



April 24, 2006

Ms. Nancy M. Morris
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Subject: Petition for Commission Action to Protect the Investing Public from Unlawful and Deceptive Securities Promotions

Dear Ms. Morris:

Pink Sheets LLC ("Pink Sheets") respectfully petitions the Securities and Exchange Commission (the "Commission") to take immediate action to protect investors and prevent inequitable and unfair practices in the market for over-the-counter ("OTC") securities. Specifically, Pink Sheets requests that the Commission exercise its authority under Section 19(a) of the Securities Act of 1933 (the "Securities Act") to promulgate a rule (the "Proposed Rule") under Sections 5 and 17 of the Securities Act to expose and prevent unlawful and deceptive activities by securities promoters and their sponsors.

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 rule we propose primarily relies on disclosure to expose fraudulent stock promoters and their sponsor, employing four straightforward strategies:

- Promotional materials must identify promoters and their sponsors, and the nature and amount of consideration paid for the promotion.
- Adequate current information regarding the issuer must be publicly available at the time the promotion takes place.

- Stock held by promoters and their sponsors at the time the promotion takes place is restricted and cannot be sold without registration or an appropriate exemption.
- Stock promoters must provide issuers of the stock subject to the promotion with a copy of the promotional materials, and promoters, their sponsors and issuers must inform transfer agents and broker-dealers that stock registered to or held on behalf of promoters and their sponsors is restricted.

We believe that the implementation of these requirements will provide the transparency needed by investors to clearly identify fraudulent promotions, depriving miscreants of easy prey. Other parts of the rule follow the money and are intended to cut off the usual sources of funding for fraudulent promotions – the ability to sell promoted stock into the market – by requiring transfer agents and broker-dealers to block transfers of stock owned by stock promoters and their sponsors. The rule is intended to make the activities of fraudulent stock promoters transparent; exposure renders fraudulent promotions unprofitable.

The text of the Proposed Rule is set forth immediately below:

The Proposed Rule

Unlawful and Deceptive Securities Promotion Practices.

- (a) Unlawful and deceptive securities promotion practices are prohibited.
- (b) The term “securities promotion” shall mean “the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer.”
- (c) The terms “issuer”, “underwriter”, or “dealer” shall include any affiliates thereof.
- (d) Any person that finances or engages in a securities promotion, other than the issuer of securities subject to a securities promotion, shall be

deemed an “underwriter” of the securities within the meaning of Section 2(a)(11) of the Securities Act.

(e) It shall be an unlawful and deceptive practice for any person to engage in securities promotion with respect to any security unless adequate current public information is available with respect to the issuer of such securities. Such information shall not be deemed available, unless one of the following conditions is met:

- (i) *Filing of reports.* The issuer has securities registered pursuant to section 12 of the Securities Exchange Act of 1934 (the “Exchange Act”), has been subject to the reporting requirements of section 13 of the Exchange Act for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports), other than Form 8–K reports; or has securities registered pursuant to the Securities Act, has been subject to the reporting requirements of section 15(d) of the Exchange Act for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports), other than Form 8–K reports.
- (ii) *Other public information.* If the issuer is not subject to section 13 or 15(d) of the Exchange Act, there is publicly available the information concerning the issuer specified in paragraphs (a)(5)(i) to (xiv), inclusive, and paragraph (a)(5)(xvi) of Rule 15c2–11 under the Exchange Act, or if the issuer is a “foreign private issuer” as defined in Rule 3b-4 under the Exchange Act, the information concerning the issuer specified in Rule 12g3-2(b) under the Exchange Act or, if the issuer is an insurance company, the information specified in section 12(g)(2)(G)(i) of the Exchange Act. Information shall be deemed “publicly available” if it can be viewed on an Internet site accessible without charge by members of the public that is maintained by the principal market where the issuer’s securities are quoted for purchase or sale.

- (f) It shall be an unlawful and deceptive practice for any person to engage in securities promotion with respect to any security unless the promotional message contains all of the following information and is provided by such person to the issuer of such security by certified mail, return receipt requested:
- (i) a description of the Internet site where adequate current public information regarding the issuer can be viewed;
 - (ii) the name and a true and correct address and telephone number, and email address, if available, of such person;
 - (iii) the identity of the source of funds for the securities promotion, including a true and correct address of the person or persons paying for such securities promotion;
 - (iv) the nature and amount of consideration paid for such promotion, whether in cash, securities or otherwise;
 - (v) the names in which any person that finances or engages in a securities promotion directly hold or have a beneficial ownership in securities subject to the securities promotion;
 - (vi) the name and address of any brokerage firm or bank where any person that finances or engages in a securities promotion hold securities subject to the securities promotion;
 - (vii) a statement that, upon the request of any recipient of the securities promotion, the person that engages in the securities promotion will remove the name of the recipient from any distribution list used to deliver promotional materials to the recipient and that the CAN-SPAM Act of 2003 provides penalties and civil remedies for the unlawful use of email to send commercial messages.
- (g) It shall be unlawful for any person financing or engaging in a securities promotion to sell securities subject to such promotion without registration under the Securities Act or an exemption therefrom. Any such person shall notify any broker-dealer or bank that holds such securities on their behalf that such securities have not been registered under the Securities Act and may not be resold without registration or an exemption therefrom. The issuer of such securities shall exercise reasonable care to assure that the securities are not sold in violation of Section 5 of the Securities Act, which reasonable care may be demonstrated as follows:

- (i) by placement of a legend on the certificate or other document that evidences the securities beneficially owned by any person that finances or engages in a securities promotion stating that such securities have not been registered under the Securities Act and setting forth or referring to the restrictions on transferability and sale of the securities, and
- (ii) by written notification to the issuer's transfer agent and any broker-dealer that holds such securities that the securities are held by a person financing or engaged in a securities promotion, are not registered under the Securities Act and cannot be sold without registration under the Securities Act or an exemption therefrom.

Investors Need Protection from Unsolicited Spam Emails and Faxes Unlawfully Promoting Securities

The deceptive promotion of securities using the Internet and fax transmission has reached epidemic proportions. There is hardly a household in America with Internet access that has not been inundated with spam emails making fantastic claims of easy profits, "guaranteed" to any purchaser of some obscure stock.

The limited requirements under 17(b) of the Securities Act that securities promotions identify the nature and amount of consideration paid to the promoter for disseminating such information are inadequate for the protection of investors in the electronic age. Today's spammers do not provide information about the identity of the spammer, or of the persons paying for the promotion. Little information is generally available regarding the issuer or its securities, and the information that is available is often from questionable sources.

Securities promoters may be paid by issuers or affiliates of the issuer, or increasingly often third parties that may or may not be affiliates of the issuer. In most cases, securities promoters and those who finance their activities hope to make a quick profit when investors buy securities in the market in response to the questionable claims made in promotional materials. There is often no fundamental basis for the optimistic claims made by promoters, but investors are left in the dark with no source of adequate current information regarding the issuer's financial position or business. In "pump and dump" schemes, when the promoter's stock is sold, the promotion ceases. The stock soon plummets,

leaving the hard-earned money of investors in the pockets of unscrupulous swindlers.

Fraudulent stock promotions are like “bad money that chases away the good.” Legitimate investment research is drowned out by the flood of questionable information flowing into the market. Recent years have witnessed a decline in research activities by investment houses, particularly with respect to smaller public companies. At the same time, there is greater investor interest in these issuers and therefore a greater need for good research materials. Unfortunately, this vacuum has been partly filled with spam securities promotions, many of which are fraudulent. The proposed rule is intended to restore order. The removal of questionable spam securities promotions from the market should enable legitimate investor relations devices to develop. Investors will benefit from an increase in legitimate information for smaller public companies.

It has been argued that more enforcement resources should to be devoted to rid the OTC equity markets of spammers and the securities promotion scourge. We agree. But we also believe, along with the late Justice Brandeis, that transparency is the most effective protection for investors: “Sunlight is the best of disinfectants; electric light the most efficient policeman.” As recently as 1998, the Commission pointed out that fraudulent activities in the securities of smaller public companies 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 securities. Investors consequently can fall prey to persons who make false representations and unrealistic predictions about these securities.”

The proposed rule is intended to make the spam activities of securities promoters transparent. In some cases, issuers may not be aware of or involved in (or may claim to be unaware of) securities promotion targeting their securities. The proposed rule will enable issuers to know who is promoting their stock and who is paying for the promotion. Issuers will be obligated to deprive spammers of unlawful gain. By placing restrictions on the transferability of securities, issuers can deprive spammers and their financiers of illicit profits from “pump and dump” schemes.

It may be true that “pump and dump” schemes are already illegal under existing rules forbidding market manipulation. The proposed rule is nonetheless required to provide greater clarity regarding widespread illegal practices. Moreover, the proposed rule will mandate disclosures that are not currently required under existing rules prohibiting market manipulation, thereby exposing spam securities promotions to the spotlight of increased transparency.

On the other hand, an issuer and its affiliates that finance promotional activities ought to make adequate current information about the issuer publicly available to investors. It has long been a principle of US securities law that issuers encouraging trading in their securities should be required to make adequate disclosure to investors. The value of increased trading in an issuer's securities extends beyond the obvious increased ability to raise capital. In addition, the issuer's products are advertised, it is more attractive as an employer, and it can more readily finance expansion activities using its own securities. For those reasons, from its inception, the Exchange Act has required issuers that list on national securities exchanges to make adequate current information publicly available to investors.¹ Under the same principle, issuers and their affiliates that finance securities promotions should also be required to make adequate information publicly available. Engaging in promotion is a choice; no promoter has to engage in promotion and can easily desist if adequate current information is not publicly available.

Our proposal is intended to bring sunlight to bear where securities are the subject of promotional activities. The activities of securities promoters should be entirely transparent. Legitimate securities promotions will disclose to investors the location of current adequate public information about the issuer. The legitimate promoter will provide its identity and information about the source and funding of promotional material. Promotions that are fraudulent will be easily identified by investors and regulators as lacking this critical information.

Increased transparency will foster investor education by making it easier to explain to investors how to identify fraudulent securities promotions. Transfer agents and broker-dealers will identify securities beneficially owned by securities promoters and their sponsors, thereby depriving spammers and "pump and dump" con artists of illicit profits. The toxic promoters, and the account names used to distribute securities, will be more easily identified by the legitimate participants in securities markets. The spotlight of disclosure will cause illegitimate promoters to scatter. Those who remain will be efficiently scooped up by regulators; transparency of promotion will provide regulators with better tools to locate and bring swindlers to justice.

¹ "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 in* Louis Loss and Joel Seligman, Securities Regulations § 6-A (3d ed. 2004).

The Commission Has Authority to Adopt the Proposed Rule.

The Commission has authority to adopt the propose rule pursuant to Section 19(a) of the Securities Act, which provides, in part, as follows: “The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title, . . .” The term “this title” includes Sections 5 and 17 of the Securities Act. The Commission is therefore authorized to make rules necessary to carry out the intent of Congress expressed in these Sections.

Section 5 of the Securities Act prohibits the sale of a security by any person, unless a registration statement is in effect for such security. Section 4(1) of the Securities Act provides a transactional exemption from the registration requirements of Section 5 when the person selling the security is not an “issuer, underwriter, or dealer.” Accordingly, securities sold by an “underwriter” must be registered under Section 5.

Section 2(a)(11) of the Securities Act includes within the definition of an “underwriter” any person who “offers or sells” for an issuer or an affiliate of an issuer, directly or indirectly, in connection with a distribution of securities. Using its authority under Section 19(a), the Commission has promulgated Rules 144 and 144A, which clarify the circumstances under which a person that has purchased securities from an issuer is not engaged in a distribution of securities and is therefore not an underwriter within the meaning of Section 2(a)(11). The Commission clearly has the authority to determine that securities promoters that encourage trading in an issuer’s securities are “underwriters” within the meaning of Section 2(a)(11).

Section 17(a) of the Securities Act generally prohibits frauds in the offer or sale of securities:

It shall be unlawful for any person in the offer or sale of any securities . . . , directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (3) to engage in any transaction, practice, or course of business

which operates or would operate as a fraud or deceit upon the purchaser.

Securities promotion is intended to encourage trading in an issuer's securities. Spam securities promotions that occur in the absence of current adequate public information regarding the issuer operate as a fraud or deceit on investors that are influenced to make investment decisions on the basis of the promotion. Such spam securities promotions are therefore prohibited by Section 17(a).

Section 17(b) requires promoters who are receiving consideration for the promotion to disclose that fact in any publication or communication and to also disclose the amount of the consideration.² This section was clearly designed with the particular intent to "meet the evils of the 'tipster sheet'" and other communications that "purport to give an unbiased opinion but which opinions in reality are bought and paid for."³ It is also clearly designed to apply to securities traded in the aftermarket, as well as new issuances.⁴

The Commission clearly has the authority under Section 19(a) of the Securities Act to make the activities of stock promoters fully transparent and effectuate the Congressional intent expressed in Sections 5 and 17. Section 5 is intended to make sure that investors receive current adequate public information regarding securities they are being encouraged to buy. Section 17 is intended to prevent fraudulent practices in securities distribution, and in particular, 17(b) specifically targets fraudulent securities promotions.

It is specious to claim that securities promotion does not directly involve the offer or sales of securities and therefore is not subject to the provisions of Sections 5 and 17, other than 17(b). It is true that Section 2(a)(3) of the Securities Act defines a "sale" as "every contract or disposition of a security or interest in a security, for value." However, the federal courts have long held that activities intended to encourage an active trading market should be considered "offers and sales" for purposes of Section 5, even where no literal sales of securities by an issuer takes place.

² It has been held that there is no element of intent necessary to prove a violation of Section 17(b). See *In the Matter of Lehl*, S.E.C. Admin. Proceeding No. 3-9201 at 11 (2002); see also *S.E.C. v. Liberty Capital Group, Inc.*, 75 F. Supp. 2d 1160, 1163 (W.D. Wash. 1999).

³ H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933); see *U.S. v. Amick*, 439 F.2d 351, 365 (7th Cir. 1971); see also *In the Matter of Lehl*, S.E.C. Admin. Proceeding No. 3-9201 at 11 (2002).

⁴ See S. Rep. No. 47, 73d Cong., 1st Sess. (1933); see also H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933), *both cited with approval in S.E.C. v. Wall Street Publishing Institute, Inc.*, 851 F.2d 365, 369 (D.C. Cir. 1988).

In *SEC v Harwyn*, 326 F. Supp 942 (SDNY 1971), the federal court determined that a spin-off distribution by a public parent company of the unregistered shares of a subsidiary would, under certain circumstances, be considered an unlawful distribution of securities in violation of Section 5. In that case, the defendants created a shell subsidiary of the parent that was merged into an operating company in a transaction where the parent received a portion of the resulting company's shares. The parent then distributed these shares to its shareholders as a dividend. The district court rejected arguments that because the shares were distributed as a dividend, without the receipt of any consideration, no sale of securities had occurred because the disposition was made "without value." Instead, the court maintained that the transaction violated the spirit of the Securities Act, which was intended to ensure that current adequate information was made available to public investors. The court pointed out that the transaction was intended to encourage the formation of a trading market in the former subsidiary's shares, which provided numerous benefits to the issuer and its insiders, even though they were personally precluded from selling stock in the resulting aftermarket. The encouragement of an active trading market in the issuer's securities was sufficient to require that current adequate information should be made available to the investing public.

Similarly, spam securities promotion in the absence of current adequate public information violates the letter and spirit of the Securities Act. Such promotions encourage trading activity without providing investors with the information needed to make good investment decisions. We urge the Commission to adopt the Proposed Rule to expose the activities of spam securities promotions to the light of transparent disclosure and deprive swindlers of access to easy targets and illicit profits.

The Nature of Issuer Disclosure

For purposes of determining the type of information regarding the issuer that should be provided to the market when securities promotion is ongoing, the proposed rule has relied entirely on the information requirements contained in Rule 144, which describes the circumstances under which persons that purchase securities from an issuer may resell such securities without being considered an underwriter under Section 4(1) of the Securities Act. Reporting issuers are required to be current in complying with their reporting obligations. Non-reporting issuers are required to make certain information enumerated in Section 15c2-11 under the Exchange Act publicly available.

Investors also need transparency with respect to the promotion. Investors must be able to identify the securities promoter and persons who finance the promotion. The nature and amount of consideration paid to the promoter must be exposed to public scrutiny. Issuers should know who is promoting their securities so that appropriate restrictions can be placed on their transferability. Broker-dealers need to know that certain securities they are holding for customers are held by spammers and their financiers and therefore may not be sold without registration or an appropriate exemption from registration. Transfer agents must be able to identify such securities as restricted so that their free transfer may be blocked.

It is also necessary to clarify the means by which information about the issuer is made publicly available. Any legitimate securities promotion will clearly identify where current adequate information about the issuer may be viewed by investors. In the case of reporting companies, information can easily be accessed through the SEC's EDGAR system. For non-reporting companies, Pink Sheets has created the Pink Sheets News Service, an Internet repository where issuers can post disclosure and financial information at an extremely low cost. This information is displayed for free to all investors, regulators and any other interested person on the Pink Sheets Internet site. We believe that any venue publishing quotes for non-reporting issuers should make such a repository available so that there is an appropriate medium for making adequate current information freely available to investors.

Conclusion

The OTC equity markets form the great salt marsh of this nation's economy. This is the market that fuels the dreams of America's budding entrepreneurs. Every one of the nation's greatest companies was once a smaller public company.

This great breeding ground for the nation's economy is now under attack from predators, securities promoters filling investors' email inboxes with spam. Spammers seek to pollute the OTC equity markets for unlawful gain, leaving behind a wasteland where nothing can prosper. The Commission's immediate action is required to deprive spammers of the profits from illegal activities. The glaring spotlight of full transparency will drive the crooked securities promoters away from the OTC equity markets and facilitate recovery from the pollution caused by the unlawful and deceptive practices of spammers and those who finance their activities.

We believe that the Proposed Rule will enable investors to easily identify spam securities promotions as fraudulent, depriving swindlers of easy targets. The

Proposed Rule will provide investors with access to information that will greatly increase their ability to make sound investment decisions. Issuers and broker-dealers will be obligated to take appropriate action to deprive spammers and their financiers from profits in pump and dump schemes. In summary, the Proposed Rule will rid the OTC markets of the spam polluting the market for smaller public companies so that this great breeding ground for the nation's economy will perform its role – the facilitation of small business capital formation and the efficient allocation of resources within the OTC markets.

We urge the Commission to adopt the Proposed Rule, together with any modifications that are necessary or desirable to serve the interests of the investing public and Congressional intent.

Please call me if you have any questions or need any additional information.

Respectfully submitted,

R. Cromwell Coulson
Chief Executive Officer

cc: Chairman Christopher Cox
Commissioner Cynthia A. Glassman
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Annette L. Nazareth