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July 19, 2004

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. S7-24-04 Issuer Restrictions or Prohibitions on Ownership by
Securities Intermediaries

Dear Mr. Katz:

We are submitting this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comments on the Commission's proposed prohibitions on transfers by registered transfer agents of equity securities registered under the Securities Exchange Act of 1934 (the "Exchange Act") if such securities are subject to any restriction or prohibition on transfer to or from a securities intermediary.¹ We appreciate the opportunity to comment on the matters discussed in the Proposing Release.

According to the Proposing Release, "[a] small but growing number of issuers whose securities are registered under Section 12 or are reporting under Section 15(d) of the Exchange Act recently have restricted, or indicated their intention to restrict, ownership of their securities by prohibiting their transfer agents from acknowledging ownership of shares registered in the name of DTC or by prohibiting transfer of their securities to DTC or in some cases to any securities intermediary."² "Issuers imposing these restrictions, sometimes referred to as 'custody-

¹ Issuer Restrictions or Prohibitions on Ownership by Securities Intermediaries, Exchange Act Release No. 34-49804 (June 4, 2004), 69 Fed. Reg. 32784. We refer to this release as the "Proposing Release."

² *Id.* at 32787.

only trading,' frequently state that they are imposing ownership or transfer restrictions on their securities to protect their shareholders and their share price from 'naked' short selling.'³

In the view of the Commission, such restrictions can cause a number of problems and defeat the overall aims of Section 17A of the Exchange Act, which was adopted to avoid the inefficiencies and risks that arise from custody-only trading. As the Proposing Release notes, however, a new rule is actually unnecessary in most cases. "The vast majority of securities trading on exchanges or Nasdaq are already subject to market rules requiring depository eligibility of securities and mandating members' use of depositories. . . . Accordingly, the proposed rule effectively would supplement the market rules to expand the scope of securities covered to include most public company securities (*i.e.*, registered under Section 12 or securities of issuers subject to reporting under Section 15(d)) that trade in the non-Nasdaq over-the-counter market."⁴

We are concerned that the proposed rule would prohibit restrictions on transfer beyond those intended to be covered. The proposed rule states, "Except as provided in paragraph (c) of this section, no registered transfer agent shall transfer any equity security . . . if such security *is subject to any* restriction or prohibition on transfer to or from a securities intermediary."⁵ As currently worded, the proposed rule would not only cover custody-only trading restrictions on equity securities not listed on an exchange or quoted on Nasdaq. It would also prohibit issuers with exchange-listed or Nasdaq-quoted equity securities that are cleared through a securities intermediary such as DTC from separately issuing equity securities of the same class that are "*subject to*" transfer restrictions that may be imposed for a variety of commercial reasons, such as escrow arrangements, collateral security arrangements and the issuance of equity securities in private placements. For example, securities issued in a transaction exempt from registration under Section 4(2) of the Securities Act of 1933 (the 'Securities Act'), such as a private placement of acquiring company stock as consideration for an acquisition, do not contain restrictions specifically limiting transfers to a depository or securities intermediary, but nonetheless are "*subject to*" such restrictions because they contain general restrictions on their transfer intended to support reliance on the Section 4(2) exemption. Once these general restrictions on transfer lapse—*i.e.*, when the transfer of the restricted securities is registered or the restricted securities otherwise become freely saleable, such as after the lapse of a two-year holding period pursuant to Rule 144(k) under the Securities Act—the securities could be traded through a securities intermediary such as DTC.

³ *Id.*

⁴ *Id.* at 32789

⁵ *Id.* at 32793 (emphasis added).

It is our belief and understanding that the proposed rule is not intended to cover equity securities subject to such transfer restrictions when equity securities of the same class are cleared through a securities intermediary such as DTC. To that end, we offer you in bold below a suggested modification of the text of the proposed rule that is consistent with the exchange and Nasdaq rules requiring depository eligibility for listed or quoted securities:

(c) The provisions of this section shall not apply to:

(i) any equity security issued by a partnership as defined in § 229.901(b) of Regulation S-K; or

(ii) any restriction or prohibition on transfer of an equity security when equity securities of the same class are eligible for clearance through a securities intermediary.

Such a revision, we believe, would allow the proposed rule to limit restrictions on transfers of equity securities contrary to the purposes of Section 17A of the Exchange Act without resulting in interference with a variety of customary uses of transfer restrictions.

* * *

We thank you for the opportunity to comment on the Proposing Release. We would be happy to discuss with you our comments or any other matters that you feel would be helpful in your review of the proposal. Please do not hesitate to contact Jeffrey D. Karpf (212-225-2864) or Leslie N. Silverman (212-225-2380) if you would like to discuss these matters further.

Very truly yours,

CLEARY, GOTTlieb, STEEN & HAMILTON

cc: The Honorable William H. Donaldson, Chairman
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
Annette L. Nazareth, Director, Division of Market Regulation
Jerry Carpenter, Assistant Director, Division of Market Regulation
Susan M. Petersen, Senior Special Counsel, Division of Market Regulation
Alan L. Beller, Director, Division of Corporate Finance