



November 1, 1999

Richard K. Wulff  
Assistant Director  
Office of Small Business  
Division of Corporation Finance  
450 5<sup>th</sup> Street, N.W.  
Washington, D. C. 20549

Re: Tradeability of Securities Distributed by Means Other than Public Offerings

Dear Mr. Wulff:

The purpose of this letter is to request the guidance of the Division of Corporation Finance ("Division") as to whether certain specific factual scenarios present potential violations of Section 5 of the Securities Act of 1933 ("Securities Act"). The Market Regulation Department's OTC Compliance Unit ("Unit") reviews Form 211 filings submitted by potential market makers to determine whether they are in compliance with SEC 15c2-11 and NASD Rule 6740 before they are cleared to initiate or resume quotation of a non-Nasdaq security in any quotation medium. During the course of these reviews, the staff has been presented with certain factual scenarios that, based on the nature of the initial security distribution of blank check shell company issuers, either the initial distribution or the redistribution of the shares in the aftermarket may constitute violations of Section 5 of the Securities Act. Set forth below are various scenarios that the Unit has encountered, or feels that it may encounter, while reviewing Form 211 filings. The staff requests that the Division provide its opinion on the following scenarios with respect to potential violations of the securities rules:

1. As a gift the issuer transferred a nominal amount of its shares (less than 10% of the total float) to between 20 and 50 individuals under Section 4(2) of the Securities Act. After the gift recipients have held their shares for two years, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who controls the issuer frequently has gifted shares of other companies to the same individuals on other occasions.
2. The issuer transferred a significant amount of its shares to one individual under Section 4(2) of the Securities Act. Then that individual in turn gifts a nominal amount of the shares to between 20 and 50 individuals. After the gift recipients have held their shares for two years, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who gifted the shares frequently has gifted shares of other companies to the same individuals on other occasions.

3. The issuer transferred a significant amount of its shares to one individual under Section 4(2) of the Securities Act. That individual holds the shares for two years and then in turn gifts a nominal amount of the shares to between 20 and 50 individuals. After the gift recipients have held their shares a few months, a broker/dealer submits a Form 211 citing the gifted shares as the only free-trading securities. The application does not disclose whether the recipients are sophisticated investors, although the individual who gifted the shares frequently has gifted shares of other companies to the same individuals on other occasions.
4. A small number of shareholders (less than ten) hold all of the free-trading shares. A broker/dealer submits a Form 211 indicating that the concentration of ownership in the hands of so few shareholders will not result in an ongoing distribution because it expects the market for the security to develop slowly.
5. A small number of shareholders (less than ten) control nearly all (more than 90%) of the free trading shares in the issuer. The remaining nominal amount of free-trading shares (less than 10%) are widely dispersed among a larger number of shareholders (50 or more individuals). A broker/dealer submits a Form 211 indicating that the concentration of ownership in the hands of so few shareholders will not result in an ongoing distribution because it expects the market for the security to develop slowly and considers the number of total shareholders to be determinative.
6. An issuer controlled by one individual issued shares to another company controlled by the same individual pursuant to SEC Rule 701. The issuer filed a Form 10 with the SEC that became effective by default. The second company then sells all its shares in the issuer through a brokerage firm. A second broker/dealer submits a Form 211 indicating that the shares sold through the first broker/dealer are all free-trading securities.
7. A reporting shell company merged with a private company and the former controlling shareholder of the reporting shell company sold his shares to numerous individuals more than three months after he ceased to be an affiliate of the post-merger company. A market maker submits a Form 211 citing the post-merger shares sold by the former control person as the only free-trading shares.

Thank you for your attention to this matter. We look forward to receiving the Division's guidance on whether any of these scenarios are of regulatory concern to the Division. If you have any questions, please do not hesitate to contact me at (301) 978-2097.

Sincerely,



Ken Worm  
Assistant Director  
OTC Compliance Unit