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Via Electronic Mail

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Attention: Johnathan G. Katz, Secretary

Re: **File No. SR-DTC-2003-03**
Release No. 34-47365
Requests for Withdrawal of Certificates by Issuers

Ladies and Gentlemen:

This letter responds to the request of the Securities and Exchange Commission (the "Commission") for comments on the Depository Trust Corporation ("DTC") February 13, 2003 release entitled Requests for Withdrawal of Certificates by Issuers (the "Release"). In short, we suggest that the proposed rule be amended to provide that an Issuer may elect either to not enter the DTC electronic stock transfer system or to withdraw from the DTC electronic stock transfer system; provided that (i) withdrawal or the Issuer's decision to not the enter the DTC electronic stock transfer system are in conformance with the corporate law of the Issuer's jurisdiction of incorporation, (ii) the corporation's articles of incorporation/certificate of incorporation or bylaws either contained such restrictions before any shares were issued or the restrictive provisions were properly approved by the Corporation's shareholders after the issuance of shares.

Summary

We have focused our comments on three subjects: (i) the failure to provide issuers the opportunity to determine whether to participate in the DTC electronic transfer system or to mandate that registration of transfer shall be in certificate form and that certificates may not be registered in the name of a nominee or depository conflicts with fundamental principles of state corporate law, (ii) participation in the DTC system permits naked short selling, and (iii) DTC has consented to the withdrawal of several issuers from the DTC system and is now arbitrarily seeking to block additional issuers from withdrawal. We suggest the Commission revise the proposed rule to provide for issuer withdrawal where, in accordance with state corporate law, the corporation's shareholders have approved an

amendment to the corporation's articles of incorporation/certificate of incorporation or bylaws to provide for the stock transfer restriction that provides for trading in certificate only form and stock certificates may not be held in the name of any nominee or depository.

1. DTC's Failure to Provide Issuers the Opportunity to Determine Whether to Participate in or Withdraw from the DTC System Conflicts with State Corporate Law.

In the Release, DTC seeks, upon receipt of a withdrawal request, "to process a request from a participant and refuse to effectuate the withdrawal based upon an issuer request." The Release states that DTC will continue to not honor issuer withdrawal requests regardless of any purported approval of the issuer withdrawal request by the shareholders or board of directors of the issuer.

The proposed rule conflicts with various state corporate laws if the articles of incorporation/certificate of incorporation contain restrictions requiring that the shares be in certificate form only and that no shares may be registered in the name of a nominee or depository. It is a fundamental principle of corporate law that corporations and their owners—the shareholders—may agree upon and have such restrictions and limitations in their charter or bylaws. Del. Corp. Code § 109(a)(2001); Nevada Revised Statute 78.060(f)(2002). "The fundamental power to adopt and amend bylaws resides in the shareholders." *Danaher Corp. v. Chicago Pneumatic Tool Co.*, 1986 WL 7001 (S.D.N.Y. 1986)(citing *In Re A.A. Griffing Iron Co.*, 41 A. 931 (N.J. Sup. Ct. 1898).

Upon formation, a corporation's articles of incorporation/certificate of incorporation or bylaws may contain such restrictions. Alternatively, subsequent to formation and after the issuance of shares a corporation may adopt a provision in either its articles of incorporation/certificate of incorporation or bylaws regulating the mode and procedure for transferring shares of stock provided that the shareholders approve such a provision.

The general purpose of such provisions is to protect existing shareholders by giving them some control over the disposition of shares, control over the business, and to enhance the value of their shares.

Fletcher Cyclopedic of the Law of Private Corporations Ch. 50 § 4206 (2002)(citing official Comment to Model Bus. Corp. Act. § 6.27 (1984).

Provisions in the articles of incorporation/certificate of incorporation or bylaws regulating the procedure of transferring shares of stock which are reasonably designed to protect the corporation or give it the means of knowing at any time who are its shareholders and as such entitled to receive dividends, vote at corporate meetings and otherwise participate in its management, or enable it to take advantage of charter or statutory

provisions giving it a lien on its stock, or to acquire such a lien by contract, have repeatedly been upheld by the courts.

Fletcher Cyclopedic of the Law of Private Corporations Ch. 50 § 4206 (2002)(citing Giesen v. London American Mortg. Co., 102 F. 584 (Dist. Minn 1900); Planters' & Merchants Mut. Ins. Co. v. Selma Sav. Bank, 63 Ala 585 (Ala. 1879); Star Mut. Tel. Co. v. Longfellow, 85 Kan. 353 (Kan. 1911)).

Thus, provisions in the articles of incorporation/certificate of incorporation or bylaws requiring certain formalities, such as entry on the books of the corporation and the surrender of the certificate, to attend the transfer of stock may be binding on the parties to the extent that the transferor will not be released from liabilities nor relieved from duties as a shareholder or member, and the transferee cannot demand that the corporation recognize the transferee as a shareholder or member, or claim the privileges and benefits of one unless and until there is a compliance.

Id. (citing Rice v. Gilbert, 1763 Ill. 348, 352 (Ill. 1898); Morrill v. Little Falls Mfg. Co., 53 Minn 371 (Minn. 1893)).

Section 78.242 of the Nevada Revised Statutes provides the corporation the right to enforce a written restriction on the transfer or the registration of transfer of a security of a corporation. N.R.S. § 78.242(1). "A restriction on the transfer or registration of transfer of securities of a corporation may be imposed on the certificate of incorporation or by the bylaws...." N.R.S. § 78.242(2). "No restriction so imposed is binding with respect to stocks issued before the adoption of the restriction unless the stockholders are parties to an agreement or voted in favor of the restriction." Id. The Delaware Court of Chancery has held that "the bylaws are generally regarded as the proper place for the self-imposed rules and regulations deemed expedient for its convenient functioning to be laid down." Gow v. Consolidated Coppermines Corp., 165 A. 136, 140 (Del. Ch. 1933).

The validity of bylaw restrictions are generally governed by the law of the state of incorporation. Palmer v. Chamberlin, 191 F.2d 532 (E.D. La. 1956). A bylaw cannot render the transfer or alienation of shares absolutely prohibited or subject to the unrestrained discretion of the corporation, its directors, officers, or other shareholders; but where statute or charter permits, a bylaw may impose partial or temporary restrictions on the right to protect the corporation. Fletcher Cyclopedic of the Law of Private Corporations Ch. 50 § 4205 (2002)(citing Davis v. Davis, 262 Ga 420, 419 SE.2d 913 (1992)).

Consider for example a Nevada corporation with Bylaw provisions as noted below in effect either prior to the issuance of shares or after being amended upon a vote of the shareholders:

XYZ Company shares must be evidenced in certificate form under seal of XYZ Company and signed by its President and Secretary. As a result,

common shares of XYZ Company shall, from this date forward, be transferred only within the provisions of “Certificate Only” status. XYZ Company certificates shall not be held in the name of any nominee or depository.

No certificates shall be printed or entered into the Company’s books via its transfer agent in the names of either CEDE & CO, Depository Trust Corporation, CDS & CO., or any other such type of depository or nominee for certificates; and certificates shall only be printed or entered on XYZ Company’s books in the name of the beneficial owner of the shares of XYZ Company’s stock. All certificates surrendered to the Company shall be cancelled and no new certificates shall be issued until the former certificate for the same number of shares have been surrendered and cancelled. No certificate shall be valid unless it is signed by the President and Secretary.

In this case, the bylaws of the corporation contain a transfer restriction that shares must be transferred only within the provisions of “Certificate Only” status, and the stock certificates may not be held in the name of any nominee or depository. The proposed rule would conflict directly with the corporation’s bylaws and the intent of the shareholders.

Further, the proposed rule would conflict with the Nevada Revised Statutes by prohibiting a corporation’s restriction on the transfer and registration of its own shares of stock. However, this argument may be asserted in any state, subject to the state’s corporate law.

2. Participation in the DTC System Permits Naked Short Selling

Naked short selling occurs when shares of a public company are sold but never borrowed, never delivered to the seller, and where the seller collects money for the stock that was required to be delivered in the three day timeline prescribed under National Association of Securities Dealers (“NASD”) rules. The three day settlement system run by the National Securities Clearing Corporation (“NSCC”) does not ensure that shares that are sold in a transaction are ever delivered.

The result of naked short selling is the undermining of actual shareholder ownership resulting from failed deliveries of real certificates that artificially inflate share ownership and devalue the trading prices of shares in the marketplace. Further, brokers and market makers may conspire to manipulate and devalue the price of securities in this way, a practice in violation of NASD rules and United States securities laws. The Commission has stated that naked short selling can potentially present “substantial manipulative concerns.” SEC Release No. 34-29278 (June 7, 1991).

By allowing an Issuer to withdraw from DTC’s electronic stock transfer system or never to enter the electronic transfer system and to prohibit the registration of its shares in the name of any nominee or depository such as DTC or Cede & Co., an issuer may

restrict the registration and transfer of its shares to certificate only, which facilitates buyers receiving certificates for stock purchased even when purchased from a short seller. This would in effect require short sellers to cover their short sales and in effect eliminate naked short selling. Issuers should be afforded the opportunity to withdrawal from the DTC system to protect themselves from the practice of naked short selling.

3. DTC's Decision to Allow some Issuers to Withdrawal from the DTC System and to Obstruct others is Arbitrary

The Release provides that “DTC’s current rules and procedures do not provide for DTC to comply with an Issuer Withdrawal Request without participants’ instructions.” However, in 2002, DTC allowed the following companies to withdraw from the DTC system: Genemax, Petrogen Corp. and Vega Atlantic. Although DTC claims they do not have a modus operandi for exiting companies from their system, DTC has allowed the companies listed above to withdraw without such a procedure in place. DTC’s decision to allow these companies to withdraw, while inhibiting others is entirely arbitrary. The arbitrary nature of the Release causes problems for corporations that wish, in accordance with state corporate law, to restrict the transfer and registration of their shares.

4. DTC asserts that failure to reregister certificates pursuant to DTC's instructions is a violation of the transfer agent's obligations under, among other things, DTC's rule and procedures, and DTC's Operational Arrangements.

We believe that DTC’s statements are inaccurate. Transfer Agent’s are agents of the Issuer, and as such have a duty to follow the instructions of the Issuer (the Transfer Agent’s principal). Further, the Transfer Agent is bound to follow the requirements set forth in the Issuer’s Articles of Incorporation/Certificate of Incorporation or Bylaws. Failure to either follow the Issuer’s instructions or to comply with the specific requirements of the Issuer’s Articles of Incorporation/Certificate of Incorporation or Bylaws would be a breach of the Transfer Agent’s duties to its principal. If an Issuer has voluntarily agreed for its securities to be DTC eligible, which is of course required for NASDAQ SmallCap, NASDAQ National Market System, the American Stock Exchange or the New York Stock Exchange, following DTC’s instructions or procedures would of course not be a problem, since the Issuer had consented for its securities to be DTC eligible by listing them. Securities traded on the Electronic Bulletin Board or the “Pink Sheets” are not required to be DTC eligible, so an Issuer would be free subject to compliance with state corporate law to elect out of the DTC system as noted above. It is also unclear to us how DTC can properly assert any authority over Transfer Agents, unless the Transfer Agent is following the instructions of its principal—the Issuer whose have elected to be DTC eligible. Further, unless the Issuer has elected to be DTC eligible, Transfer Agents are not subject to DTC’s rules and regulations as well as operational arrangements but rather subject to Commission and NASD rules and regulations.

Recommendation

We recommend that the Commission revise the proposed rule to provide that: (i) an issuer may elect to withdraw from DTC's electronic stock transfer system or never to enter the electronic transfer system, (ii) an issuer may restrict the registration and transfer of its shares to certificate only form, (iii) an issuer may further prohibit the registration of its shares in the name of any nominee or depository such as DTC or Cede & Co. The restrictions noted in the preceding sentence shall be subject to the following requirements: (i) all such provisions are in conformance with the corporate law of the Issuer's jurisdiction of incorporation, (ii) the corporation's articles of incorporation/certificate of incorporation or bylaws either contained such restrictions before any shares were issued or the restrictive provisions were properly approved by the Corporation's shareholders after the issuance of shares.

It should be noted that this rule would only be effective for companies whose securities are traded on the electronic bulletin board or in the "pink sheets," since NASDAQ SmallCap, NASDAQ National Market System, American Stock Exchange and New York Stock Exchange companies are required to be DTC eligible.

We appreciate the opportunity to submit comments. We are available to speak with the Commission or the Staff to respond to any questions.

Yours very truly,

SCHLUETER & ASSOCIATES, P.C.

Henry F. Schlueter

HFS/

cc: Global Securities Transfer