

choice as to whether the company's securities are eligible for deposit at DTC,<sup>12</sup> particularly, as some of these commenters argued, when making the securities eligible for deposit at DTC requires the issuer's consent.<sup>13</sup> Most of the twenty-six commenters stated that issuers should have the right to withdraw their securities from DTC in order to protect their shareholders and their share price from the alleged negative consequences of naked short selling by broker-dealers.<sup>14</sup> These commenters believe that by requiring certification and by prohibiting ownership by nominees, including depositories, issuers will better be able to track, address, or preclude naked short selling.<sup>15</sup>

Ten commenters raised a number of concerns regarding the legal basis for the proposal.<sup>16</sup> Seven of the ten commenters stated that DTC's refusal to honor issuers' withdrawal requests or to allow issuers the option of not having securities deposited at DTC conflicts with state law and that state corporation laws, not DTC rules, govern whether a company can restrict securities so that all positions must be certificated or so that just custody-only trading is allowed.<sup>17</sup> Further, they contend that state law determines the conditions that must be met for the proper transfer of securities. One commenter argued that a transfer agent is the agent of the issuer and that unless the issuer has elected to make its securities eligible at DTC, its

transfer agent is not subject to DTC rules and regulations or operational arrangements but rather is subject to Commission and NASD rules and regulations.<sup>18</sup> Another of these commenters stated that if transfer agents, which are agents of issuers and as such generally have a duty to follow issuers' instructions including any restrictions imposed by the issuer's by-laws or articles of incorporation, have obligations to both the issuer and to DTC, transfer agents will be effectively "frozen," and the parties will be forced to litigate their disputes.<sup>19</sup>

Four of the seven commenters questioned the need for the filing and in particular questioned DTC's statement that it was only clarifying its existing rules and procedures rather than promulgating a new rule.<sup>20</sup> Some of these commenters said that if this were true, DTC would have either not filed at all or would have filed a rule interpretation pursuant to Section 19(b)(3) of the Act,<sup>21</sup> which would not have required Commission approval. One of the seven commenters observed that while DTC stated that its rules do not provide for issuers' requests to withdraw their securities, DTC did not cite to any rule prohibiting honoring such requests.<sup>22</sup>

Three commenters believe that the manner in which DTC handled this "policy change" was arbitrary, capricious, and detrimental to companies, particularly in light of the fact that DTC has worked with some companies to withdraw their securities but has refused to assist other companies to withdraw their securities.<sup>23</sup> Several commenters also stated they did not understand how at least one company, such as AT&T, could have the right to determine that its stockholders must hold their stock in book-entry form but other issuers do not have the right to determine that their stockholders must hold their stock in certificated form.<sup>24</sup>

Eight commenters took issue with the fact that DTC does not effectively work to protect the interest of the issuer or the issuer's shareholders but rather works in the interest of its participants, the same

entities that profit from naked short selling.<sup>25</sup> One of these commenters suggested that this conflict of interest should disqualify DTC from deciding whether an issuer could withdraw its securities.<sup>26</sup>

Finally, eight commenters suggested that the Commission should deny approval of DTC's proposal until the Commission or DTC can investigate and consider appropriate regulation to address naked short selling or until the public is given an opportunity to more fully comment on the proposal.<sup>27</sup> Some of these commenters argued that DTC's current course of action (*i.e.*, filing a proposed rule change) does not sufficiently provide a vehicle for in-depth analysis or meaningful public comment. Several of these commenters suggested that alternatives to DTC such as issuers or transfer agents operating their own book-entry system or a certificated, custody-only system, are available and could be used in lieu of DTC.

#### *B. Comment Letters Supporting DTC's Proposed Rule Change*

A majority of the thirty-five commenters supporting DTC's proposed rule change expressed concern that permitting issuers to withdraw their securities from DTC undermines the securities industry's long-term efforts to streamline securities processing, settlement, custodianship in the U.S. market, to achieve straight-through-processing ("STP"), and to ultimately shorten settlement cycles. Twenty-four of these commenters contended that one of the major stumbling blocks to achieving STP involves the difficulties related to processing certificates, which is primarily a manual process.<sup>28</sup> The

<sup>12</sup> Letters from Aegis Assessments, Inc., H. Glenn Bagwell, Blue Industries, Inc., Bruce Barrett, Cybertel Communications Corporations, Dennis DeJose, James Hendricks, Gordon D. House, JAG Media Holdings, Inc., James Barclay Alan Inc., Eric Lihme, Medinah Minerals Inc., Joseph Meuse, John O'Brien, John M. Osmanski, David E. Patch, Joseph Raia, Peter Richardson, Henry F. Schlueter, Robert J. Scott, Joseph J. Selinger, Marshall Shichtman, Michael Sondow, Super VP, Transfer Online, Inc., and Valesc Medical Specialists.

<sup>13</sup> Letters from Henry F. Schlueter, Joseph J. Selinger, and Marshal Shichtman.

<sup>14</sup> Letters from Aegis Assessments, Inc., H. Glenn Bagwell, Blue Industries, Inc., Cybertel Communications Corporations, Dennis DeJose, James Hendricks, Gordon D. House, JAG Media Holdings, Inc., James Barclay Alan Inc., Erick Lihme, John O'Brien, John M. Osmanski, David E. Patch, Joseph Raia, Peter Richardson, Henry F. Schlueter, Robert J. Scott, Joseph J. Selinger, Marshall Shichtman, Michael Sondow, Transfer Online, Inc., and Valesc Medical Specialists.

<sup>15</sup> Some commenters refer to allowing the transfer of certificated positions registered only in the name of the final beneficial owner as "custody-only trading."

<sup>16</sup> Letters from H. Glenn Bagwell, Jr., Bruce M. Barrett, JAG Media Holdings, Inc., John M. Osmanski, David E. Patch, Greg Rotman, Henry F. Schlueter, Joseph J. Selinger, Marshal Shichtman, and Solution Capital.

<sup>17</sup> Letters from Bruce M. Barrett, JAG Media Holdings, Inc., David E. Patch, Henry F. Schlueter, Joseph J. Selinger, Marshal Shichtman, and Greg Rotman.

<sup>18</sup> Letter from Henry F. Schlueter.

<sup>19</sup> Letter from Marshal Shichtman. The commenter did not explain why he believed the transfer agent has an obligation to DTC.

<sup>20</sup> Letters from H. Glenn Bagwell, Jr., JAG Media Holdings, Inc., John M. Osmanski, and David E. Patch.

<sup>21</sup> Letters from JAG Media Holdings, Inc., John M. Osmanski, and David E. Patch.

<sup>22</sup> Letter from Joseph J. Selinger.

<sup>23</sup> Letters from JAG Media Holdings, Inc., David E. Patch, and Henry F. Schlueter.

<sup>24</sup> Letters from JAG Media Holdings, Inc., David E. Patch, and Solution Capital.

<sup>25</sup> Letters from Cristy Barrett, Jake Barrett, Joseph Meuse, David Patch, Joseph Raia, Joseph J. Selinger, StockTransfer.com, and Wizzard Software Corporation.

<sup>26</sup> Letter from Joseph J. Selinger.

<sup>27</sup> Letters from Aegis Assessments, Inc., Leonard W. Burningham, David E. Patch, David Salk, Joseph J. Selinger, Marshall Shichtman, StockTransfer.com, and Transfer Online, Inc.

<sup>28</sup> Letters from Ameritrade, Inc., Banc of America Securities LLC, Bank Depository User Group, Cashiers' Association of Wall Street, Inc., Mark Cashion, Citibank North America, Inc., Credit Suisse First Boston LLC, Edward Jones, ING Financial Markets LLC, JP Morgan Securities, Inc., Merrill Lynch, Mizuho Trust & Banking Co. (USA), National Financial Services LLC, National Investor Services Corp., Pershing LLC, Prudential Securities Incorporated, RBC Dain Rauscher, Salomon Smith Barney, Stearns Securities Corp., Securities Industry Association, Securities Industry Association Customer Account Transfer Division State Street Corporation, Sterne, Agee & Leach, Inc., USB Warburg LLC, and Union Planters Trust & Investment Group. Several commenters referred to dematerialization or immobilization as a "building