
May 14, 2020

VIA ELECTRONIC SUBMISSION

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
rule-comments@sec.gov

Re: Comment Letter on Proposed Amendments to SEC Rule 15c2-11, File No. S7-14-19, Publication or Submission of Quotations Without Specified Information

Ladies and Gentlemen:

We are grateful for the opportunity to respond to the request by the U.S. Securities and Exchange Commission (the "**SEC**" or "**Commission**") for comments regarding the above referenced proposed rule (the "**Proposed Rule**").¹ Through the Proposed Rule the Commission is seeking to, in part, provide greater transparency to investors and market participants, increase the protection of retail investors, reduce regulatory burdens on broker-dealers for the publication of quotations of over-the-counter securities, and streamline Rule 17 CFR 240.15c2-11 ("**Rule 15c2-11**") without undermining relevant investor protections.²

Sosnow & Associates PLLC (the "**Firm**") is a boutique corporate and securities law firm with offices in New York City and Orange County, California. The Firm has been an early supporter of the JOBS Act and is heavily engaged in, *inter alia*, representing start-ups and emerging companies in their capital formation endeavors. In this capacity, the Firm advises clients throughout their lifecycles, from inception to exit events, and regularly counsels clients with regard to the OTC Markets matters. In developing these comments, we have drawn on our extensive experience in the capital markets arena.

We appreciate the SEC's initiative to amend and modernize Rule 15c2-11. Rule 15c2-11 casts a significant role within the ecosystem of secondary trading of securities and will have an increasingly critical role in the future for many small to mid-sized companies in particular, and the U.S. economy in general. This is even more true, given the recent impact of the global pandemic on capital markets in the U.S. and worldwide.

In general, we strongly support the Commission's Proposed Rule and the thoughtful propositions accompanying the foregoing. The Commission has dissected the pressing

¹ Publication or Submission of Quotations Without Specified Information, File No. S7-14-19 (September 25, 2019).

² Proposed Rule at page 1.

underlying issues and afforded an attentive response in the form of the Proposed Rule. While we do agree with most aspects of the Proposed Rule, we are also mindful of the practical implications of the Proposed Rule and eager to share some considerations in response to the SEC's request for comments.

I. Information Review Standard for Broker-Dealers

Paragraph (a)(1)(iii) of the Proposed Rule, similar to the current review requirement, states that broker-dealers, based upon a review of certain information enumerated in paragraphs (b) and (c) of the Proposed Rule, need to form a reasonable basis under the circumstances that the information about the issuer is accurate in all material respects and from a reliable source.³ The Commission's underlying rationale is that this information review standard helps to reduce manipulative or fraudulent schemes in the securities markets.⁴ We believe, however, that maintaining this status quo is misaligned with the Commission's stated intention to, in part, ease broker-dealers of their regulatory burden as set forth in the Proposed Rule.⁵

In fact, broker-dealers intending to publish or submit a quotation should not be required to form a reasonable basis under the circumstances for believing the issuer information set forth in paragraph (b) and (c) is accurate in all material respects. It is well established by the Commission that the responsibility for complete and accurate disclosures lies within the disclosing company, its corporate management and directors.⁶

In addition, the information required to disclose under paragraph (b) of the Proposed Rule is subject to existing antifraud provisions of the Securities Act as well as the Securities Exchange Act. The anti-fraud regime offers sufficient investor protections and holds, among others, issuers, directors, officers, and underwriters accountable. More specifically, section 11 and section 12 of the Securities Act as well as section 10(b) of the Exchange Act and Rule 10(b)-5 compose of the necessary legal safeguards to ensure the accuracy of material information contained in disclosures enumerated in paragraph (b) of the Proposed Rule. As perhaps best stated by the OTC Markets, "Issuers create their disclosure and are best positioned to ensure its accuracy."⁷

As a result, we respectfully ask the Commission to carefully reconsider the roles of issuers and broker-dealers in the context of the information review standard. The current Rule 15c2-11, as well as the Proposed Rule, places a needless, disproportionate burden on broker-dealers as they are required to ensure the accuracy and completeness of issuer information as provided in paragraphs (b) and (c) of Proposed Rule. A double-layered process that, in addition to the issuer, prescribes that broker-dealers review the accuracy of issuer information does more harm than good. In fact, it generates market inefficiencies while not effectively addressing fraudulent or manipulative schemes in the over-the-counter securities markets. Rather than requiring broker-dealers to rule as to the accuracy of issuer information, the Proposed Rule should mandate a standard of review that requires broker-dealers to confirm

³ Proposed Rule at page 24.

⁴ Proposed Rule at page 10.

⁵ Proposed Rule at page 1.

⁶ See SEC Filing Review Process, available at: <https://www.sec.gov/divisions/corpfin/cffilingreview.htm>; see also SEC Proposed Rule Certification of Disclosure in Companies' Quarterly and Annual Reports, Exchange Act Release No. 34-46079 (June 17, 2002), available at: <https://www.sec.gov/rules/proposed/34-46079.htm>.

⁷ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at page 4.

(i) the completeness of all material information of an issuer and (ii) that the source of the information is reliable. As elaborated above, the accuracy of the issuer information is within the purview of the issuer itself and safeguarded by antifraud laws.

In conclusion, we believe that the foregoing suggestions offer a modernized legal framework that redefines standards and reallocates responsibilities proportionally and adequately in accordance with existing securities law and regulations while maintaining requisite investor protection.

II. Form 211

Broker-dealers undergo a protracted registration process with the SEC and Finra. Once registered with the SEC and registered as a member by an SRO, broker-dealers are subject to heavy regulatory oversight. Registered broker-dealers play an integral role in connection with the purchase and sale of securities and must comply with federal and state securities laws as well as many other requirements designed to maintain a high industry standard, including antifraud provisions.⁸

The Commission, through interpretative statements and enforcement actions and the courts, through case law, have further developed these antifraud provisions and their applicability to broker-dealers. As a consequence, broker-dealers owe to their customers, *inter alia*, a duty of fair dealing⁹ and have to comply with the concept of suitability. Under the concept of suitability, a broker-dealer must have an "adequate and reasonable basis" for any recommendation it makes. Therefore, broker-dealers do have an obligation to investigate and obtain information about the securities they are recommending to their clients.

Finra Rule 6432 ("**Rule 6432**") requires broker-dealers, prior to submitting or publishing a quotation of a security, to demonstrate their compliance with Rule 15c2-11 by filing a Form 211 with Finra. Rule 6432 mandates that broker-dealers should be permitted to submit or publish quotations three (3) days after Form 211 has been filed. In contrast, however, and as expressed by the OTC Markets,¹⁰ a Form 211 review undergoes an extensive review process, including requests for additional information prior to clearance. This process very often escalates and can take up anywhere from weeks to months,¹¹ and it is not supported by the plain language of the rule. Additionally, the SEC's review process in connection with registration statements as well as the heavy, ongoing public obligations of reporting companies do further support the plain language interpretation of Rule 6432.¹²

⁸ For example, Section 10(b) of the Securities Exchange Act prohibits the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. In addition, sections 15(c)(1) and 15(c)(2) of the Securities Exchange Act apply to the over-the-counter securities. Section 15(c)(1) prohibits broker-dealers from effecting transactions in, or inducing the purchase or sale of, any security by means of "any manipulative, deceptive or other fraudulent device," and Section 15(c)(2) prohibits a broker-dealer from making fictitious quotes.

⁹ This includes the duties to execute orders promptly, disclose certain material information (i.e., information the customer would consider important as an investor), charge prices reasonably related to the prevailing market, and fully disclose any conflict of interest.

¹⁰ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at pages 5-6.

¹¹ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at page 6.

¹² Offering statements on form S-1 and offering circulars on form 1-A, are subject to the Commission's review and approval. In addition, reporting companies file annual, quarterly, and current reports on form 10-K, form 10-Q, and form 8-K, respectively.

The Commission and Finra, in collaboration, should resolve this deficiency and provide for a streamlined Form 211 review process, resulting in a mandated time frame that must not exceed three (3) days. Further, the Commission and Finra in a joint effort should ensure that Rule 6432 does not result in a merit-based review.

Further, we strongly support the OTC Markets proposal, which would allow quoting broker-dealers to rely upon a qualified IDQS' determination that issuer information is complete and from a reliable source without filing a Form 211.¹³ The OTC Markets proposal is thoroughly articulated, well balanced, and allows for a modernized and more efficient quoting process while strengthening investor protection.¹⁴

III. Elimination of Piggyback Exception for Shell Companies

A. The Commission's Proposed Amendment

The Commission's proposed amendments with regard to the piggyback exception would, in essence, prohibit broker-dealers from relying upon the piggyback exception for quoting securities of shell companies. In its effort to protect retail investors from fraudulent schemes involving so-called "shell factories," the Commission took a two-step approach and introduced a new definition of "shell companies" while prohibiting broker-dealers from relying on the piggyback exception with respect to those shell companies. The underlying proposition prompts two main concerns, which we briefly summarize in III.A. and further elaborate on in III.B and C., respectively.

First, we believe that the broad proposed definition of shell companies will very likely inadvertently harm companies the Commission had not in mind while crafting this definition. In fact, the proposed definition of shell companies leaves room for broad interpretation that may very well include Startup Companies (see definition in III.B.).

Second, we disagree with the Commission's proposed amendment to prohibit broker-dealers from relying on the piggyback exception for quoting securities of shell companies. Rather, we believe the Commission should implement a set of rules to provide for heightened scrutiny of insiders and affiliates to alleviate from the righteously stated concerns relating to fraudsters abusing shell companies and to mitigate investor fraud.¹⁵

B. Proposed Definition of Shell Companies in Rule 15c2-11(f)(8)

We are aware of the Commission's mindfulness of the proximity of the proposed definition of "shell company" on the one hand, and startup companies or companies with limited operating history (collectively "**Startup Companies**"), on the other hand.¹⁶ In anticipation of critique, the Commission clarified that Startup Companies that have a limited

¹³ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at page 6.

¹⁴ In addition, the OTC Markets has developed a broad repertoire of "flags" that help investors to identify opportunity and quantify risk.

¹⁵ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at pages 16-18, where the OTC Markets properly addressed the underlying problem by introducing certain thresholds.

¹⁶ Proposed Rule at page 67 ("The proposal should not prohibit reliance on the piggyback exception for quotations of startup companies or companies with limited operating history.") (quoting Revisions to Rules 144 and 145, Securities Act Release No. 8869 (Dec. 6, 2007), 72 FR 71546, 71557 n.172 (Dec. 17, 2007)).

operating history do not meet the condition of having 'no or nominal operations'.¹⁷ However, in practice, broker-dealers will refrain from quoting securities of Startup Companies due to the blurry lines between the proposed definition and actual Startup Companies. Especially, early-stage technology, life sciences, and healthcare companies will be within the spectrum of companies that will be adversely affected by the proposed definition. These types of companies are by their very nature heavily invested in research and development and hard to distinguish from the proposed definition of shell companies. In addition, the Proposed Rule states that a Startup Company may become very well a shell company over time and that broker-dealers "would need to remain vigilant regarding whether they may rely on, or continue to rely on, the piggyback exception if the issuer of that security becomes a shell company."¹⁸

In consequence, and in response to Question 34 in the Proposed Rule, the proposed ongoing scrutiny obligations of broker-dealers combined with the broad proposed definition of shell companies, are very likely to shy broker-dealers away from publishing or submitting quotations for Startup Companies operating in the aforementioned industries. Most broker-dealers will not be willing to run the risk of mischaracterizing early stage technology, life sciences, and healthcare Startup Companies in the first place, or expose themselves to continuous due diligence to assess whether such Startup Company has become a shell company within the definition under the Proposed Rule. Further, the Commission's proposition that broker-dealers could instead "rely on publicly available determination by a qualified IDQS or by a registered national securities association that the securities are eligible for the piggyback exception" does not mitigate the root issue at hand—the construction of the definition.¹⁹ Thus, we expect that broker-dealers will likely take the conservative route and decline engagements with Startup Companies for quoting, ultimately harming liquidity and pathways to capital formation for small businesses.

Startup Companies in these industries are of particular importance to the U.S. economy, are the main driver of innovation, and should not become collateral damage of proposed definition of "shell company." We respectfully ask the Commission to reconsider the proposed definition given the likely negative practical impact we expect will result.

Rather, and in response to Question 36 in the Proposed Rule, we propose a more close-knitted definition that leaves less room for interpretation. We encourage the Commission to focus on a definition that is comprised of ascertainable financial figures, which provide broker-dealers with sufficient legal certainty. Whereas such a definition protects Startup Companies from becoming collateral damage, it has the power to serve the purpose of capturing shell companies while not exceeding a reasonable scope. In particular, we strongly believe that a proposed definition of shell company should establish certain thresholds in order to assess whether a company is considered a shell company. In greater detail, (i) annual revenues, (ii) annual gross profits and losses, (iii) total assets, as well (iv) expenses allocated toward research and development, would serve this purpose best and provide utmost legal certainty for broker-dealers in identifying shell companies.²⁰

¹⁷ In furtherance of this, the Commission referenced to Rule 144(i)(1)(i) and stated that "[...] startup companies that have limited operating history do not meet the condition of have 'no or nominal operations' for the purposes of Rule 144(i)(1)(i)."

¹⁸ Proposed Rule at page 67-68.

¹⁹ Proposed Rule at page 68.

²⁰ OTC Markets comment letter in response to the Proposed Rule, dated April 8, 2020, at page 6.

C. Shell Companies and Capital Markets

Although we tag along with the Commission's valid statement about its concerns regarding the maltreatment of shell companies for fraudulent schemes,²¹ we are respectfully asking for a more nuanced approach addressing this concern. The benefits shell companies provide to the capital markets and companies going public outweigh the risks of fraudulent and manipulative schemes centering around such shell companies, so called "shell factories"²². Doing away the piggyback exception for shell companies would not only severely harm companies seeking to go public through a reverse merge but also investors who initially made a good faith investment in a company that ultimately turned into a shell.

In general, shell companies play a pivotal role for private companies willing to go public. As very well elaborated by other commenters, the current legal framework provides essentially four pathways for private companies to publicly trade their securities: (1) filing a Form S-1 with the Commission, (2) filing a Form 1-A, (3) by conducting a so called "Slow PO," or (4) completion of a reverse merger with a shell company.

Registration statements on Form S-1 and offering statements on Form 1-A are subject to the Commission's approval and regularly consume significant time and monetary resources many companies in need of immediate capital cannot afford. For example, the Commission estimated that issuers expend approximately 731 hours to prepare and file an offering statement on Form 1-A.²³ This number is presumably as high or higher with regard to a registration statement on Form S-1.

The existing option for private companies to reverse merge into a shell company provides a viable and swift avenue to go public. This option is particularly important, given that the current legal framework does not sufficiently incentivize private companies to go public due to the lengthy and cost-intensive process. However, going public is very often inevitable in the process of growth and satisfying investors' demands for liquidity. Rather than eliminating the piggyback exception for shell companies, which would, in fact, stall any reverse mergers, the Commission's effort should be directed to the core underlying problem.

As the Commission righteously stated, the underlying problem is not so much the very legal concept of a reverse merger, many of which take place for valid, non-fraudulent purposes²⁴, but insiders and affiliates who ill-use them.²⁵ The OTC Markets has set forth a well-articulated concept addressing the issue by enhanced sales restrictions for affiliates and insiders of shell companies.²⁶ Specifically, the OTC Markets refers to restrictions with regard to (i) holding periods, (ii) manners of sale, (iii) volume limitation, (iv) and governance standards relating to trading activities of insiders and affiliates of shell companies.²⁷

Further, under the Commission's Proposed Rule, information about issuers must be current and publicly available. This is also true for post reverse merger companies and would provide additional investor protection under the Proposed Rule. The foregoing analysis and

²¹ Proposed Rule at page 65.

²² Proposed Rule at page 65, n.97.

²³ Conditional Small Issues Exemption Under the Securities Act of 1933 (Regulation A), 84 Fed. Reg. 21 (January 31, 2019) at 528. *Federal Register: The Daily Journal of the United States*. Web. 2 March 2019.

²⁴ Proposed Rule at page 66.

²⁵ Proposed Rule at page 66.

²⁶ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at pages 16-18.

²⁷ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at pages 16-17.

approach strikes a reasonable balance between maintaining a viable option for private companies to go public through reverse mergers and the SEC's efforts to quash fraudulent and manipulative schemes involving "shell factories."

IV. Securities Trading with No Current and Publicly Available Issuer Information

The Proposed Rule does not contemplate the trading of securities of companies for which no information is current and publicly available. The foregoing implies that the Commission is not intending to allow the trading of securities without current information of the respective company.

In general, given the lack of investment knowledge of retail investors, we agree with the Commission approach to prohibit the trading of securities over-the-counter for which information is not current and publicly available. As much as it is of importance to protect retail investors from fraudulent schemes and heightened risks of a loss, it is of equally great importance to entertain sophisticated and experienced investors' demands for those investment opportunities. The latter scenario, however, does not seem to find its way in Proposed Rule. As Commissioner Peirce mindfully articulated, "getting the balance right is difficult."²⁸

We would appreciate a more balanced and nuanced approach that promotes the protection of main street investors without preempting sophisticated and savvy investors from the type of investment opportunities they regularly seek out.

Conceptually, the OTC Markets outlined the establishment of an "Expert Market." The proposed concept (i) takes into account the needed protective measures for retail investors, (ii) provides sophisticated investors with a gateway to trade securities with no current information, (iii) and keeps minority shareholders with a viable option to sell their securities within a trading market where not only majority shareholders are potential buyers.²⁹ In essence, this seems to be the right balance Commissioner Peirce was referring to when referencing the difficulties in striking the perfect balance.

V. Conclusion

In conclusion, we believe that a properly drafted and modernized Rule 15c2-11 can be more streamlined in various aspects while maintain or strengthening investors' protection, as needed. The achievement of both will not only encourage investors to more frequently access these markets but also provide small and mid-sized companies much needed access to public markets within a streamlined environment that fosters and encourages them to "go public."

Further, we make reference to the OTC Markets' submissions, dated November 25, 2019, December 30, 2019, and April 8, 2020. We strongly support the measures and suggestions advocated by Daniel Zinn and Cass Sanford on behalf of the OTC Markets and believe that these recommendations provide for an amended Rule 15c2-11 that more

²⁸ Hester M. Peirce, Commissioner, Broken Windows: Remarks before the 51st Annual Institute on Securities Regulation, available at: <https://www.sec.gov/news/speech/peirce-broken-windows-51st-annual-institute-securities-regulation>.

²⁹ OTC Markets comment letter in response to the Proposed Rule, dated December 30, 2019, at pages 7-11.

comprehensively, effectively, efficiently, and more fairly addresses the needs of all stakeholders, including but not limited to investors, issuers, broker-dealers, and IDQs.

We thank the Commission for the opportunity to submit comments and the collaborative fashion under which the Commission operates. Please do not hesitate to contact Robin Sosnow [REDACTED] or Manuel Pesendorfer [REDACTED] with any questions, concerns or requests for additional information.

Very truly yours,

Robin Sosnow

Robin Sosnow, Esq.
Managing Partner

Manuel Pesendorfer

Manuel Pesendorfer, Esq.
Attorney