June 10, 2005

Mr. Jonathan Katz
Secretary
United States Securities and Exchange Commission
One Station Place
100 F Street, N.E.
Washington, D.C. 20549

Subject: **File No. 265-23**

Dear Mr. Katz:

This written statement is submitted for consideration at the public meeting of the SEC's Advisory Committee on Smaller Public Company to be held on Thursday, June 16, 2005, and Friday, June 17, 2005, at Columbia Law School, Jerome Greene Hall, Room 103, 435 West 116th Street, New York, New York.

Pink Sheets is the leading provider of pricing and financial information for the over-the-counter (OTC) securities markets and, among other things, operates an Internet-based, electronic quotation and trade negotiation service for OTC equities and bonds for market makers and other broker-dealers registered under the Securities Exchange Act of 1934 (the "Exchange Act").

Pink Sheets urges the Committee to consider the need for appropriate regulation of publicly traded, non-reporting smaller public companies.[1] The current regulation of non-reporting issuers is woefully deficient and fails to protect investors.

Pink Sheets therefore respectfully requests the Committee's consideration of the following recommendations: First, the Securities and Exchange Commission (the "Commission") should reconsider its current disclosure policy for non-reporting issuers, which places the disclosure burden inappropriately on broker-dealers and fails to adequately protect investors. Second, the Commission should explicitly recognize the

[1] A "non-reporting smaller public company" or a "non-reporting issuer" is defined as an issuer without a class of securities that is registered under Section 12 of the Exchange Act.

disclosure duties of non-reporting issuers when (i) corporate insiders are trading securities in the public markets or (ii) the issuer is conducting promotional activities intended to encourage public trading in its securities. Third, the disclosure obligations placed on non-reporting issuers under these circumstances should be based on the informational requirements prescribed in Regulation A or Rule 144(c)(2) under the Securities Act of 1933 (the "Securities Act"). Fourth, the Commission should designate an Internet repository where issuers can make such disclosure publicly available to investors and regulators. Finally, broker-dealers should be permitted to collect advisory fees for assisting the issuer to satisfy its disclosure obligations, and these fees should also be disclosed to the public.

Disclosure for Non-Reporting Publicly Traded Issuers

As the Committee considers recommendations to scale securities regulations for smaller public companies to assure that the costs and burdens of the regulations are commensurate with the benefits to investors and the public, we urge the Committee not ignore non-reporting issuers.

In the first place, in terms of sheer number of issues, more equity securities of non-reporting issuers are traded in the public markets than those of reporting issuers. Federal securities regulation of smaller public companies would be wholly inadequate if such a large group of publicly traded securities were excluded from its scope.

More to the point, the focus on reporting obligations under the Exchange Act forces procrustean "all or nothing" solutions to disclosure obligations. We submit that the Committee's proposals for "scaled" regulation must include the vast universe of publicly traded, non-reporting issuers if they are to be relevant for most small public companies.

Moreover, there is a critical need for improved disclosure by non-reporting issuers. Improving equity markets have been accompanied of late by an observed increase in the speculative trading of securities of non-reporting issuers.[2] These securities are often aggressively touted by promoters, despite a dearth of publicly available information regarding the securities or their issuers. As recently as 1998, the Commission pointed out that fraudulent activities in the securities of non-reporting issuers flourish because of the lack of good disclosure: "Microcap fraud frequently involves issuers for which public information is limited, especially when issuers are not subject to reporting requirements. Without information, it is difficult for investors, securities professionals, and others to evaluate the risks presented by microcap

[2] Pink Sheets Strumpet, Christopher Byron, NY Post 8/16/2004, http://www.nypost.com/business/28926.htm.

securities. Investors consequently can fall prey to persons who make false representations and unrealistic predictions about these securities."[3]

The Failure of Existing Rules to Protect Investors

Pink Sheets respectfully submits that existing disclosure regulations with respect to non-reporting issuers, conceived three decades ago, have consistently failed to protect the investing public from frauds and inequitable and unfair practices in publicly traded over-the-counter securities. Pink Sheets believes this failure is attributable to a design flaw in this regulatory regime.

The federal securities laws are based on the premise that adequate disclosure is the best way to protect the public from unethical and dishonest practices. "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[4] Under this theory, securities regulation is not intended to protect investors from making unwise choices. Any investment, no matter how foolish, may be sold to the public, provided that investors are adequately informed regarding the inherent risks of the security and the venture it represents.

The regulation of non-reporting issuers turns all of this on its head. Broker-dealers are required under Exchange Act Rule 15c2-11 to gather material information regarding such issuers before entering quotations into a quotation medium. But, having gone through the trouble and expense of gathering and reviewing the information, and confirming its accuracy, the quoting broker-dealer is not required to make such information publicly available. To the contrary, the quoting broker-dealer is commanded by regulation to stuff the information into its files where, in all likelihood, it will never again see the light of day. Rule 15c2-11 is a rule of darkness.

The Rule is based on the premise that an honest broker-dealer, having reviewed financial and other information about an issuer, will refuse to place quotations that cannot be justified by such information. It is argued that the participation of broker-dealers is essential to the success of frauds involving micro-cap securities. Accordingly, it is hoped that, while the rule will not deter dishonest broker-dealers, the Commission will identify such miscreants and root them out of the industry. Ultimately, under this most optimistic of regulatory theories, manipulative schemes will fail because there will no dishonest broker-dealers left to participate in them.

The notion that fraud can be defeated by eliminating access to industry tools is not new. This is essentially the reason for making underwriters, accountants and lawyers liable as "gatekeepers" for participating in the fraud of issuers making a public

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[3] "Publication or Submission of Quotations Without Specified Information," SEC Release No. 34-39670 (1988).
[4] L. Brandeis, *Other People's Money,* ch. 5 (1914), quoted by Loss and Seligman, *Securities Regulations*, 3d, § 1-G (2004).

offering. In theory, the institution of "gatekeepers" enables the Commission to make a more efficient use of its enforcement resources because the gatekeepers – underwriters, accountant and lawyers – who are often directly within the Commission's regulatory oversight, greatly reduce the costs of investigation and prosecution.[5] Moreover, such gatekeepers usually have much less incentive to engage in fraud because they are generally not the direct recipients of its proceeds. Gatekeeper accountability, it is hoped by its adherents, reduces the number of frauds that require use of the Commission's limited enforcement resources.

While gatekeeper theory surfaces often in the enforcement dogma of federal securities regulation, Exchange Act Rule 15c2-11 is unique in its virtually total reliance on the doctrine. The regulatory design of the Securities Act, for example, requires an issuer in a public offering to make certain disclosures to investors. Underwriters and other gatekeepers review this work and confirm the basis for the disclosures. However, having completed their review, the underwriters do not then hide the issuer's disclosures in their files and announce a public offering price. Instead, the public is provided with the resulting disclosure documents and arrives at its own conclusions regarding the issuer and its prospects, sometimes agreeing with the valuation proposed by the underwriter and often placing a different value on the public offering. The Securities Act relies for its regulatory success on the theory that sunlight is the best disinfectant. In contrast, Rule 15c2-11 does not require that the public receive any disclosures regarding a micro-cap security or its issuer. Instead, the broker-dealer reviewing the information and confirming its accuracy simply puts it in a file and proceeds to publish a quote.

This theory of darkness is difficult to reconcile with other anti-fraud rules. To cite just one example, Rule 10b5-1 under the Exchange Act generally forbids trading by persons in possession of material nonpublic information. Yet, assuming the information gathered by a quoting broker-dealer under Rule 15c2-11 is material, and why make anyone gather non-material information, it might be thought that Rule 10b5-1 would require the broker-dealer to disclose such information to the public or abstain from publishing a quotation that offers the security to an ignorant public. Instead, broker-dealers are only required to provide such information to would-be purchasers on request.

Rule 15c2-11's reliance on broker-dealer "gatekeepers" to protect the investing public from fraud in the trading of securities of non-reporting issuers is badly misplaced. At best, valuation is more art than science. Fair market valuations are always preferred to the most insightful and well-considered appraisal. A lone broker-dealer's judgment as to the value of a security can never be superior to the values determined by a well-informed market. Moreover, the Commission reviews hundreds of public offering

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[5] Comments of former Commissioner Irving Pollack on Rule 15c2-11, Securities And Exchange Commission Historical Society, The Roundtable On Enforcement (September 25, 2002).

documents, but has not demonstrated much success in identifying frauds during the process of this review. Experience tells us that broker-dealers are no better at rooting out fraud than federal securities regulators or any other market participant.

The fact is that frauds in the securities of non-reporting issuers depend primarily on the lack of good information about smaller public companies and their securities, rather than the services of a complicit broker-dealer. The sunlight of disclosure chases away frauds, not merit review by a quoting broker-dealer.

To make matters worse, in 1997 the Commission required the NASD to promulgate Rule 2460 so that broker-dealers are forbidden from accepting compensation from the issuer for gathering and reviewing the information required under Exchange Act Rule 15c2-11. Information cannot be obtained and reviewed without cost. It follows that the broker-dealer who complies with Rule 15c2-11 must believe that the costs of information gathering and review can be recouped in its trades with investors or other broker-dealers. Disclosure, even in the limited gathering, review and filing context of Rule 15c2-11, is a form of advertising that benefits the issuer. It is difficult to understand the policy reasons for shifting the costs of disclosure from the issuer to investors.

Because broker-dealers are unwilling to assist the issuer to provide public disclosure information without receiving compensation for their efforts, unregulated public relations firms fill this void, as there are no rules to prevent them from rendering such assistance for a fee. These unregulated entities produce promotional materials containing glowing reports intended to produce excitement among investors that are frequently fraudulent, and at their best, fail to provide the most minimal disclosures required under the federal securities laws.

Incidents involving fraud and manipulation of micro-cap securities continue to rise, strongly suggesting that Rule 15c2-11 has failed to achieve its essential purpose.[6] In response, the Commission has proposed requiring market makers to obtain more information prior to publishing quotes, information that will produce more fodder for broker-dealer files, but provide no more information to the investing public.[7] Moreover, the Commission proposes to eliminate the "piggy-back" rule, which would vastly increase the burden and cost of regulation without any corresponding disclosure benefit. First, this change would greatly increase the number of companies for which broker-dealers would be required to gather and review information. Second, it would require broker-dealers to gather and review information annually with respect to each quoted issuer. Finally, it would require each quoting broker-dealer to duplicate the gathering

[6] "Publication or Submission of Quotations Without Specified Information," Securities Exchange Act Release 34-29670 (February 17, 1998).
[7] "Publication or Submission of Quotations Without Specified Information," Securities Exchange Act Release 34-41110 (February 25, 1999).

and review function performed by each other quoting broker-dealer. However, none of this information would be shared with other broker-dealers or the investing public.[8]

In recent years, the Commission has proposed changes to Rule 15c2-11 three times, each with the goal of increasing the burden of information gathering and review on broker-dealers. In each case, the proposal has confronted widespread criticism from the financial press, investors, smaller public companies, the securities industry and even other regulators, including the North American Securities Administrators Association and the editorial pages of Business Week Magazine. We are deeply distressed at efforts to resurrect this failed regulation by placing it on the Committee's agenda. The Committee should understand that the Commission's proposed changes to Rule 15c2-11 would vastly increase regulatory burdens and costs on the legitimate participants in OTC markets while providing little or nothing in the way of additional disclosure to investors.

Pink Sheets urges the Committee to recommend to the Commission that it permanently abandon its ill-conceived efforts to revise Rule 15c2-11. Instead, the Commission should focus on alternatives that will produce more disclosure to investors, placing the responsibility and burden of continuing disclosure where it belongs – on issuers. No information gathering and review can occur under Rule 15c2-11 or any other regulatory regime unless the issuer is willing to provide the information, and public disclosure also cannot occur without the issuer's cooperation. The burden of disclosure therefore must rest on the non-reporting issuer, rather than the broker-dealer and its customers.

Three decades of failure is sufficient to prove the truth of the famous aphorism by Justice Brandeis. Sunlight, not broker-dealer merit review, is the best way to discourage fraud in the securities of non-reporting issuers. Public disclosure, not broker-dealer information gathering and review, is the best way to protect investors.

We therefore consider the circumstances under which publicly traded, non-reporting issuers should be required to make disclosures to the public.

Required Disclosure for Non-Reporting Publicly Traded Issuers

Pink Sheets believes that federal securities laws should require non-reporting issuers to make information about their business and securities publicly available under two circumstances: First, when corporate insiders – officers, directors or large shareholders – are buying and selling securities in the public marketplace. Second,

[8] Requiring broker-dealers to publicly disclose this information raises difficult issues of liability. Broker-dealers are not the source of this information; it is unreasonable to require them to vouch for the integrity of information provided by an issuer, particularly in the absence of a due diligence defense.

when the issuer is encouraging the public to trade its stock by paying promoters to advertise its prospects. These rules should apply with equal force whether an issuer has no registered securities and therefore no explicit duty to make public disclosures or is late in satisfying its reporting requirements.[9] We consider each of these principles of disclosure in turn.

Disclosure to Equalize Access to Information

A duty of disclosure for non-reporting issuers when corporate insiders are trading in the markets is based on a fundamental principle of market fairness: T**he uninformed may trade with the uninformed, those who are informed may trade with each other, but the informed may not trade with the uninformed.** Corporate insiders of a non-reporting issuer have access to material information regarding the current earnings and business of the issuer – other shareholders have none. A greater disparity can scarcely be imagined. Under such circumstances, ordinary shareholders are ripe for plucking by unscrupulous insiders. Moreover, corporate insiders have the power to correct the informational disparity by requiring the issuer to make public disclosure. It is both fair and realistic to require public disclosure under these circumstances.

We submit that unequal access to information is a problem that can be properly addressed by regulation. Corporate insiders, an issuer's officers, directors, large shareholders and others, have access to material information regarding the issuer whether or not the issuer has a class of securities registered under the Exchange Act. At present, the ordinary investor is placed at a great disadvantage when trading with insiders, unless the issuer is subject to and in compliance with Exchange Act reporting requirements.

When buyers and sellers have equal access to information, even if the information is of poor quality, the price set by them is fair. It may not be the correct price. Better information generally yields better prices. Either party may not decide to search for or review the information that is available or may misinterpret the information due to differences in education, time or personality. Nonetheless, markets function best when traders are rewarded for seeking new information and analyzing it correctly under circumstances where access to information is available to everyone.[10]

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[9] Pink Sheets believes that all insider trading and promotion should be frozen if a reporting issuer is late in its reporting obligations. Moreover, the Commission should bring enforcement actions in the event there is any trading by insiders or promotion occurring in the securities of late reporting issuers.

[10] This is the gist of Chief Justice Marshall's famous explanation for not requiring a buyer of tobacco to inform the seller, a merchant, of news that the War of 1812 had ended, which the buyer had discovered by rising early in the morning and reading handbills that were being distributed publicly by messengers: "The question in this case is, whether the intelligence of extrinsic circumstances, which might influence the price of the commodity, and which was exclusively within the knowledge of the vendee, ought to have been communicated by him to the vendor? The court is of opinion that he was not bound to communicate

Corporate insiders, on the other hand, have information that is not equally available to those who are not insiders. Moreover, the information available to insiders is not produced as a result of their seeking it out or analyzing it correctly. Instead, they receive the information as a windfall because of their favored position as insiders. When corporate insiders trade on the basis on material information of non-reporting issuers with those to whom such information is not available, the price set in the market is not only incorrect, but unfair. This discourages the diligent pursuit of information by ordinary investors and degrades the proper functioning of the market.

The problem of unequal access to information is substantially alleviated in the case of issuers with a class of registered securities. Although there is always room for improvement, the disclosures required of reporting issuers generally place corporate insiders and ordinary investors on a level information playing field. In contrast, the lack of regulatory guidance on minimum information disclosure for non-reporting issuers leaves investors holding unregistered securities at the mercy of corporate insiders, and this is where reform is badly needed.[11]

Disclosure When Promoters are Encouraging Public Trading

Advertising by promoters serves the same function as listing on a national securities exchange – to encourage trading in an issuer's securities. Issuers benefit from the active trading of their securities, even where the issuer does not intend to raise capital from the sale of its securities. Among other things, active trading serves to

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it. It would be difficult to circumscribe the contrary doctrine within proper limits, where the means of intelligence are equally accessible to both parties." *Laidlaw v. Organ,* 15 U.S. (2 Wheat.) 178, 195 (1817).

[11] Affiliates of non-reporting issuers are generally prohibited from selling stock to the public in market transactions, unless adequate current information is publicly available regarding the issuer and its securities. Securities Act Rule 144(c)(2). And, broker-dealers are required to know their customers and the securities those customers are selling to make sure they are not facilitating unlawful distributions of securities. See, *Distribution By Broker-Dealers Of Unregistered Securities*, Securities Act of 1933, Release No. 4445; Securities Exchange Act of 1934, Release No. 6721, (February 2, 1962); *Sales of Unregistered Securities By Broker-Dealers*, Securities Act of 1933, Release No. 5168; Securities Exchange Act of 1934, Release No. 9239 (July 7, 1971).

We believe these rules are too narrow, and in any event fail to protect investors for three reasons: First, Rule 144 only governs sales and not purchases. Second, it has been over thirty years since comprehensive regulatory guidance was published in this area, and we believe they are largely ignored by much of the broker-dealer community. Finally, for reasons that are inexplicable, in 1990, the Commission withdrew all of its prior guidance describing how a non-reporting issuer could make adequate current information publicly available under Rule 144(c)(2). See, *SEC No-Action Letter to Anadac, Inc.* (March 15, 1990). As a result, we believe this salutary requirement is most often honored in its breach.

advertise the issuer's products and improves its ability to obtain commercial loans and other forms of non-security financing.[12]

Promoters are paid by issuers to advertise their securities to encourage trading among ordinary investors. For similar reasons, reporting issuers pay listing fees to national securities exchanges to encourage trading in their securities. The advertising value of listing is the basis for requiring listed issuers to register under Section 12 of the Exchange Act.[13] For the same reasons, a non-reporting issuer should also be required to make publicly available a baseline of information to the market during those times that promoters are being paid to advertise its stock to encourage trading among ordinary investors.

Any successful reform requiring disclosure by non-reporting issuer must, however, be practical. The cost of providing information must be taken into account.

The Problem of Costly Information

Among publicly traded securities, two different standards exist for providing disclosures to investors. First, companies with a class of securities registered under Section 12 of the Exchange Act that are current in their obligations as a registrant provide annual, quarterly and periodic reports on Forms 10K, 10Q and 8K, proxy statements and other special reports from time to time. This vast quantity of information is mailed to investors and made available electronically to anyone with Internet access through the EDGAR system maintained by the Commission. The second category contains companies that do not have a class of securities registered under the Exchange Act, or are not current in their obligations as an Exchange Act registrant. Such non-reporting issuers generally provide little or nothing in the way of information to investors and the information that is provided usually is woefully deficient.

The first category of publicly traded companies includes those listed on a national securities exchange, NASDAQ and the OTC Bulletin Board. The second category contains all of the issues that cannot qualify for trading in these markets. Some registered securities trade on the Pink Sheets, although registration is not required, and many securities that trade in the Pink Sheets are not registered. Many securities in this second category are also traded among broker-dealers specializing in "gray market" stocks by telephone, without accessing any quotation medium. Exact numbers are not

[12] See *Securities and Exchange Commission v. Harwyn Industries,* 326 F. Supp. 943, 952-53 (NYSD 1971).

[13] "The causes of dangerous speculation in the securities markets . . . include inadequate corporate reporting which keeps in ignorance of necessary factors for intelligent judgment of values of securities a public continually solicited to buy such securities by the sheer advertising value of listing." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 5, 11-12 (1934), *quoted by* Loss and Seligman, *Securities Regulations*, 3d, § 6-A.

known, but we estimate there are at least as many unregistered issues trading in the public markets as registered issues.

The informational disparity between reporting and non-reporting issuers and the resulting inability of investors to make informed decisions, are not new. For the 30 years following the adoption of the Exchange Act, registration was only required for securities that were listed on a national securities exchange. No registration was required, or even possible, for securities trading in the over-the-counter markets. Numerous studies produced during this period demonstrated that, in the absence of mandated disclosure requirements, the information provided by issuers to investors was uniformly of poor quality.[14]

There can be no doubt that securities markets best perform their function of setting fair and accurate prices where buyers and sellers have full and complete access to all material information.[15] Nevertheless, as a practical matter, information cannot be made available without cost, and good information may be quite costly to produce. Recent changes to the federal securities laws mandated by The Sarbanes-Oxley Act have increased the cost of providing information for reporting companies, and this increased cost has resulted in a trend toward deregistration.[16] For many issuers of publicly traded securities, the cost of being a reporting issuer is now prohibitive.

It is not practical to require all issuers of publicly traded stock to register under the Exchange Act. Small, poorly funded issuers generally have no incentive to register merely to facilitate trading among ordinary investors. And, the costs of registration will, in many cases, be prohibitive. Moreover, ordinary investors with little or no information about an issuer trade on a level information playing field with each other. The prices set in such transactions may not be ideal, but they are at least fair. In a perfect world, each investor would have access to all material information necessary to make a proper investment decision. But in a world where providing material information may be prohibitively costly, it is sufficient for the proper functioning of the markets that buyers and sellers have equal access to the same information, even if that information is less than ideal.

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[14] For example, the Commission's Director Loomis testified in 1963: "The overwhelming preponderance of fraud cases before the Commission in past years have involved the securities of companies which have not been subject to the reporting requirements of the Exchange Act." SEC Legislation, 1963, Hearings on S. 1642, before Senate Comm. on Banking & Currency, 88th Cong., 1st Sess. 288--307 (1963), as quoted by Loss and Seligman, *Securities Regulations*, 3d, § 1-G-1, at n. 95.

[15] As noted by a House Committee in 1934: "No investor, no speculator, can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 5, 11-12 (1934), as quoted by Loss, *supra*, § 6-A.

[16] See C. Coolidge, "Who Needs the Aggravation?" *Forbes*, October 14, 2002.

The practical solution is to require non-reporting issuers of publicly traded stock to provide material information to the market during those times that corporate insiders buy and sell the issuer's securities or when the issuer is paying promoters to encourage public trading of its securities. The corporate insider must cause the issuer to disclose, or abstain from trading. The issuer that promotes public trading should be required to bear the cost of providing appropriate disclosure to investors.

The question then becomes: What should be disclosed? We agree that the costs and burdens of disclosure should be commensurate with its benefits.

Quality of Disclosure

Using Regulation A, a small public company can issue up to $5 million in securities without registration under the Securities Act and generally is not required to register the securities under the Exchange Act. The securities are nonetheless freely tradable. Under Rule 144(c)(2), when a corporate insider desires to sell securities in a public market (but not when the insider buys), an issuer is required to provide to make publicly available the information specified in paragraphs (a)(5)(i) through (xiv), and (xvi) of Exchange Act Rule 15c2-11.[17] Unfortunately, the Commission's staff has refused to provide guidance to issuers with respect to acceptable methods for making this information publicly available.[18] Nonetheless, we believe that the applicable information required for small public companies issuing securities using Regulation A or the information required under Rule 144(c)(2) also describe the minimum necessary disclosure that must be publicly available to investors in a non-reporting issuer before a corporate insider may purchase or sell securities or when an issuer is engaged in promotional activities to encourage public trading of its securities.

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[17] The following is the basic information regarding the issuer required under the rule: (i) the exact name of the issuer and its predecessor (if any); (ii) the address of its principal executive offices; (iii) the state of incorporation, if it is a corporation; (iv) the exact title and class of the security; (v) the par or stated value of the security; (vi) the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year; (vii) the name and address of the transfer agent; (viii) the nature of the issuer's business; (ix) the nature of products or services offered; (x) the nature and extent of the issuer's facilities; (xi) the name of the chief executive officer and members of the board of directors; (xii) the issuer's most recent balance sheet and profit and loss and retained earnings statements; (xiii) similar financial information for such part of the 2 preceding fiscal years as the issuer or its predecessor has been in existence; (xiv) whether the broker or dealer or any associated person is affiliated, directly or indirectly with the issuer; (xv) whether the quotation is being published or submitted on behalf of any other broker or dealer, and, if so, the name of such broker or dealer; and (xvi) whether the quotation is being submitted or published directly or indirectly on behalf of the issuer, or any director, officer or any person, directly or indirectly the beneficial owner of more than 10 percent of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of such person.

[18] See *SEC No-Action Letter to Anadac, Inc.* (March 15, 1990). See also, note 11.

Under either rule, smaller public companies are not required to provide audited financials, unless those financials are otherwise available. This scaled-down approach significantly reduces the cost of disclosure, while still providing to regulators and the investing public sufficient information to prosecute frauds and evaluate the wisdom of an investment in such issuers.

Most important, there must be some means by which information supplied using the standards set for in Regulation A or Rule 144(c)(2) can be made publicly available. At the present time, there is no Commission guidance for making such information publicly available. The public must be allowed to review public disclosures provided by the issuer and make its own determination regarding the wisdom of investment decisions in the securities of smaller public companies.

Pink Sheets has recently provided a repository on its website where issuers have been encouraged to provide Rule 144(c)(2) information where it can be viewed by regulators and public investors at no cost. We believe that the disclosures posted in this repository have enabled the Commission to identify and prevent several fraudulent offerings in early stages. Moreover, these disclosures have enabled investors to view with skepticism the promotional materials regarding these issuers delivered through other mediums. Sunlight, as always, is the best disinfectant.

Finally, there is no good reason to foster the growth of a promotional industry for non-reporting issuers that operate beyond Commission regulatory oversight. Broker-dealers, with their knowledge of the markets, securities regulations and the investing public, are best situated to assist non-reporting issuers to prepare appropriate disclosure. But, the advice and assistance necessary to generate good disclosure cannot be provided without cost. Broker-dealers therefore should be entitled to receive a fee for assisting an issuer to prepare public disclosures and those fees should be disclosed to the investing public.

In this regard, we can benefit from the example of the Alternative Investment Market (AIM) that is part of the London Stock Exchange. Issuers in AIM are required to appoint and retain a nominated advisor to assist them to comply with the disclosure requirements of the AIM market. The nominated adviser must be an authorized person under the British securities laws, independent of the issuer, and acceptable to the British regulators. The London Stock Exchange maintains a list of nominated advisers who have completed the required application forms and meet the general and any special eligibility criteria. The responsibilities, among others, of the nominated adviser include making certain that the issuer makes certain required disclosures under the AIM rules. A nominated advisor that fails to provide proper advice to an issuer risks loss of this designation and is subject to other penalties.[19]

[19] See, Gleeson and Bloomenthal, *The Public Offer of Securities in the United Kingdom,* 27 Denv. J. Int'l L. & Pol'y 359, 399 (1999).

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Conclusion

The great promise of the Exchange Act is to ensure the maintenance of fair and honest securities markets.[20] Adequate and regular public disclosure is the method most often employed under this legislation to achieve this great and lofty purpose. Unfortunately, only about half of publicly traded issues currently benefit from its disclosure regime. As the cost of disclosure by reporting issuers has increased, more publicly traded issues have escaped from its grasp.

We believe the federal securities laws should require non-reporting issuers to provide certain basic material information to the public when corporate insiders, who control issuers, trade in public markets or when the issuer is engaged in promotional activities intended to encourage public trading in its securities. At other times, the benefits of such disclosure do not justify its costs. We have suggested that the disclosures required under Regulation A or Rule 144(c)(2) under the Securities Act serve as an appropriate baseline for minimum disclosure standards for non-reporting issuers under these circumstances. Pink Sheets has offered a repository where such public information can be maintained at low cost and reviewed by interested members of the public and regulators. We believe that broker-dealers should be encouraged to provide assistance to issuers who are required to make these disclosures and should be entitled to charge for this service.

We freely admit this solution is not perfect. Ideally, every investor should have full and immediate access to all material information regarding every publicly traded security and their issuers. Regrettably, the ideal solution is not possible, and pragmatic answers are never ideal. It is impractical to require every non-reporting issuer of a class of publicly traded securities to register the class under Section 12(g) of the Exchange Act. Nonetheless, the solution proposed here will increase the baseline of publicly available information for non-reporting issuers. It will ensure that persons who trade securities of non-reporting issuers have equal access to information about such issuers. Investors will have access to information that will better allow them direct their investment dollars. Without more, this improvement in disclosure policy will increase the efficiency of the market and vastly improve the small business capital formation process.

We hope this proposal will prompt the Committee to make recommendations to the Commission that will encourage fair and honest dealing in the securities of non-reporting issuers. If we can achieve this goal, more investors will be willing to commit their hard-earned investment capital to small, fledgling businesses, and will see their

[20] See Exchange Act, Section 2.

investment capital put to good use. All of us will then reap the benefits of enlightened regulation in this great breeding ground of our national economy.

I would be pleased to provide any additional information that the Committee would find helpful in its deliberations.

Respectfully submitted,

R. Cromwell Coulson
Chief Executive Officer