UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
CORPORATION FINANCE

January 21, 2000

Mr. Ken Worm
Assistant Director
OTC Compliance Unit
NASD Regulation, Inc.
9513 Key West Avenue
Rockville, MD 20850

Re: NASD Regulation, Inc.
Incoming letter dated November 1, 1999

Dear Mr. Worm:

You have raised a question regarding the "free trading" status[1] of securities initially issued by so-called blank check companies in a number of factual scenarios.

A blank check company is a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person. In 1990, the U. S. Congress found that offerings by these kinds of issuers were common vehicles for fraud and manipulation in the market for penny stocks which undermines investor confidence and inhibits legitimate capital formation by small issuers and other companies.[2] The Commission has adopted several rules, as Congress directed, to deter fraud in connection with registered offerings by blank check companies.[3] The Commission has also excluded blank check companies from eligibility for several exemptions from Securities Act registration requirements.[4]

Each of your scenarios suggests the availability of Rule 144 or Section 4(1) of the Securities Act following the lapse of some period of time following the issuance of shares in the

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1 Because the Securities Act of 1933 establishes the requirement to register securities for sale, subject to a series of exemptions, the concept of freely tradable securities is not a technically accurate one. In common parlance, the term is used to describe securities subject to the exemption provided by section 4(1) when it is available because no issuer, underwriter or dealer is engaged in the transaction.

2 Securities Enforcement Remedies and Penny Stock Reform Act of 1990, S. 647, Pub. L. 101-429. See H. R. Rep. No. 101-617; 101 Cong., 2d Sess. at 23.

3 Rule 419 under the Securities Act of 1933 and Rule 15g-8 under the Securities Exchange Act of 1934.

4 See, e.g., Rule 504 under Regulation D and Regulation A.

blank check company regardless of whether a merger has occurred. In a number of cases, promoters of these issuers appear to be in the business of creating blank check companies, then gifting or selling the securities of the companies without registration, either directly or through intermediaries.

Section 4(1) exempts transactions not involving issuers, underwriters or dealers. The availability of the exemption depends upon the facts and circumstances of each particular situation, which the staff generally is not in a position to determine. Nonetheless, transactions in blank check company securities by their promoters or affiliates, especially where they control or controlled the "float" of the "freely tradable" securities, are not the kind of ordinary trading transactions between individual investors of securities already issued that Section 4(1) was designed to exempt.[5]

Furthermore, as the Commission has indicated, purchasers who are mere conduits for a wider distribution of the securities are "underwriters." When they do sell, these purchasers assume the risk of possible violation of the registration requirements of the Securities Act and consequent civil liabilities. Persons engaged in the business of buying and selling securities who function in this capacity are subject to careful scrutiny.[6]

It is our view that, both before and after the business combination or transaction with an operating entity or other person, the promoters or affiliates of blank check companies, as well as their transferees, are "underwriters" of the securities issued. Accordingly, we are also of the view that the securities involved can only be resold through registration under the Securities Act.[7] Similarly, Rule 144 would not be available for resale transactions in this situation, regardless of technical compliance with that rule, because these resale transactions appear to be designed to distribute or redistribute securities to the public without compliance with the registration requirements of the Securities Act.[8]

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5 SEC v. Cavanagh, 1 F. Supp. 2d 337 (S.D.N.Y 1998).

6 Release No. 33-4552 (Nov. 6, 1962).

7 This view is analogous to the one the Commission has expressed with respect to business combinations under Rule 145 where affiliates of parties to the transaction are viewed to be "underwriters." Further, the nature of these types of resale transactions are closely analogous to shares from an unsold allotment held by professional underwriters. Generally, these securities are only resaleable through registration. Shares purchased by non-affiliates in a registered transaction such as one offered in compliance with Rule 419, however, would not be subject to this restriction.

8 Release No. 33-5223 (Jan. 11, 1972).

> In view of the objectives and policies underlying the Act, the rule shall not be available to any individual or entity with respect to any transaction which, although in technical compliance with the provisions of the rule, is part of a plan by such individual or entity to distribute or redistribute securities to the public. In such case, registration is required.

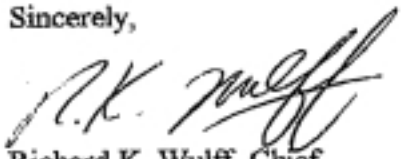
Each of your scenarios illustrates what we believe to be a scheme to evade the registration requirements of the Securities Act. Consequently, it is our view that the resale of the shares in scenarios 1 through 7 would require registration.

In addition, with regard to scenario 6, we are of the view that Rule 701 is not available for issuances to companies or entities, but only to individuals. In view of the business of a blank check company which generally has few or no employees, it seems unlikely that reliance upon this exemption would be appropriate. It is our view that Rule 701 would generally not be available to blank check companies for issuing shares to their consultants or advisors.

Moreover, we have been advised by staff of the Division of Market Regulation that Rules 101 and 102 of Regulation M[9] impose restrictions on issuers, selling shareholders and distribution participants when they effect transactions in securities that are part of a distribution. Generally, a distribution exists when a sufficient magnitude of shares is being sold and special selling efforts are employed to sell these shares. If a distribution exists, the persons involved in the distribution are prohibited from bidding for or purchasing the securities in distribution. The rule covers persons selling securities, their affiliates, and others participating in the distribution. Persons selling in the manner described in your letter should carefully analyze the facts surrounding the sales to determine whether the security being sold is in distribution for purposes of Regulation M. This analysis should specifically consider the actions taken by any persons assisting with the transactions. In particular, selling through a market maker into an illiquid market raises heightened concerns regarding compliance with Regulation M.[10]

Because these positions are based upon representations made in your letter, any different facts or conditions might require a different conclusion.

Sincerely,



Richard K. Wulff, Chief
Office of Small Business

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9 17 CFR 242.101 - 102.

10 See Release No. 34-38067 (Dec. 20, 1996).