficial to the Company's stockholders to have a combined role allowing Mr. Perisano to present to our customers, suppliers and stockholders a clear and consistent message on how the Company is managing through the recent recession and looking for growth opportunities. Each of the directors other than Mr. Perisano is independent and the Board believes that the independent directors provide effective oversight of management. The independent directors regularly hold executive sessions. Each director also has full access to Mr. Perisano to provide any feedback from executive sessions or to suggest items for the agenda for future board meetings, as the Company does not believe it is necessary to have any hierarchy among its independent directors.

The Board as a whole has responsibility for risk oversight, with reviews of certain areas being conducted by the relevant committees that report on their deliberations to the Board. The oversight responsibility of the Board and its Committees is enabled by management reporting processes that are designed to provide visibility to the Board about the identification, assessment and management of critical risks and management's risk mitigation strategies. These areas of focus include competitive, economic, operational, financial (accounting, credit, liquidity, and tax), legal, regulatory, compliance, health, safety and environment, and reputational risks. The Board and its Committees oversee risks associated with their respective principal areas of focus. Each Committee meets in executive session, if necessary with representatives of outside advisors and key members of management.

### **Attendance at Annual Meeting and at Meetings of the Board and Its Committees**

Although we do not have a policy on our directors attending our annual meeting, we normally expect each of our directors to be present at the stockholders' meeting. At last year's annual meeting, all of our directors attended the meeting. All of our directors attended at least 75% of the aggregate of all the board and committee meetings on which they served during fiscal 2011.

### **Board Committee Matters**

Our Board of Directors met six (6) times during 2011. Our Board of Directors has three principal committees: the Audit Committee, the Compensation Committee, and the Nominating Committee. All of the members of each of these committees are **independent** directors as defined under applicable NYSE Amex rules and rules of the SEC, including, in the case of the Audit Committee, the additional independence criteria for determining eligibility for director service on audit committees under applicable NYSE Amex and SEC rules.

In addition to the principal committees described above, our Board of Directors also has a Real Estate Committee, consisting of Messrs. Perisano and Vassaluzzo, which considers, from time to time, store location and store lease issues in conjunction with our senior management.

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Our Board of Directors has adopted corporate governance guidelines which are available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com).

The following charts describe the function and number of times that each committee of the Board of Directors met in 2011 and the membership of each committee:

**Audit Committee 4 Meetings**

<b>Function</b>	<b>Members</b>
• Engage the independent registered public accounting firm	Frank W. Haydu III (Chairman)
• Review the annual and quarterly financial statements	Daniel I. DeWolf
• Review control procedures and accounting practices	
• Monitor accounting and reporting practices	
• Review compliance with the conflict-of-interest policy	
• Review our capital structure	
• Exercise such other functions as mandated by the Sarbanes-Oxley Act and other applicable laws and regulations	

We have a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. Each member of our Audit Committee is independent as defined under applicable rules of the SEC and the NYSE Amex. Our Board of Directors has also determined that each of Messrs. Haydu and DeWolf is an audit committee financial expert as defined by applicable regulations promulgated by the SEC pursuant to Section 407 of the Sarbanes-Oxley Act.

The Audit Committee has adopted a charter which is available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com). We have also adopted a whistleblower policy which is available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com).

See the report of the Audit Committee on page 25 below.

**Compensation Committee 3 Meetings**

<b>Function</b>	<b>Members</b>
• Review and approve compensation and benefit programs	Daniel I. DeWolf (Chairman)
• Determine compensation of senior executives	Frank W. Haydu III
• Make recommendations to the full Board regarding director compensation	
• Administer stock option plans	

The Compensation Committee, composed of non-employee directors who qualify as **independent** under applicable SEC and NYSE Amex rules, is responsible for approving all matters concerning our total compensation practices and philosophy, including the conducting of periodic reviews of those practices and the philosophy that underlies them to ensure that they support the objectives of iParty and the interests of its stockholders. In particular, the Compensation Committee is responsible for the review and recommendation to the full Board of Directors of the compensation of iParty's Chief Executive Officer, review and approval of the compensation of our other executive officers pursuant to employment agreements between iParty and such executive officers, and review and approval of other employee benefit plans. The Committee is also primarily responsible for assisting the full Board in administering and interpreting our 2009 Stock Incentive Plan. The Committee also reviews and makes recommendations to the full Board regarding compensation arrangements involving iParty's directors.

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The Company's Chief Executive Officer, Mr. Perisano, is not a member of the Compensation Committee and does not vote at Compensation Committee meetings. Mr. Perisano does, however, regularly attend Compensation Committee meetings, but does not participate in executive sessions or deliberations about his compensation.

Pursuant to the Compensation Committee's charter, the Committee may form and delegate to subcommittees of the Committee its responsibilities. To date, however, the Compensation Committee has not formed or delegated any of its responsibilities to any subcommittees. To the extent permitted by and consistent with applicable law and the provisions of a given equity-based plan, the Compensation Committee's charter allows the Committee to delegate to one or more executive officers of the Company the power to grant options or other stock awards pursuant to an equity based plan to employees of the Company who are not directors or executive officers of the Company.

To date, however, the Compensation Committee has not delegated to any executive officer this power, nor does it presently intend to do so.

The Compensation Committee has sole authority to retain and/or terminate all external consultants to the Compensation Committee and to commission surveys or analyses that it determines necessary to fulfill its responsibilities. Additionally, the Compensation Committee has sole authority to approve the fees of the external consultants. The Compensation Committee's charter is available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com).

### Nominating Committee 1 Meeting

Function	Members
• Review and recommend to the full Board nominations for election to the Board of Directors	Joseph S. Vassalluzzo (Chairman) Daniel I. DeWolf Frank W. Haydu III

The Nominating Committee has adopted a charter which is available on the Investor Relations page on our website at [www.iparty.com](http://www.iparty.com).

The Nominating Committee will consider candidates for our Board that are recommended by our stockholders to the extent such nominations are provided no later than the deadline for stockholder proposals and in the manner for stockholder proposals outlined above on page 7. The Nominating Committee is committed to evaluating nominees recommended by our stockholders no differently than other nominees. The Nominating Committee believes that all nominees must possess, as a minimum qualification, the personal integrity necessary to comply with all applicable legal and regulatory duties imposed on directors of public companies, including without limitation, the fiduciary duties of care and loyalty, and must possess sufficient business and other relevant experience to be able to exercise business judgment in the best interests of iParty and its stockholders.

Stockholder recommendations for director should include: (i) the name and address of the stockholder recommending the person to be nominated; (ii) a representation that the stockholder is a holder of record of stock of iParty, including the number of shares held and the period of holding; (iii) a description of all arrangements or understandings between the stockholder and the recommended nominee; (iv) such other information regarding the recommended nominee as would be required to be included in a proxy statement filed pursuant to Regulation 14A promulgated by the SEC pursuant to the Securities Exchange Act of 1934, as amended; and (v) the consent of the recommended nominee to serve as a director of iParty, if so elected.

It is expected that the Nominating Committee will have direct input from the Chief Executive Officer. Input on nominees will also be solicited from the other members of the Board. Management and other external sources may also identify prospective Director nominees.

### Report of the Audit Committee

The Audit Committee hereby states that it:

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- Has reviewed and discussed the audited financial statements as of and for the year ended December 31, 2011 with iParty's management;
- Has discussed with iParty's independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, as amended (AICPA, Professional Standards Vol. 1, AU Section 380), as adopted by the Public Company Accounting Oversight Board ( PCAOB ) in Rule 3200T, as may be modified or supplemented, relating to the conduct of the audit;



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- Has received the written disclosures and the letter from the independent auditors required by applicable requirements of the PCAOB regarding the independent auditors' communication with the audit committee concerning independence, and has discussed with the independent auditors the independent auditors' independence; and
- Based upon the above mentioned reviews and discussions, has recommended to the Board of Directors of iParty (and the Board of Directors has approved) that the audited financial statements be included in iParty's Annual Report on Form 10-K for the fiscal year ended December 31, 2011 for filing with the Securities and Exchange Commission, which was filed with the SEC on March 28, 2012.

The Audit Committee is solely responsible for the selection, compensation and oversight of the work of the independent registered public accounting firm for the purpose of preparing and issuing an audit report.

Management has primary responsibility for iParty's financial statements and the overall reporting process, including iParty's system of internal controls.

The independent auditors audit the annual financial statements prepared by management, express an opinion as to whether those financial statements fairly present the financial position, results of operations and cash flows of iParty in conformity with generally accepted accounting principles and discuss with us any issues they believe should be raised with us.

The Audit Committee oversees the financial reporting process on behalf of the Board of Directors, reviews iParty's financial disclosures, and meets privately, outside the presence of management, with the independent auditors to discuss internal accounting control policies and procedures. These discussions address the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in iParty's financial statements. The Audit Committee reports on these meetings to the Board of Directors.

Pursuant to applicable NYSE Amex rules, the Audit Committee certifies that it has adopted a formal written Audit Committee Charter and that the Audit Committee has a policy in accordance with said rules of the NYSE Amex of reviewing and reassessing the adequacy of the Audit Committee Charter on an annual basis.

During 2011, iParty paid no fees to Ernst & Young LLP for consulting work outside the review and audit of their financial statements and related tax research and compliance tax return preparation.

### **Submitted by:**

Frank W. Haydu III, *Chairman*

Daniel I. DeWolf

**DIRECTOR COMPENSATION**

At the meeting of our Board of Directors held on June 10, 2011, the board (on recommendation of the Compensation Committee) voted that each independent director (determined to be each of Messrs. DeWolf, Haydu and Vassalluzzo) would be granted an option on June 10, 2011 exercisable for the purchase of 25,000 shares of our common stock and be paid a \$25,750 cash payment in respect of his service as a director. The Board of Directors approved the Compensation Committee's recommendation that each such option would vest quarterly over a one-year period and the \$25,750 cash payment would be paid quarterly over a one-year period. As a result of these determinations, each of Messrs. DeWolf, Haydu, and Vassalluzzo was granted an option exercisable for 25,000 shares. Each of these stock option grants was made pursuant to the 2009 Stock Incentive Plan, at an exercise price equal to the market price of our common stock at the close of business on the grant date. These options expire on the earlier of 10 years from the date of grant or three years from the date the grantee ceases to serve as a director.

At that same meeting held on June 10, 2011, the Board of Directors also voted to accept the Compensation Committee's recommendation to engage Mr. Vassalluzzo as a part-time consultant to our company for a one-year period at an annual fee of \$61,800. The Board of Directors voted in favor of the Compensation Committee's recommendation in this regard. Pursuant to this arrangement, our Chairman and CEO, Mr. Perisano, consults with Mr. Vassalluzzo with respect to various retail, operational, strategic, real estate and store location issues, as may from time to time be necessary and appropriate. Such services on occasion require Mr. Vassalluzzo's presence at our corporate headquarters in Dedham, Massachusetts and/or current or proposed store location sites, principally in New England and Florida.

Also at the June 10, 2011 meeting, the Board of Directors (on recommendation of the Compensation Committee) voted that each independent director would be paid an annual fee of the following amounts in cash, payable in equal quarterly installments, for serving on the various committees of our Board of Directors. This amount is in addition to the annual director fee described above.

Director	Annual Committee Compensation	
Frank W. Haydu III	\$	20,600
Daniel I. DeWolf	\$	10,300
Joseph S. Vassalluzzo	\$	25,750

#### DIRECTOR COMPENSATION TABLE

The table below summarizes the compensation that we paid our non-employee, independent directors for the fiscal year ended December 31, 2011. Our one employee-director, our Chairman of the Board and Chief Executive Officer, Mr. Perisano, earned no compensation for his service as a director in 2011.

Name	Fees Earned or Paid in Cash	Stock Awards	Option	Non-Equity Incentive Plan	Change in Pension Value and Nonqualified Deferred	All Other
Total Sales	582,549		970,379	(387,830 )		(40 )%
Cost of Sales — Products	819,116		612,346	206,770		34 %
Cost of Sales — Engineering Services	—		31,900	(31,900 )		(100 )%
Total Cost of Sales	819,116		644,246	174,870		27 %
Gross Profit (Loss)	(236,567 )		326,133	(562,700 )		(173 )%

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Gross Profit (Loss) %	(41 )%	34 %		
Operating Expenses:				
Research and Development	2,177,957	944,426	1,233,531	131 %
Selling and Marketing	839,947	469,443	370,054	79 %
General and Administrative	1,274,698	1,120,982	153,716	14 %
Depreciation and Amortization	196,370	88,285	108,085	122 %
Loss from Operations	(4,725,089)	(2,297,003)	(2,428,086)	106 %
Other Income (Expense)				
Interest Income	8,144	12,621	(4,477 )	(35 )%
Other Taxes	(19,124 )	(30,443 )	11,319	(37 )%
Foreign Exchange (Loss) Gain	(13,781 )	287	(14,068 )	(4,902)%
Loss on Fixed Asset Disposal	(25,890 )	—	(25,890 )	(100 )%
(Loss) Gain on Derivative Valuation	(59,120 )	58,239	(117,359 )	(202 )%
Amortization of Senior Term Debt Discount & Financing Costs	(167,020 )	(127,716 )	(39,304 )	34 %
Interest Expense, net of Interest Income	(33,981 )	(40,956 )	6,975	(17 )%
Total Other Income (Expense)	(310,772 )	(127,968 )	(182,804 )	143 %
Loss Before Income Taxes Provision (Benefit) for Income Taxes	(5,035,861)	(2,424,971)	(2,610,890)	108 %
Net Loss	\$ (5,035,861)	\$ (2,424,971)	\$ (2,610,890)	108 %

*Sales.* There was an overall decrease in product sales for the three months ended September 30, 2016 over the same period in 2015 of \$308,080 or 35%. The reduction was primarily the result of a 40% decrease in sales of the M100 Smart Glasses over the 2015 period. After the announcement of the new M300 at CES in January 2016, many customers have delayed further purchases of our smart glasses until we commence shipping the M300. Pre-order deposits for the new M300 and new orders of our M100/M300 migration packages have primarily resulted in deferred revenues and will not be recognized as revenues until those units ship to the customer. Our iWear Video Headphone sales were 29% of product revenues for the three months ending September 30, 2016 versus \$0 in the same period in 2015 when it was not yet available. Revenues from this product line have continued to be constrained due to production difficulties, particularly with the tight component tolerances required to manufacture a high quality product. For the 2015 comparative period, approximately 5% of total product revenues came from the Wrap series of AR products which was discontinued in the summer of 2015, and as a result no such product revenues were reported in the 2016 period. In summary, monocular smart glasses and waveguide product sales were 69% of total product revenues versus 86% in the prior year's period.

Sales from our engineering programs for the three months ended September 30, 2016, were \$0 as compared to \$79,750 over the same period in 2015.

*Cost of Sales and Gross Profit (Loss).* Cost of product revenues and engineering services is comprised of materials, components, labor, warranty costs, freight costs, manufacturing overhead, and the non-cash amortization of software development costs related to the production of our products and rendering engineering services. The decreased net gross profit (loss) percentage earned in the three months ended September 30, 2016 as compared to the same period in 2015 was primarily the result of lower sales levels to absorb many of our relatively fixed manufacturing overheads and amortization costs along with the fact that we earn significantly lower gross margins on iWear as compared to our smart glasses and prior Wrap AR products. Manufacturing overhead costs increased primarily due to use of temporary contract labor for iWear rework costing \$39,723 and increased rent and utility cost allocations of \$42,220 due to our larger plant. Freight costs continued to be substantially higher for the 2016 period as compared to 2015. As our new iWear product is bulkier and heavier and ships in a larger retail package than our prior products, the costs of air shipments have become prohibitively material now that production volumes from China have risen. We are switching to sea transport in the fourth quarter of 2016 as we expect the volumes of shipments to increase. The following table reflects the components of our cost of goods sold for products:

<b>Component of Cost of Sales</b>	<b>3 Months Ended September 30, 2016</b>	<b>As % Related Sales</b>		<b>3 Months Ended September 30, 2015</b>	<b>As % of Related Sales</b>	<b>Dollar Change</b>
Product Cost of Sales	\$ 297,240	51	%	\$ 287,302	32	% \$9,938
Freight Costs	141,011	24	%	58,914	7	% 82,097
Manufacturing Overhead	226,034	39	%	127,988	14	% 98,046
Warranty Costs	26,662	5	%	30,020	3	% (3,358 )
Amortization of Software Costs	71,613	12	%	71,612	8	% 1

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Software Royalties	56,556	10	%	36,510	4	%	20,046
Total Cost of Sales – Products	\$ 819,116	141	%	\$ 612,346	69	%	\$206,770
Gross Profit (Loss)– Product Sales	\$ (236,567 )	(41	)%	\$ 278,283	31	%	\$(514,850)

*Research and Development.* Our research and development expenses consist primarily of compensation costs for personnel, related stock compensation expenses, third party services, purchase of research supplies and materials, and consulting fees related to research and development costs. Software development expenses to determine technical feasibility before final development and ongoing maintenance that are not capitalized are included in research and development costs.

Research and development costs were \$2,177,957 for the 3 months ending September 30, 2016 as compared to \$944,426 and for the three months ended September 30, 2015, an increase of \$1,233,531 or 131%. Comparing the research and development costs for the three months ending September 30, 2016 versus the same period in 2015, there was an increase in 2016 salary, benefits and stock compensation expenses and recruitment costs of \$271,827, primarily the result of additional R&D staff versus the same period in 2015, offset partially by a \$42,581 reduction in hiring and recruitment fees; an increase in project development and research costs of \$884,102 primarily related to the new M300 and the beginning of production design for manufacturing refinement activities on the M3000 Smart Glasses with our contract manufacturer who will ultimately produce the unit; an increase in \$57,917 in rent and utility costs related to the expanded R&D portion of our new corporate facilities; an increase of \$62,792 in external research related consulting fees; and a \$24,959 decrease in travel costs related to fewer international visits to our China and our North American M300 contract manufacturer by our development teams.

*Selling and Marketing.* Selling and marketing costs consist of trade show costs, advertising, travel costs, sales staff compensation costs including stock compensation expense, consulting fees, PR agency fees, website costs and sales commissions paid to full-time staff and outside consultants. These costs increased overall for the three months ended September 30, 2016 by \$370,054 or 79% as compared to the same period in 2015 primarily due to the following factors: higher salary, commissions, benefits and stock compensation expenses related to new staff additions totaling \$137,576 domestically and in Europe; increased trade show costs of \$71,329 during the quarter versus the same period in 2015 due to more frequent attendance at shows, including our first booth this September 2016 at IFA Germany; increased public relations costs of \$50,687 due to the hiring of a second PR firm; a \$34,131 increase in advertising and promotional expenses; a \$25,126 increase in travel costs and a \$15,675 increase in software subscriptions, primarily for CRM; partially offset by a \$19,370 decrease in website costs.

*General and Administrative.* General and administrative costs include professional fees, investor relations (IR) costs including shares and warrants issued for IR services, salaries and related stock compensation, travel costs, office and rental costs. These costs increased by \$153,716 or 14% for the three months ended September 30, 2016 as compared to the same period in 2015 primarily because of: increased IR activities and shareholder communications costs of \$145,719; \$144,631 increase in professional fees, with the majority being for SOX consultants retained to assist management in designing and implementing improvements in our financial reporting controls and accruals for expected additional audit fees, as compared to the same period in 2015 when no such consultants were retained; increased legal fees of \$18,265; partially offset by a \$170,679 decrease in salaries, benefits and stock compensations expenses, primarily the result of reductions in stock award expense; and a decrease in travel expenses of \$22,940.

*Depreciation and Amortization.* Depreciation and amortization expense for the quarter ended September 30, 2016 was \$196,370 as compared to \$88,285 in the same period in 2015, an increase of \$108,085. The increase in depreciation and amortization expense is due to new investments in depreciable assets at our new facility and new product tooling that took place after the quarter had ended September 30, 2015 during the second half of 2015.

*Other Income (Expense).* Total other expense was \$310,772 for the three months ended September 30, 2016 compared to an expense of \$127,968 in the same period in 2015. The increase in expenses was primarily the result of a loss of \$59,120 on the derivative liability valuation mark-to-market revaluation for the 2016 period versus the prior 2015 quarter gain of \$58,239 and a increase of \$39,305 in senior debt discount and issuance expense amortization for the 2016 period versus 2015.

*Provision (Benefit) for Income Taxes.* There were no provisions for income taxes for the three months ended September 30, 2016 or 2015.

*Comparison of Nine months ended September 30, 2016 and September 30, 2015*

The following table compares the Company's consolidated statements of operations data for the nine months ended September 30, 2016 and 2015.

	9 Months Ended September 30,		Dollar Change	% Increase (Decrease)	
	2016	2015			
Sales of Products	\$1,367,766	\$2,014,015	\$(646,249 )	(32 )	%
Sales of Engineering Services	139,500	193,331	(53,831 )	(28 )	%
Total Sales	1,507,266	2,207,346	(700,080 )	(32 )	%
Cost of Sales — Products	2,069,964	1,590,284	479,680	30	%
Cost of Sales — Engineering Services	39,060	77,332	(38,272 )	(49 )	%
Total Cost of Sales	2,109,024	1,667,616	441,408	26	%
Gross Profit (Loss)	(601,758 )	539,730	(1,141,488)	(211 )	%
Gross Profit (Loss) %	(40 )%	24 %			
Operating Expenses:					
Research and Development	5,121,713	2,191,624	2,930,089	134	%
Selling and Marketing	2,627,543	1,172,252	1,455,291	124	%
General and Administrative	3,350,441	5,079,131	(1,728,690)	(34 )	%
Depreciation and Amortization	549,244	226,472	322,772	143	%
Loss from Operations	(12,250,699)	(8,129,749)	(4,120,950)	(51 )	%
Other Income (Expense)					
Interest Income	20,923	12,621	8,302	66	%
Other Taxes	(53,749 )	(44,508 )	(9,241 )	21	%
Foreign Exchange (Loss) Gain	(21,267 )	1,335	(22,602 )	(1,693 )	%
Loss on Fixed Asset Disposal	(25,890 )	—	(25,890 )	100	%
(Loss) Gain on Derivative Valuation	(57,133 )	(968,467 )	911,334	(94 )	%
Amortization of Senior Term Debt Discount & Financing Costs	(426,201 )	(670,689 )	244,488	(36 )	%
Interest Expense, net of Interest Income	(101,075 )	(118,693 )	17,618	(15 )	%
Total Other Income (Expense)	(664,392 )	(1,788,401)	1,124,009	(63 )	%



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Loss Before Income Taxes	(12,915,091)	(9,918,150)	(2,996,941)	(30)	)%
Provision (Benefit) for Income Taxes	—	—	—	—	
Net Loss	\$(12,915,091)	\$(9,918,150)	\$(2,996,941)	(30)	)%

*Sales.* There was an overall decrease in product sales for the nine months ended September 30, 2016 over the same period in 2015 of \$646,249 or 35%. The decrease was primarily the result of a 36% decrease in sales of the M100 Smart Glasses. After the announcement of the new M300 at CES in January 2016, many customers have delayed further purchases of our smart glasses until we commence shipping the M300 Smart Glasses. Pre-orders for the new M300, including migration packages, are included primarily as deferred revenues and will not be recognized as revenues until those orders are finally shipped to the customer. Our iWear Video Headphones sales were 17% of product revenues for the nine months ending September 30, 2016 versus nil in the same period in 2015 when it was not yet available. Revenues from this product line continue to be constrained due to production difficulties, but production capacities are consistently improving. For the 2015 comparative period, approximately 7% of revenues came from the Wrap AR series of products which was discontinued in the summer of 2015, whereas no such product revenues were reported in the 2016 period. Sales of waveguide related component sales were 2% of total product revenues versus 11% in the prior period, partially due to customers awaiting shipments of the next generation of waveguides.

Sales from our engineering services programs for the nine months ended September 30, 2016, were \$139,500 or 9% of total revenues as compared to \$193,331 or 9% of total sales in the same period in 2015.

*Cost of Sales and Gross Profit (Loss).* Cost of product revenues and engineering services is comprised of materials, components, labor, warranty costs, freight costs, manufacturing overhead, and the non-cash amortization of software development costs related to the production of our products and rendering engineering services. The decreased net gross profit (loss) percentage earned in the nine months ended September 30, 2016 as compared to the same period in 2015 was primarily the result of lower sales levels to absorb many of our relatively fixed manufacturing overheads and amortization costs; as well as increased manufacturing overhead costs of \$159,482 due to additional staff and larger plant facilities costs, component material scrapping costs of \$89,523 related to iWear Video Headphones in the first quarter of 2016; significantly lower gross margins in iWear compared to our smart glasses and previous Wrap AR products; as well as a \$209,758 increase in freight costs for the 2016 period as compared to 2015. The following table reflects the components of our cost of goods sold for products:

<b>Component of Cost of Sales</b>	<b>9 Months Ended September 30, 2016</b>	<b>As % Related Sales</b>		<b>9 Months Ended September 30, 2015</b>	<b>As % of Related Sales</b>	<b>Dollar Change</b>
Product Cost of Sales	\$ 795,616	58	%	\$ 671,375	33	% \$ 124,241
Freight Costs	355,965	26	%	146,207	7	% 209,758
Manufacturing Overhead & Labor	542,072	40	%	382,590	19	% 159,482
Warranty Costs	49,829	4	%	75,091	4	% (25,262 )
Amortization of Software Costs	214,838	16	%	214,838	11	% —
Software Royalties	111,644	8	%	100,183	5	% 11,461
<b>Total Cost of Sales – Products</b>	<b>\$ 2,069,964</b>	<b>151</b>	<b>%</b>	<b>\$ 1,590,284</b>	<b>79</b>	<b>% \$ 479,680</b>
<b>Gross Profit (Loss)– Product Sales</b>	<b>\$(702,198 )</b>	<b>(51 )</b>	<b>%</b>	<b>\$ 423,731</b>	<b>21</b>	<b>% \$(1,125,929)</b>

*Research and Development.* Our research and development expenses consist primarily of compensation costs for personnel, related stock compensation expenses, third party services, purchase of research supplies and materials, and consulting fees related to research and development costs. Software development expenses to determine technical feasibility before final development and ongoing maintenance that are not capitalized are included in research and development costs.

Research and development costs were \$5,121,713 as compared to \$2,191,624 for the 9 months ending September 30, 2016 and 2015 respectfully, an increase of \$2,930,089 or 134%. Comparing the research and development costs for the nine months ending September 30, 2016 versus the same period in 2015, there was an increase in 2016 salary, benefits and stock compensation expenses of \$991,870, primarily the result of additional R&D staff versus the same

period in 2015; a \$62,253 reduction in new staff recruitment fees; an increase in project development and research costs of \$1,628,370 primarily related to the new product development for the M300 Smart Glasses and to a smaller extent the M3000, with the majority of these amounts being spent with outside contractors which assisted in the development work; an increase in \$177,639 in rent and utility costs related to the expanded R&D portion of our new corporate facilities; an increase of \$120,501 in external research related consulting fees for optics and waveguide research; and a \$32,877 increase in travel costs related to our China based iWear production contractor and development work at our new contractors facility of our forthcoming M300 Smart Glasses.

*Selling and Marketing.* Selling and marketing costs consist of trade show costs, advertising, travel costs, sales staff compensation costs including stock compensation expense, consulting fees, PR agency fees, website costs and sales commissions paid to full-time staff and outside consultants. These costs increased overall for the nine months ended September 30, 2016 by \$1,455,291 as compared to the same period in 2015 primarily due to the following factors: higher salary, commissions, benefits and stock compensation expenses related to new staff additions totaling \$416,330 in both North American and Europe; increased trade show costs of \$390,958 due to larger exhibit booth sizes and show rentals and attendance several additional major trade shows during the year versus the same period in 2015; increased public relations costs of \$238,074 due to the hiring of an additional PR and marketing service firm as compared to the 2015 period; new 2016 period video production costs of \$63,143; a \$161,171 increase in website costs including additions to our main new corporate and European websites; a \$91,980 increase in travel costs; and a \$32,121 increase in rent and utility costs and allocations with our new corporate offices.

*General and Administrative.* General and administrative costs include professional fees, investor relations (IR) costs including shares and warrants issued for IR services, salaries and related stock compensation, travel costs, office and rental costs. These costs decreased by \$1,728,690 or 34% for the nine months ended September 30, 2016 as compared to the same period in 2015 primarily because of: lower compensation expense related to stock awards totaling \$1,375,000 to our officers and directors awarded in January 2015; a \$44,021 decrease in travel costs; decreased IR activities and IR consultant fees of \$407,822 resulting from reductions in compensation awards of shares and warrants for these services as compared to the 2015 period; \$99,598 decrease in legal fees, primarily related to a stock award made to our attorneys in January 2015; partially offset by: an increase of \$20,367 in fees paid to our external board members as compared to the 2015 period when lower fee arrangements were in place; a \$192,593 increase in accounting and audit fees, with the majority of the change being for SOX consultants retained to assist management in designing and implementing improvements in our financial reporting controls and accruals for expected additional external audit fees, as compared to the same period in 2015 when no such consultants were retained; and increased rent and occupancy costs of \$36,937 due to our larger corporate offices.

*Depreciation and Amortization.* Depreciation and amortization expense for the nine months ended September 30, 2016 was \$549,244 as compared to \$226,472 in the same period in 2015, an increase of \$322,772. The increase in depreciation and amortization expense is due to new investments in depreciable assets at our new facility as well as new product tooling costs that took place during the second half of 2015 and for the current 2016 period.

*Other Income (Expense).* Total other expense was \$664,392 for the nine months ended September 30, 2016 compared to an expense of \$1,788,401 in the same period in 2015. The \$1,124,009 reduction in expenses was primarily the result of a loss of \$57,113 on the derivative liability valuation mark-to-market revaluation for the 2016 period versus a loss of \$968,467 in the same nine-month period of 2015, and a reduction of \$244,488 in senior debt discount and issuance expense amortization for the 2016 period versus 2015, due primarily to ongoing debt conversions.

*Provision (Benefit) for Income Taxes.* There were no provisions for income taxes for the nine months ended September 30, 2016 or 2015.

## **Liquidity and Capital Resources**

As of September 30, 2016, we had cash and cash equivalents of \$5,941,661, a decrease of \$5,935,396 from \$11,877,058 as of December 31, 2015.

At September 30, 2016 we had current assets of \$11,071,515 compared to current liabilities of \$4,354,048 which resulted in a positive working capital position of \$6,717,467. At December 31, 2015, we had current assets of

\$16,530,211 compared to current liabilities of \$1,802,122 which resulted in a working capital position of \$14,728,089. Our current liabilities are comprised principally of accounts payable, accrued expenses and the current portion of convertible debt.

*Operating Activities.* We used \$10,038,160 of cash for operating activities for the nine months ending September 30, 2016 and \$8,874,705 in the same period in 2015, primarily the result of an increased operating loss after adding back non-cash items. The major changes in operating assets and liabilities for 2016 resulted from a \$623,445 increase in inventories, a \$223,135 increase in prepaid expenses, a \$206,409 decrease in accounts receivable and a \$622,119 increase in accounts payable. The major operating items for the nine-month period ending September 30, 2015 were a \$1,122,184 increase in vendor component deposits, a \$849,958 increase in inventory and a \$281,034 increase in accounts receivable, offset by a \$1,785,638 decrease in accounts payable.

*Investing Activities.* Cash used in investing activities was \$1,654,516 for the nine months ending September 30, 2016 as compared to \$719,753 in the same period in 2015. During the nine months ending September 30, 2016, \$1,551,141 was used primarily for the purchase of fixed assets for our new clean room equipment for our new manufacturing facility as well as additions to product tooling for the M300 and computer equipment additions, as compared to spending of \$553,448 for the same period in 2015, primarily for the purchase of manufacturing equipment and mold tooling, as well as computer equipment additions. The costs of registering our intellectual property rights, included in the investing activities totals described above, were \$103,375 in the nine-month period ending September 30, 2016 and \$166,305 in the same period in 2015.

*Financing Activities.* We generated \$5,757,279 of cash for financing activities for the nine months ending September 30, 2016 as compared to generating \$25,581,713 of cash from financing activities in 2015. For the 2016 period, financing activities consisted of a public offering of 1,150,000 shares of common stock, resulting in proceeds after offering expenses of \$5,764,695, repayment of \$52,416 in notes payable and the receipt of \$45,000 from cash warrant exercises. During the nine months ended September 30, 2015, the primary sources of cash from financing activities were the proceeds of \$24,813,000 from the sale of Series A Preferred Stock on January 2, 2015 to Intel Corporation, less direct offering costs of \$214,169 and the cash proceeds of \$1,262,626 from warrant exercises.

*Capital Resources.* As of September 30, 2016, we had a cash balance of \$5,941,661.

The net loss for the nine months ending September 30, 2016 was \$12,915,091. The Company incurred annual net losses of \$13,427,478 in 2015 and \$7,868,858 in 2014, and has an accumulated deficit of \$70,503,959 as of September 30, 2016. The Company will need to grow its business significantly to become profitable and self-sustaining on a cash flow basis or it will be required to raise new capital. The Company's management intends to take actions necessary to continue as a going concern, and accordingly our condensed consolidated financial statements included in this report have been prepared assuming that we will continue as a going concern. This basis of accounting contemplates the recovery of our assets and the satisfaction of liabilities in the normal course of business. These condensed consolidated financial statements do not include any adjustments to the specific amounts and classifications of assets and liabilities, which might be necessary should we be unable to continue as a going concern.

The Company's cash requirements are primarily for funding operating losses, working capital, research, debt service and capital expenditures. On July 11, 2016, the Company closed its public offering of 1,150,000 shares of common stock, at a public offering price of \$5.75 per share. Total net proceeds from the public offering were \$5,764,695, after underwriting discounts and commissions and other offering expenses payable by Vuzix. On January 2, 2015 we closed a Series A Preferred Stock sale to Intel Corporation, for an aggregate purchase price of \$24,813,000. Our cash requirements related to funding operating losses depend on numerous factors, including new product development activities, our ability to commercialize our products, our products' timely market acceptance, selling prices and gross margins, and other factors. In order for us to achieve positive cash flow from operations, our product sales will need to significantly increase. In the fourth quarter of 2016, the Company will begin shipping new models and products as compared to its offerings in the prior years. We will also introduce a waveguide based smart glasses product, the M3000 in late spring 2017 that leverages heavily from the M300 design and electronics. However, if these new products are not successful within a reasonable time period, we will have to raise additional capital to maintain operations and/or materially reduce our operating and new product development costs.

Historically, the Company has met its cash needs by borrowings under notes, sales of convertible debt, and the sales of equity. If the Company raises additional funds by these methods, the ownership interest of existing shareholders may be diluted. The amount of such dilution could increase due to the issuance of new warrants or securities with other dilutive characteristics, such as full ratchet anti-dilution clauses or price resets.

However, there can be no assurance that we will be able to raise capital in the future or that if we raise additional capital it will be sufficient to execute our business plan. To the extent that we are unable to raise sufficient additional capital, we will be required to substantially modify our business plan and our plans for operations, which could have a material adverse effect on us and our financial condition.

In regards to our ongoing capital needs, management intends to limit further growth over the next 4 quarters in our levels of spending on sales and marketing as well as research and development activities. We intend to reduce our attendance at tradeshow in 2017, invest less in tradeshow booths, reduce our spending on external marketing services, as well as curtail any further growth in our sales force until the sales of our new product dictate a compelling need to meet demand. In the area of research and development activities, we intend to reduce reliance on external contractors for engineering and design services over the next year. Fortunately, we will be leveraging much of the prior development work on the M300 up to the waveguide based M3000 smart glasses and as a result we expect that new product's development costs to be less than half the original M300 smart glasses. Additionally, for the B3000 smart sunglasses, we have already reached a well-designed stage utilizing primarily Vuzix personnel and not the costlier external design services utilized on the M300, and it will soon be ready to commence manufacturing tooling. The B3000 is also based on waveguides and will utilize the same Cobra II projector engines we designed and had built in 2016 for the upcoming M3000 waveguide smart glasses. As a result, we expect the costs and other resources needed to bring these products to market in 2017 will likely be less than our 2016 spending. Further as the costs over the last 12 months to bring our new corporate office and manufacturing facilities up to our requirements has been concluded, we expect our capital spending in these areas to be lower in 2017.

Operationally in 2016, although we are now able to produce high quality iWear Video Headphones, we continue to have component tolerance issues that are reducing yield problems with certain optical components which has limited our overall manufacturing yields. As a result, we have not been able to produce at anywhere near our planned production rates. We have a focused effort on improving the parts yield issues and we have just recently opened a second production line in Asia; as a result, production volumes have been rising. Despite these production challenges we continue to experience solid customer interest in Vuzix iWear and we have finally begun to implement our broader planned marketing and sales activities around iWear, inclusive with a focus on using our iWear as an all-digital and low latency companion product FPV drone and other FPV remote control vehicle users. As we have approximately \$1,900,000 in component inventories for iWear, representing approximately 70% of their cost to build around 7,500 units already paid for in our supply chain due to these production issues, we expect to draw down this inventory and convert it into cash with ongoing iWear sales. Such iWear sales will contribute more to our cash flow than just the normal gross margins earned would generate.

The announcement of our new M300 Smart Glasses products slowed our M100 Smart Glasses sales throughout 2016 and has delayed further pilots and roll-outs by many enterprise customers that prefer to employ the latest proven technology. And as there are many improvements offered by the upcoming M300 Smart Glasses, customers have been waiting. The commencement of our promotional package in February 2016 that allowed such customers to easily upgrade their new M100 purchase to an M300 when it is available or place pre-order deposits for the M300 has most of these sales recorded as deferred revenue or deposits, approximately \$350,000 as of September 30, 2016. Final engineering verifications and regulatory testing is near complete as of the date of this quarterly report, and we expect volume commercial shipments of the M300 to start taking place before the end of November.

We have thus far not made any real adjustments in the selling prices of our existing M100, but we expect we may do so once the M300 gains strong traction. We had approximately 2,500 M100 Smart Glasses in stock or as work in progress as of September 30, 2016, representing approximately \$700,000 in paid for inventory. If the M100 prices are lowered as contemplated, but only to a level where Vuzix still generates positive gross margins, this would allow more price sensitive customers to work with Vuzix smart glasses and see their positive impact on their operations. Many thereafter would be expected to ultimately upgrade to the M300 or M3000 smart glasses in the future.

We are continuing our waveguide development and ramp up for volume production by mid-2017. Positive further strides are being made in waveguide performance, clarity, component materials and tightly controlled replication techniques.

Regarding our new waveguide based products, the M3000 waveguide smart glasses have been released to production engineering for tooling and should commence volume production by summer 2017. We expect to release the Blade 3000, a proposed model name for our first fashion smart sunglasses, by fall of 2017.

We believe our existing cash and cash equivalent balances and reductions in spending on new product releases, along with lower cash requirements for future operations as sales of the new products accelerate, will, if we successfully implement our operating plan, be sufficient to meet our working capital and capital expenditure needs for the foreseeable future even with continued operating losses for the next two quarters. There can, however be no assurance that we will be able to generate positive cash flows from operations in the near future or thereafter.

## **Forward Looking Statements**

This quarterly report includes forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include



statements concerning:

- Our cash needs and financing plans;
- Our possible or assumed future results of operations;
- Our business strategies;
- Our ability to attract and retain customers;
- Our ability to sell additional products and services to customers;
- Our competitive position;
- Our industry environment;
- Our potential growth opportunities;
- Expected technological advances by us or by third parties and our ability to leverage them;
- The effects of future regulation; and
- The effects of competition.

All statements in this quarterly report that are not historical facts are forward-looking statements. We may, in some cases, use terms such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “may,” “plans,” “potential,” “projects,” “should,” “will,” “would” or similar expressions that convey uncertainty of future events or outcomes to identify forward-looking statements.

The outcome of the events described in these forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements.

All such forward-looking statements are subject to certain risks and uncertainties and should be evaluated in light of important risk factors. These risk factors include, but are not limited to, those that are described in “Risk Factors” under Item 1A and elsewhere in our 2015 annual report on Form 10-K and other filings we make with the Securities and Exchange Commission and the following: business and economic conditions, rapid technological changes accompanied by frequent new product introductions, competitive pressures, dependence on key customers, inability to gauge order flows from customers, fluctuations in quarterly and annual results, the reliance on a limited number of third party suppliers, limitations of our manufacturing capacity and arrangements, the protection of our proprietary technology, the effects of pending or threatened litigation, the dependence on key personnel, changes in critical accounting estimates, potential impairments related to investments, foreign regulations, liquidity issues, and potential material weaknesses in internal control over financial reporting. Further, during weak or uncertain economic periods, customers’ may delay the placement of their orders. These factors often result in a substantial portion of our revenue being derived from orders placed within a quarter and shipped in the final month of the same quarter.

Any of these factors could cause our actual results to differ materially from our anticipated results. We caution readers to carefully consider such factors. Many of these factors are beyond our control. In addition, any forward-looking statements represent our estimates only as of the date they are made, and should not be relied upon as representing our estimates as of any subsequent date. While we may elect to update forward-looking statements at some point in the future, except as may be required under applicable securities laws, we specifically disclaim any obligation to do so, even if our estimates change.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Not required for a smaller reporting company.

### **Item 4. Controls and Procedures**

#### Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's (SEC) rules and forms. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate to allow timely decisions regarding required disclosure. Disclosure controls include components of internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

As reported in our 2015 Annual Report on Form 10-K (the "2015 Form 10-K"), as of December 31, 2015, our management identified material weaknesses in our internal control over financial reporting that have a direct impact on our financial reporting. Due to these material weaknesses in internal control over financial reporting, our management concluded in our 2015 Form 10-K that our disclosure controls and procedures were ineffective as of December 31, 2015.

Our management, with the participation of our CEO and CFO, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2016. As part of its evaluation, our management has evaluated whether the control deficiencies related to the reported material weaknesses in internal control over financial reporting continue to exist. As of September 30, 2016, we had completed the development, and implemented many of the changes in controls and procedures that we believe are necessary to remediate the material weaknesses. However, we have not completed the assessment and testing of those changes in controls and procedures that we believe are necessary to conclude that the material weaknesses have been remediated and, therefore, our management has concluded that we cannot assert that the control deficiencies relating to the reported material weaknesses have been effectively remediated. As a result, our CEO and CFO have concluded that our disclosure controls and procedures were ineffective as of September 30, 2016.

In light of the foregoing conclusion, we undertook additional procedures in order that management could conclude that reasonable assurance exists regarding the reliability of financial reporting and the preparation of the consolidated financial statements contained in this filing. Accordingly, management believes that our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for the period ended September 30, 2016 fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented.

**Changes in internal control over financial reporting**

Except for the actions described above that were taken to address the material weaknesses, there were no changes in our internal controls during the three months ended September 30, 2016 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Part II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are not involved in any current or pending legal proceeding or litigation and we are not aware of any such proceedings contemplated by or against us or our property. To our knowledge, there are no material legal proceedings to which any our directors, officers or affiliates, or any beneficial owner of more than five percent of our common stock, or any associate of any of the foregoing, is a party adverse to us or any of our subsidiaries or has a material interest adverse to us or any of our subsidiaries.

### **Item 1A. Risk Factors**

In addition to the other information set forth in this report you should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our annual report on Form 10-K for the year ended December 31, 2015. There have been no material changes from those risk factors. The risks discussed in our 2015 annual report could materially affect our business, financial condition and future results.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Sale of Unregistered Securities –

During the three months ended September 30, 2016 we issued 632 shares of common stock upon the cashless exercise of stock options to an employee of the Company.

During the three months ended September 30, 2016, we issued 142,015 shares of common stock upon conversion of convertible notes in the principal amount of \$304,500 and \$15,035 of accrued interest.

In connection with the foregoing, we relied upon the exemption from registration provided by Section 4(a)(2) under the Securities Act of 1933, as amended, for transactions not involving a public offering.

Purchase of Equity Securities – none

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

Not Applicable

**Item 5. Other Information**

None

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**Item 6. Exhibits**

**Exhibit No. Description**

31.1	Certification of the Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer of the Registrant pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer of the Registrant pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Link base Document
101.DEF	XBRL Taxonomy Extension Definition Link base
101.LAB	XBRL Taxonomy Extension Label Link base Document
101.PRE	XBRL Taxonomy Extension Presentation Link base Document

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**VUZIX CORPORATION**

Date: November 14, 2016 By: /s/ Paul J. Travers  
Paul J. Travers  
President, Chief Executive Officer  
(Principal Executive Officer)

Date: November 14, 2016 By: /s/ Grant Russell  
Grant Russell  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)