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U.S. DISTRICT COURT
DISTRICT OF NEVADA
FILED— AFTER HOURS
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CLERK, U. S. DISTRICT COURT
DISTRICT OF NEVADA
BY DEPUTY

UNITED STATES DISTRICT COURT

DISTRICT OF NEVADA

NUTEK, INC., a Nevada corporation; WILLIAM J. TANNAZ, individually, and as Trustee for the TANNAZ FAMILY TRUST; RAY HOUGH; MARK TANNAZ; MICHAEL LEPKOWSKI; BRYAN SCOTT CHRISTIAN; TODD 'BRYANT; ALAN SPITALNICK,

Plaintiffs,

v.

AMERITRADE, INC., a Nebraska corporation; E*TRADE GROUP, INC., a Delaware corporation; FIDELITY BROKERAGE SERVICES, LLC, a Delaware Limited Liability Company; MAXIM GROUP, LLC, a New York Limited Liability Company; CHARLES SCHWAB & CO., INC., a California corporation; DOES I through C, inclusive; ROE CORPORATIONS I through C, inclusive,

Defendants.

Case No.: CV-S-03-0321-JCM-RJJ

MEMORANDUM IN SUPPORT OF DEFENDANTS' JOINT MOTION TO DISMISS NUTEK'S CLAIMS

Defendants Ameritrade, Inc., E*TRADE Group, Inc., Fidelity Brokerage Services, LLC, Maxim Group, LLC, and Charles Schwab & Co., Inc. submit this memorandum of law in support of their joint motion to dismiss the claims asserted against them by Nutek, Inc. ("Nutek") pursuant to Fed. R. Civ. P. 12(b)(6).

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INTRODUCTION

In this suit, Nutek, an issuer of stock, seeks to piggyback on claims asserted by several Nutek shareholders (the "Shareholder Plaintiffs") against the five defendant securities brokerage firms. The Shareholder Plaintiffs' claims arise out of the customer agreements that they executed with their respective brokerage firms, and relate to the Plaintiff Shareholders' request that the defendants provide them with paper certificates representing their Nutek shares.[1]

Nutek's claims are fundamentally flawed because, unlike the Shareholder Plaintiffs, Nutek has no legally cognizable interest in the Nutek securities at issue and no relationship with the defendant securities brokerage firms on which to base its claims. In short, Nutek's status differs from that of the Shareholder Plaintiffs in the following key respects:

- Unlike the Shareholder Plaintiffs, Nutek cannot allege that it purchased securities through or from the defendant securities brokerage firms or that it owns the Nutek securities at issue in this lawsuit. Nutek parted with its ownership interest in the Nutek securities at issue when it issued the shares.
- Unlike the Shareholder Plaintiffs, Nutek cannot allege that it has any contractual relationship whatsoever with the defendants.
- Unlike the Shareholder Plaintiffs, Nutek cannot allege that it is owed any duties by the defendants, by virtue of either contract or common law.

That Nutek has no legally protectable interest in the Nutek securities owned by the Shareholder Plaintiffs and that there is no relationship, contractual or otherwise, between Nutek and

[1] The Shareholder Plaintiffs are William J. Tannaz, the Tannaz Family Trust, Ray Hough, Mark Tannaz, Michael Lepkowski, Bryan Scott Christian, Todd O'Bryan, and Alan Spitalnick. Defendants have moved by separate motions to compel arbitration with respect to the claims asserted by the plaintiffs other than Nutek, based on the customer agreements these plaintiffs entered into with the defendants.

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the defendant securities brokerage firms that could provide support for Nutek's claims is made abundantly clear by a June 4, 2003 Order (the "June 4 Order") issued by the Securities and Exchange Commission (the "SEC"). The SEC's June 4 Order, which is discussed in more detail below, approved a rule proposed by the Depository Trust Company (the "DTC"), the entity which, *inter alia*, acts as a central depository for issued shares. Typically, DTC participants, such as brokerage firms, deposit issued shares in the DTC system. The DTC system, in turn, functions to facilitate the prompt settlement of trades among its participants, by, among other things, making shares eligible for book-entry, thereby obviating the need for the physical transfer of paper certificates. As explained below, the June 4 Order makes it clear that issuers such as Nutek have no continuing ownership interest in their issued securities and thus no right to demand physical delivery of stock certificates on behalf of Nutek shareholders.

Undeterred by the lack of a legal basis for its position, Nutek asserts claims for breach of contract, breach of the implied covenant of good faith and fair dealing, negligence and conversion.[2] Nutek also seeks declaratory and injunctive relief. Because Nutek, as an issuer of securities, has not and cannot allege any facts that would give it standing to bring any claims against the defendant brokerage firms, its claims should be dismissed without leave to amend.

FACTUAL BACKGROUND

The following facts are based on the allegations set forth in the Complaint:

There are two different groups of plaintiffs in this case: (a) Nutek, a Nevada company whose securities are traded over the counter on the Over The Counter Bulletin Board; and (b) the Shareholder Plaintiffs, who allege that they purchased Nutek securities through their accounts with

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[2] While the Shareholder Plaintiffs assert securities fraud and fraud counts against the defendants, it does not appear from the face of the Complaint that plaintiff Nutek also asserts such claims. However, in the event that Nutek contends that it does in fact allege securities fraud and fraud claims, defendants reserve the right to move for dismissal of such claims.

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the defendant securities brokerage firms. *See* Complaint, ¶¶ 2-10, 19-23. When setting up their brokerage accounts, each of the Shareholder Plaintiffs executed a customer agreement with their respective brokerage firm. *Id.*, ¶ 109. Those customer agreements set forth the rights and obligations of the customer on the one hand, and the brokerage firm on the other.

On December 2, 2002, Nutek issued a press release stating its intention to remove issued Nutek shares from the DTC and Canadian Depository for Securities Limited post-trading settlement and clearing systems. *Id.*, ¶ 24. According to Nutek, this action required Nutek shareholders to hold Nutek shares in certificated (as opposed to electronic) form on a going-forward basis. *Id.* Nutek alleges that its December 2 action also obligated brokers, such as the defendants, to clear and to settle all trades by the delivery and issuance of physical certificates evidencing the Nutek shares. *Id.*

Following its press release, Nutek instructed Nutek shareholders to request physical delivery of Nutek stock certificates from the brokers holding their shares. *Id.*, ¶ 24. In accordance with these instructions, the Shareholder Plaintiffs requested physical delivery of their stock certificates from the defendants. *Id.*, ¶¶ 25-29. At the time they filed the instant lawsuit, the Shareholder Plaintiffs had not yet received physical stock certificates.

There are additional relevant facts not set forth in the Complaint of which the Court can and should take judicial notice. (*See* Request for Judicial Notice in Support of Defendants' Joint Motion to Dismiss Nutek's Claims, which defendants have filed simultaneously with this motion.) Those facts are as follows:

On January 31, 2003, DTC petitioned the SEC for a rule clarifying DTC's obligations when a company like Nutek requests withdrawal of its issued securities from the DTC system. *See* Exhibit A. Under DTC's proposed rule, DTC would take only the following actions upon receipt of a

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withdrawal request from an issuer like Nutek: (1) notify its participants (which include brokerage firms, banks, trading houses and trading exchanges) of the receipt of the withdrawal request from the issuer and remind the participants that they can utilize DTC's withdrawal procedures if they wish to withdraw their securities from DTC; and (2) process withdrawal requests submitted by participants in the ordinary course of business, but not effectuate withdrawals based upon a request from the issuer. *Id.* Thus, DTC's proposed rule asked the SEC to confirm that DTC has no obligation to act in response to an issuer's decision to withdraw its issued shares from the DTC system, absent a request to withdraw shares from a DTC participant, such as a brokerage firm representing individual shareholders.

On June 4, 2003, after a period of notice and comment, the SEC adopted DTC's proposed rule. *See* Order Granting Approval of a Proposed Rule Change Concerning Requests for Withdrawal of Certificates by Issuers, S.E.C. Release No. 34-47978, 2003 WL 21288541 (June 4, 2003) (Exhibit B). The SEC predicated its approval on the fact that "issuers do not have continuing ownership rights in shares they have sold into the marketplace." *Id.* at *5. Equally important, the SEC noted that efforts by issuers to control their publicly traded securities through attempted withdrawal from the DTC system were improper. *Id.* at *8. In addition, the SEC stated that the imposition of a requirement that stock transfers be accomplished only by certificate might result in inefficiencies and risks that Congress sought to avoid in promulgating Section 17A of the Securities Exchange Act of 1934, which was enacted to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities. *Id.*

The June 4 Order confirms that Nutek's claims should be dismissed, as it reinforces that:

- companies requesting withdrawal of their issued securities from the DTC system have "no legal or beneficial interest" in the securities as stock issuers; and

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DTC need not effectuate the withdrawal of securities based upon a request from the company that issued the stock.

Id. at *7.

Thus, the SEC's June 4 Order is significant in at least two respects: (1) it clearly establishes that Nutek's December 2, 2002 announcement of the withdrawal of its issued shares from the DTC system – the predicate for Nutek's claims in this case – had no legal significance vis-à-vis the DTC or the defendants; and (2) it confirms that once Nutek issues shares into the marketplace, it has no continuing legal right in those shares.

MOTION TO DISMISS STANDARDS

In ruling on a motion brought under Fed. R. Civ. P. 12(b)(6), it is generally proper for a court to accept factual allegations as true. *See McKinney v. De Bord*, 507 F.2d 501 (9th Cir. 1974). However, while courts generally assume facts alleged are true for purposes of a motion to dismiss, they do not "assume the truth of legal conclusions merely because they are cast in the form of factual allegations." *Western Mining Council v. Watt*, 643 F.2d 618, 624 (9th Cir. 1981). Conclusory allegations and unwarranted inferences are insufficient to defeat a motion to dismiss. *See In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1403 (9th Cir. 1996). Where a plaintiff "can prove no set of facts in support of his claim which would entitle him to relief," a court must grant a motion to dismiss. *Lewis v. Tel. Employees Credit Union*, 87 F.3d 1537, 1545 (9th Cir. 1996).

ARGUMENT

I. Nutek's Breach Of Contract Claim Should Be Dismissed Because Nutek Is Not A Party To Any Contracts With The Defendants.

In its breach of contract claim (Count Thirteen), Nutek alleges that "[p]ursuant to the customer agreements that Plaintiffs entered into with their respective Defendant brokers, Plaintiffs were entitled to receive physical delivery of all fully paid securities in Plaintiffs' respective brokerage accounts held with Plaintiffs' respective Defendant brokers." Complaint, ¶ 109. Nutek further alleges that the defendants breached the customer agreements by "refus[ing] to tender physical delivery of their respective customer/Plaintiffs' shares of NUTEK stock," and that as a result, all of the plaintiffs, including Nutek, have been damaged. *Id.*, ¶¶ 110-11.

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It appears, then, that Nutek's breach of contract claim is based on the customer agreements that the Shareholder Plaintiffs signed with their respective brokerage firms. Nutek, however, as the issuer of the securities, has no standing to bring a breach of contract claim based on those agreements.

In Nevada, in order to have standing to pursue a breach of contract claim, a plaintiff must plead facts showing that he is either a party to the contract, or if the contract was executed by other parties, he is an assignee or third-party beneficiary of the contract. In *Wells v. Bank of Nevada*, the Nevada Supreme held that:

> Controversies arising under an agreement properly are to be determined and settled by parties to the agreement or their assigns, that is, by those who have legal rights or duties thereunder. Absent evidence of a third party beneficiary status, an assignment of contract rights or a delegation of contract duties, [entities who are not party to the contract lack] rights, duties or obligations under the Agreement.

522 P.2d 1014, 1017 (Nev. 1974).

Nutek has not pled any facts to satisfy any of the conditions enumerated in *Wells*. Unlike the Shareholder Plaintiffs, it is not a party to the customer agreements.[3] It is not an assignee of those agreements. Nutek also fails to qualify as a third-party beneficiary to these customer agreements. To achieve such status, "there must clearly appear a promissory intent to benefit the third party" in the underlying contract and "it must be shown that the third party's reliance thereon is foreseeable." *Lipshie v. Tracy Inv. Co.*, 566 P.2d 819, 824 (Nev. 1977). Nutek has not, and cannot, allege that the customer agreements reflect any promissory intent to benefit Nutek, or that Nutek forseeably relied on any such promissory intent.

In sum, Nutek's breach of contract claim should be dismissed because Nutek is not a party to the customer agreements, nor is it an assignee or third-party beneficiary of the customer agreements. Thus, it has no right to bring a claim for breach of the customer agreements.

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[3] Nor has Nutek pled that it is a party to any other contract with any of the defendants.

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II. Nutek's Breach of the Implied Covenant of Good Faith and Fair Dealing Claim Should Be Dismissed Because Nutek Lacks Standing To Assert Such A Claim.

The same reasoning applies to Nutek's claim for breach of the implied covenant of good faith and fair dealing. In Count Fourteen, Nutek alleges that "Defendants misused their position of trust and influence with their respective customer/Plaintiffs by failing to comply and abide by the terms, conditions and covenants of the aforementioned customer agreements, thereby breaching the covenant of good faith and fair dealing implied in every commercial contract and commercial dealing." Complaint, ¶ 114. Nevada recognizes both a tort-based and contract-based cause of action for breach of the implied covenant of good faith and fair dealing. The fact that Nutek is not a party to the customer agreements means that Nutek cannot bring either a tort- or contract-based claim.

"The tort action for breach of the implied covenant of good faith and fair dealing requires a special element of reliance or fiduciary duty." *Great Am. Ins. Co. v. Gen. Builders, Inc.*, 934 P.2d 257, 263 (Nev. 1997). Such reliance has been recognized in relationships formed by employment, bailment, insurance, partnership, and franchise agreements. *See id.* at 263.

Here, Nutek has not pled any such relationship, contractual or otherwise. Nor could it – the fact that the defendants act as brokers in the purchase and sale of the securities of thousands of companies, including Nutek's, cannot be a sufficient basis to justify reliance by Nutek, nor form the basis of a fiduciary relationship, such as those that exist in employment or partnership relationships. For this reason, Nutek lacks standing to assert a claim for breach of the implied covenant of good faith and fair dealing based on tort principles.

Nutek fares no better with respect to a contract-based claim for breach of the implied covenant of good fair and fair dealing, which must arise from the execution or performance of a contract. In *Alam v. Reno Hilton Corp.*, 819 F. Supp. 905, 910 (D. Nev. 1993), the Court addressed a claim for breach of the duty of good faith and fair dealing where, as in this case, there was no contract between the parties:

> Necessarily, plaintiffs['] claim of tortious breach of the implied covenant of good faith and fair dealing also fails absent a contractual relationship. Implying a covenant of good faith and fair dealing presupposes the existence of a contract.

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The Court held that without a contractual relationship between the parties, the claim failed as a matter of law. *See id.* at 911. *See also, Aluevich v. Harrah's*, 660 P.2d 986, 987 (Nev. 1983) ("an implied covenant of good faith and fair dealing has . . . been *implied in contractual relations* which involve a special element of reliance such as that found in partnership, insurance and franchise agreements") (emphasis added).

As set forth above, there is no contractual relationship between Nutek and the defendants. For that simple reason, Nutek cannot state a contract-based claim for breach of the implied covenant of good faith and fair dealing.

III. Nutek's Negligence Claim Should be Dismissed Because Defendants Do Not Owe Nutek Any Duty.

Nutek asserts that the defendant securities brokerage firms owed a duty to Nutek to (1) "take prompt steps to obtain physical possession of [the Shareholder Plaintiffs'] stock, including purchasing the stock on the open market, if necessary, and seeking reimbursement from the seller;" and (2) "to act at their customers' direction to convert [the Shareholder Plaintiffs'] securities into certificated form, as requested by [those shareholders]." Complaint, ¶¶ 103-04.

To prevail on a negligence theory in Nevada, a plaintiff must show that: (1) the defendant had a duty to exercise care towards the plaintiff; (2) the defendant breached the duty; (3) the breach was an actual cause of the plaintiff's injury; (4) the breach was the proximate cause of the plaintiff's injury; and (5) the plaintiff suffered damage. *See Perez v. Las Vegas Med. Ctr.*, 805 P.2d 589, 590-91 (Nev. 1991). Most significant to this case, Nevada courts have held that "an indispensable predicate to tort liability founded upon negligence is the existence of a duty of care owed by the alleged wrongdoer to the person injured." *Mangeris v. Gordon*, 580 P.2d 481, 483 (Nev. 1978). *See also Scialabba v. Brandise Constr. Co., Inc.*, 921 P.2d 928, 930 (Nev. 1996) (to prevail on a negligence claim, plaintiff must show defendant owed it a duty of care).

Nutek has not pled any facts to satisfy this vital predicate, and cannot do so, because the defendants did not have a duty to act in response to Nutek's announcement that it intended to withdraw its issued shares from the DTC system. The SEC's June 4 order makes it clear that Nutek's request to withdraw its issued securities from the DTC system had no legal significance, and

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thus imposed no duty on either the DTC or the defendants.[4] Because Nutek cannot plead any set of facts establishing that the defendants owed a duty to Nutek, its claim for negligence cannot be sustained.

IV. Nutek's Conversion Claim Should Be Dismissed Because Nutek Has No Continuing Ownership Rights In Nutek Shares Sold on the Market.

Nutek alleges that the defendants' failure to deliver physical shares of Nutek stock to shareholders upon request "constitute[s] an intentional exercise of dominion . . . which so seriously interferes with Plaintiffs' right to control their NUTEK stock as to constitute a conversion of Plaintiffs' property." Complaint, ¶ 96. According to Nutek, the defendants' failure to deliver physical possession of their Nutek certificates to the Shareholder Plaintiffs artificially depressed the value of and decreased the demand for Nutek stock, thereby causing "the price of Nutek stock [to be] significantly lower than it would be, but for Defendants' intentional interference with Plaintiffs' ownership of Nutek stock." *Id.*, ¶ 97. As a result, Nutek alleges that its ability to acquire new businesses and compensate its employees was severely impaired. *See id.*, ¶ 99.

There is no legal basis to support Nutek's novel theory of conversion. Conversion exists only where there is "a distinct act of dominion wrongfully exerted over another's personal property in denial of, or inconsistent with his title or rights therein or in derogation, exclusion or defiance of such title or rights." *Wantz v. Redfield*, 326 P.2d 413, 414 (Nev. 1958). Nutek's theory of conversion misapprehends a basic tenet of property law – that a party who does not own an item of property lacks a legally cognizable basis for asserting ownership rights in that item. Once Nutek sells Nutek securities in the marketplace, it retains no ownership rights or rights to control the

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[4] Moreover, a September 5, 2003 order issued by the U.S. District Court for the District of Nevada in *Genemax Corp. v. Knight Securities, LP*, CV-N-02-0509-ECR (RAM) (Exhibit C), makes it clear that the federal securities laws provide no support for Nutek's claims. In *Genemax*, plaintiff Genemax, a publicly traded company, accused several brokerage firms (including several of the defendants in the instant action) of engaging in unlawful "naked" short sales of Genemax securities. The plaintiff brought claims under, *inter alia*, Sections 9 and 10 of the Exchange Act of 1934 and Section 12(a)(2) of the Securities Act of 1933. On the defendants' joint motion to dismiss, the Court dismissed with prejudice all of the plaintiff's claims, finding that Genemax, as the issuer of the securities, was not a purchaser or seller and therefore had no standing under the federal securities laws to bring claims against the defendants.

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1 transfer of those shares. Putting it more succinctly, Nutek cannot enforce ownership rights in
2 property than it does not own. Because Nutek lacks standing to complain about the defendants'
3 alleged failure to deliver Nutek certificates to the Shareholder Plaintiffs, Nutek's conversion claim
4 should be dismissed.

5 **V. Nutek's Claims For Declaratory and Injunctive Relief Should Be Dismissed Because Nutek Has No Legal Interest in the Nutek Shares At Issue.**

6

7 In addition to seeking compensatory and punitive damages on its common law claims, Nutek
8 seeks pursuant to the Declaratory Judgment Act, 28 U.S.C. §§ 2201, *et seq.* and Fed. R. Civ. P. 57:
9 (1) a court declaration of "the rights and relationships between [the Shareholder Plaintiffs] and their
10 respective broker[s];" (2) a court declaration of shareholders' "absolute right to the physical
11 delivery" of Nutek certificates; and (3) a court order requiring the defendants "to immediately deliver
12 physical possession of certificates" to the Shareholder Plaintiffs. *See* Complaint, ¶ 120.

13 However, as the U.S. Supreme Court noted in *Aetna Life Ins. Co. of Hartford v. Haworth*,
14 300 U.S. 227, 240-41 (1937), declaratory relief is available only where a controversy is "definite and
15 concrete, touching on the legal relations of parties having adverse legal interests." Nevada law is
16 similar in this regard: a party may obtain declaratory relief only where (1) a justiciable controversy
17 exists between persons with adverse interests; (2) the party seeking declaratory relief has a legally
18 protectable interest in the controversy; and (3) the issue is ripe for judicial determination. *See Knittle*
19 *v. Progressive Cas. Ins. Co.*, 908 P.2d 724, 725 (Nev. 1996).

20 As explained above, Nutek has not and cannot plead that it is a party to the customer
21 agreements that the Shareholder Plaintiffs signed with their respective brokerage firms. And as the
22 June 4 Order makes plain, issuers of stock like Nutek have no legally protectable interest in Nutek
23 stock that is owned by Nutek shareholders. Thus, Nutek has no standing to ask the Court to clarify
24 the rights and relationships between the Shareholder Plaintiffs and their brokerage firms, to declare
25 the Plaintiff Shareholders' "absolute right to the physical delivery" of Nutek certificates, or to order
26 the defendants to immediately deliver to the Shareholder Plaintiffs paper certificates representing
27 their Nutek shares.

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The same analysis applies with respect to the injunctive relief that Nutek seeks. As the Nevada Supreme Court observed in *State Farm Mut. Auto. Ins. Co. v. Jafbros Inc.*:

> It is axiomatic that a court cannot provide a remedy unless it has found a wrong. The existence of a right violated is a prerequisite to the granting of an injunction. Accordingly, an injunction will not issue to restrain an act which does not give rise to a cause of action . . . .

860 P.2d 176, 178 (Nev. 1993) (internal citations omitted). *See also Dasco, Inc. v. Am. City Bank & Trust Co.*, 429 F. Supp. 767, 770 (D. Nev. 1977) (injunctive relief not available to plaintiff who is unlikely to prevail on merits of claims asserted).As chronicled above, Nutek's contract, tort, and property claims, which are premised on the Plaintiff Shareholders' request that the defendants provide them with paper certificates for their Nutek shares, are defective as to Nutek, and as a result, do not state a claim upon which relief can be granted. In light of these defects, and the June 4 Order establishing that the DTC is not required "to allow issuers [of stock] to withdraw securities which they have not deposited at DTC or [in which they] have no ownership interest," Nutek has not and cannot allege a wrong for which injunctive relief may be granted.

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1 **CONCLUSION**

2 For the foregoing reasons, the claims brought by Nutek against the defendants
3 (Counts 11 through 16) should be dismissed with prejudice for failure to state a claim upon which
4 relief may be granted.

5
6 Dated: September 29th, 2003

Respectfully submitted,

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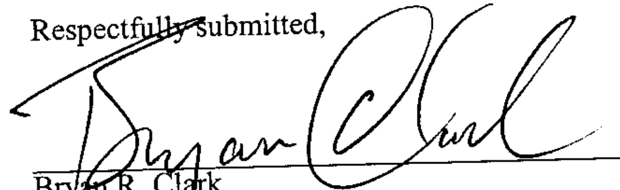

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28 #77822

EXHIBIT A

Release No. 47978, Release No. 34-47978
(Cite as: 2003 WL 21288541 (S.E.C. Release No.))

S.E.C. Release No.

*1 Securities Exchange Act of 1934

SELF-REGULATORY ORGANIZATIONS; THE DEPOSITORY TRUST COMPANY; ORDER GRANTING APPROVAL OF A PROPOSED RULE CHANGE CONCERNING REQUESTS FOR WITHDRAWAL OF CERTIFICATES BY ISSUERS
File No. SR-DTC-2003-02
June 4, 2003

I. Introduction

On February 3, 2003, The Depository Trust Company filed with the Securities and Exchange Commission ("Commission") and on February 11, 2003, amended proposed rule change SR-DTC-2003-02 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"). [FN1] Notice of the proposal was published in the Federal Register on February 22, 2003. [FN2] Eighty-nine comment letters were received. [FN3] For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

Recently a number of issuers of securities have independently requested that DTC withdraw from the depository all securities issued by them. [FN4] Generally, these issuers have also advised DTC that they will not allow their securities to be reregistered in the name of DTC or its nominee, Cede & Co. The securities of these issuers generally became eligible for DTC services at the request of DTC's participants so that they could utilize DTC's services, including its book-entry transfer system. The securities are held by DTC in its nominee name for the benefit of its participants. DTC has stated that, in its opinion, these issuers have no legal or beneficial interest in the securities they are requesting to be withdrawn from DTC.

DTC's current rules and procedures provide for participants to submit withdrawal requests if they wish to withdraw their securities from DTC. [FN5] However, DTC's current rules and procedures do not provide for DTC to comply with a withdrawal request from an issuer without also receiving instructions from its participants.

DTC's proposed rule change provides that upon receipt of a withdrawal request from an issuer, DTC will take the following actions: (1) DTC will issue an Important Notice notifying its participants of the receipt of the withdrawal request from the issuer and reminding participants that they can utilize DTC's withdrawal procedures if they wish to withdraw their securities from DTC; and (2) DTC will process withdrawal requests submitted by participants in the ordinary course of business but will not effectuate withdrawals based upon a request from the issuer.

DTC stated in its filing that the application of its procedures is not

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affected by any purported approval of the request by the shareholders or board of directors of the issuer. [FN6]

III. Comment Letters

The Commission received 89 comment letters regarding the proposed rule Change. [FN7] Forty-seven commenters submitted fifty-two comment letters opposing the proposed rule change. [FN8] Thirty-five commenters submitted thirty-six comment letters supporting the proposed rule change. [FN9] DTC submitted a letter in response to certain issues raised by comment letters opposing the rule change.

A. Comment Letters Opposing DTC's Proposed Rule Change

*2 A majority of the forty-seven commenters opposed to DTC's filing believe that approval of the proposed rule change would allow DTC to continue to facilitate, either directly or indirectly, short selling in the over-the-counter securities market in violation of DTC's obligation to promote the prompt and accurate clearance and settlement of securities transactions. [FN10] Seven of these commenters characterized DTC's current settlement process as aiding and abetting illegal short selling or as creating an environment that permits unregistered securities offerings. [FN11]

At least twenty-six commenters contended that an issuer should have a choice as to whether the company's securities are eligible for deposit at DTC, [FN12] particularly, as some of these commenters argued, when making the securities eligible for deposit at DTC requires the issuer's consent. [FN13] 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. [FN14] 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. [FN15]

Ten commenters raised a number of concerns regarding the legal basis for the proposal. [FN16] 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. [FN17] 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. [FN18] 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. [FN19]

Four of the seven commenters questioned the need for the filing and in

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particular questioned DTC's statement that it was only clarifying its existing rules and procedures rather than promulgating a new rule. [FN20] 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, [FN21] 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. [FN22]

*3 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. [FN23] 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. [FN24]

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. [FN25] One of these commenters suggested that this conflict of interest should disqualify DTC from deciding whether an issuer could withdraw its securities. [FN26]

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. [FN27] 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. [FN28] The industry, these commenters believe, has achieved success in significantly reducing risk in the trading markets and in enhancing processing efficiencies within the securities infrastructure supporting book-entry clearance and settlement. In their view, much of the success can be attributed to immobilizing stock certificates and mandating book-entry settlement among financial institutions and their financial

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intermediaries. Accordingly, many of the commenters claimed that a move to certificated securities is a step backwards in the development of the modern securities processing system and will hinder the industry's efforts to reduce risk, cost, and inefficiencies for all parties involved in securities transactions. [FN29]

*4 Fourteen commenters specifically raised concerns that an increase in the use of certificates will raise costs and cause significant inconveniences for investors. [FN30] They believe that increased costs associated with transfers, lost certificates, custody, and trading delays will ultimately be borne by investors. One commenter stated that the withdrawal from DTC might require customer securities to be held in the broker's vault in order to meet the customers' needs and will increase costs associated with transactions, including transfer costs, which are currently ranging from $50.00 to $100.00 per certificate. [FN31] This commenter claims that these costs are hard to justify to shareholders when the shareholder did not request a certificate.

Ten commenters contended that operating outside the DTC environment would undermine the ability of broker-dealers to effectively complete transactions on behalf of their customers. [FN32] Forced withdrawals of customer positions held in street name would prevent shareholders from fully participating in services provided by their broker, such as margin accounts, automated dividend payments or reinvestments, asset management, proxy services, account transfers, and prompt processing of corporate actions (particularly where old securities need to be exchanged for new securities as required, for example, in mergers and tender offers). Seven of the ten commenters also indicated that such an action would result in an increase in trading delays and trade failures, which would increase risk in the system. [FN33]

Three commenters believe that the final decision regarding custody and registration should reside with the beneficial owners or their appointed agents and not with the issuers of such securities. [FN34] These commenters objected to imposing registration restrictions on beneficial owners, because such registration restrictions would be disruptive to market practices, would impose costs on investors, and would cause inefficiencies in the market. Further, nine commenters noted that the direct registration system ("DRS") [FN35] was specifically designed by the industry to give shareholders an alternative to either holding a certificate or holding in street name registration. [FN36] Several commenters pointed to AT&T's decision to dematerialize its securities as further support of the industry's initiatives to dematerialize. [FN37]

Four commenters stated they believe DTC's proposed rule change complies with its obligation under Section 17A of the Act to promote the prompt and accurate settlement of securities transactions. [FN38] In fact, one of these commenters stated that honoring issuers' request to withdraw from DTC was inconsistent with Section 17A. [FN39] One commenter expressed surprise that DTC's filing on this issue was necessary because of the ability of an owner of a negotiable security to register the securities in whatever name it wished has existed for a long time under the Uniform Commercial Code and therefore should not be restricted by the issuer. [FN40]

*5 With regard to the naked short selling issue, one commenter indicated that the withdrawal of securities from DTC would not have any material or effective impact on the short selling concerns of issuers. [FN41] Another contended that

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short selling is vital to ensuring the asset price reflects the underlying fundamentals of the asset and thereby facilitates a more efficient market. [FN42] This commenter noted that as a result of the additional costs and trade delays associated with certificate-only securities, some brokers are refusing to conduct trades in issues that have been withdrawn from DTC, which has resulted in an illiquid market for those securities.

C. DTC's Response Letter To Opposing Comment Letters

DTC emphasizes in its response letter that the proposed rule change does not constitute a departure from DTC's existing rules and procedures approved by the Commission. Those rules, DTC contends, govern requests to make shares eligible and enable participants to withdraw shares on behalf of themselves or their customers from the DTC system through DTC's withdrawal-by-transfer mechanism. [FN43]

Further, DTC states that issuers to do not have continuing ownership rights in shares they have sold into the marketplace and therefore cannot control the disposition of shares already registered in DTC's nominee name by directing that those shares be surrendered to the transfer agent or by restricting their eligibility for book-entry transfer at DTC. [FN44] DTC contends that attempts by issuers to control their publicly traded securities are improper and may constitute conversion. DTC states that by purporting to exercise the rights of the shareholders, issuers are interfering with the legal and beneficial rights of DTC and its participants with respect to securities deposited at DTC and with DTC's obligations under Section 17A of the Act.

DTC disagreed with the commenters' contention that it had an obligation to take action to resolve the issues associated with naked short selling because those issues arise in the context of trading and not in the book-entry transfer of securities. DTC pointed out that if beneficial owners believe that their interests are best protected by not having their shares subject to book-entry transfer at DTC, then they can instruct their broker-dealer to execute a withdrawal-by-transfer, which will remove the securities from DTC and transfer them to the shareholder in certificated form.

Finally, DTC contested certain commenters' assertion that issuers cause their shares to become eligible at DTC and therefore have the right to withdraw from DTC eligibility. DTC states that most shares are made eligible at the request of participants and not issuers. But regardless of how the shares are made eligible, DTC believes it continues to own and hold the shares for the convenience and at the request of its participants. DTC believes that if it were to exit shares upon demand of an issuer, there is no mechanism to ensure that the shares entrusted to DTC by its participants would be returned to their rightful owners. This, DTC contended, would be inconsistent with its obligations under Section 17A.

IV. Discussion

***6** Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and to remove impediments to and perfect the

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mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. [FN45] For the reasons described below, the Commission finds that the rule change is consistent with Section 17A of the Act.

Pursuant to Section 17A of the Act, Congress set forth its finding that the prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and safeguarding of securities and funds related to clearance and settlement activities, is necessary for the protection of investors and those acting on behalf of investors. [FN46] Inefficient clearance and settlement procedures, Congress found, impose unnecessary costs on investors and those acting on their behalf. [FN47] Congress vested with the Commission the authority and responsibility to regulate, coordinate, and direct the operations of all persons involved in processing securities transactions toward the goal of establishing a national system for the prompt and accurate clearance and settlement of transactions in securities ("National Clearance and Settlement System") in an effort to increase efficiency and reduce risk. [FN48] The Commission's approval of DTC's registration as a clearing agency constituted an important step in its efforts to facilitate the development of a National Clearance and Settlement System and a significant step in achieving the goals established by Congress. [FN49]

As a registered clearing agency, DTC has adopted rules under Section 19(b) of the Act to act as a depository that operates a centralized system for the handling of securities certificates through book-entry movements. [FN50] Generally, those rules, including adoptions, deletions, or changes to DTC's constitution, articles of incorporation, bylaws, rules, or stated policies, practices, and interpretations, must be filed with the Commission and must be approved by the Commission if the Commission finds the rule change consistent the Act. [FN51] Furthermore, DTC can only act in accordance with its rules. DTC has adopted rules that permit deposits of securities into DTC by participants [FN52] and rules that permit withdrawals from DTC by participants and pledgees. [FN53] However, DTC has not adopted rules that permit issuers to withdraw securities from DTC. Accordingly, a procedure allowing issuers to withdraw securities from DTC would have to be filed and approved by the Commission. DTC has not filed such a rule change.

In accordance with its rules, DTC accepts deposits of securities from its participants (i.e., broker-dealers and banks), credits those securities to the depositing participants' accounts, and effects book-entry movements of those securities. [FN54] The securities deposited with DTC are registered in DTC's nominee name, Cede & Co. (making DTC's nominee the registered owner of the securities) and are held in fungible bulk. Each participant or pledgee having an interest in securities of a given issue credited to its account has a pro rata interest in the securities of that issue held by DTC. Among other services it provides, DTC provides facilities for payment by participants to other participants in connection with book-entry deliveries of securities, collects and pays dividends and interest to participants for securities, and provides facilities for the settlement of institutional trades. By centralizing and automating securities settlement, by reducing the movement of publicly traded securities in the U.S. markets, and by facilitating the prompt and accurate settlement of securities transactions, DTC serves a critical function in the

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National Clearance and Settlement System.

*7 DTC's rules also accommodate withdrawal requests from participants or under certain conditions, from pledgees. [FN55] Securities credited to a participant's or pledgee's account may be withdrawn in certificated form (if the issue is not dematerialized). [FN56] DTC's rules, both prior to and after the approval of the clarification which is the subject of this rule filing, obligates and allows DTC to take instructions only from its participants.

Some commenters opposing DTC's proposed rule change contend that issuers should have a choice as to whether their securities are made eligible for deposit at DTC. [FN57] In this way, these commenters argue, issuers would be better able to protect their shareholders from the negative effects naked short selling has on their securities' share price. [FN58] Securities deposited at DTC are registered in the name of Cede & Co. and are held beneficially for DTC participants, who in turn may hold the securities beneficially for their customers. [FN59] Since DTC participants and their customers, not issuers, have ownership interest in the securities, DTC participants and their customers have the authority to determine whether to deposit securities with DTC or not. Participants deposit certificates with DTC in order to avail themselves of the efficiencies and safeguards provided by DTC. It would not be consistent with DTC rules to allow issuers to withdraw securities which they have not deposited at DTC or have no ownership interest.

Furthermore, the issues surrounding naked short selling are not germane to the manner in which DTC operates as a depository registered as a clearing agency. Decisions to engage in such transactions are made by parties other than DTC. DTC does not allow its participants to establish short positions resulting from their failure to deliver securities at settlement. While the Commission appreciates commenters' concerns about manipulative activity, those concerns must be addressed by other means. [FN60]

Several commenters claim that DTC is acting arbitrarily by permitting some issuers to withdraw their securities while prohibiting others from withdrawing their securities because DTC did accommodate a few earlier requests from issuers in the belief that they were unusual circumstances. However, DTC only withdrew these securities based upon instructions made by participants pursuant to DTC's rules and procedures. DTC bore the substantial expense resulting from coordinating the communications and actions among DTC participants, the transfer agent, and the issuer in order to accommodate each issuer's request. When it became clear to DTC that many more issuers intended to attempt to withdraw their securities from DTC, it decided that it would no longer bear the substantial additional cost and expense of time in accommodating such requests. In none of the situations where DTC assisted an issuer in having its securities withdrawn did DTC act on an issuer's instructions. DTC facilitated the issuer by having DTC participants issue instructions to withdraw the securities.

*8 With regard to commenters' contention that state law permits companies to adopt certain restrictions on publicly traded securities, this filing does not address the validity of such restrictions since the securities that are the subject of this filing are securities which are registered in the name of (i.e., legally owned) Cede & Co. prior to the imposition of any restrictions. The securities of issuers, such as the ones that recently attempted to withdraw their securities from DTC, were issued without restrictions or notice of an

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adverse claim, and no restrictions were imposed on or claims made against the securities when DTC participants deposited the securities at DTC or when the transfer agent registered them in the name of Cede & Co.

While not a direct subject of this rule filing, we note that actions by some issuers of publicly traded securities to require transfer only by certificate [FN61] and to restrict ownership of the securities by a depository or financial intermediary could result many of the inefficiencies and risks sought to be avoided when Congress promulgated Section 17A of the Act. [FN62] We also note in this connection that Section 17A(e) directs the Commission to use its authority "to end the physical movement of the securities certificate in connection with settlement among brokers and dealers of securities transactions by means of the mails or other means or instrumentalities of interstate commerce." [FN63] Consistent with this directive, the Commission has encouraged the use of alternatives to holding securities in certificated form in an effort to improve efficiencies and decrease risks associated with processing securities certificates. Among other things, the Commission has approved the rule filings of self-regulatory organizations that require their members to use the facilities of a securities depository for the book-entry settlement of all transactions in depository-eligible securities [FN64] and require that, before any security can be listed for trading, it must have been made depository eligible if possible. [FN65] More recently the Commission has approved the implementation and expansion of DRS. [FN66]

The use of certificates can result in significant delays and expenses in processing securities transactions and can raise safety concerns associated with lost, stolen, and forged certificates. The concerns associated with lost certificates was dramatically demonstrated during the September 11, 2001, tragedy when tens of thousand of certificates maintained in broker-dealers' vaults either were destroyed or were unavailable for transfer.

Accordingly, for the reasons stated above the Commission finds that the rule change, which clarifies that DTC's rules only permit it to honor its participants' requests to withdraw securities, is consistent with Section 17A of the Act.

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A(b)(3)(F) of the Act and the rules and regulations thereunder. IT IS THEREFORE

*9 ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2003-02) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority. [FN67]

Margaret H. McFarland
Deputy Secretary

FN1. 15 U.S.C. 78s(b)(1).

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FN2. Securities Exchange Act Release No. 47365, (February 13, 2003), 68 FR 8535 (February 21, 2003).

FN3. Letters from H. Glenn Bagwell, Jr., Esq. (March 6, 2003); Bruce Barrett (March 4, 2003); Bruce M. Barrett (March 19, 2003); Cristy Barrett (March 13, 2003); Jake Barrett (March 13, 2003); Robert D. Becker, Senior Vice President, National City Bank (March 18, 2003); Lester Bianco, Director, Ingalls & Snyder LLC (April 4, 2003); Pete Bowman, Managing Director, First Clearing Corporation (March 18, 2003); Michael R. Brennan, Vice President and Managing Director of Operations, Ameritrade, Inc. (April 28, 2003); Earl D. Bukolt, Managing Director and Chief Operating Officer, Sterne, Agee & Leach, Inc. (April 21, 2003); Leonard W. Burningham, Esq. (March 21, 2003); Leonard W. Burningham, Esq. (March 22, 2003); Leonard W. Burningham, Esq. (March 24, 2003); Neil C. Carfora, Senior Vice President, State Street Corporation (March 11, 2003); Mark Cashion (March 6, 2003); David L. Cermak, Senior Vice President and Director of Operations, RBC Dain Rauscher (April 21, 2003); Frank M. Ciavarella, Cashiers Division, Prudential Securities Incorporated (April 3, 2003); John Cirrito, Senior Managing Director and Chief Operating Officer, ING Financial Markets LLC (March 17, 2003); Kevin Cundy (March 6, 2003); Richard J. Curran, Director, Credit Suisse First Boston LLC (April 14, 2003); Dennis Dejose (March 8, 2003); Patricia Dowd, Patricia Dowd Inc. (March 5, 2003); Paul A. Ebeling (March 11, 2003); Harry Filowitz, Vice President, Mizuho Trust & Banking Co. (USA) (April 7, 2003); Mary L. Forgy, Chairperson, Bank Depository User Group (March 14, 2003); Mary L. Forgy, Union Planters Trust & Investment Group (March 13, 2003); Susan A. Gessman, Assistant Vice President of Operations, Raymond James and Associates (April 25, 2003); Russell Godwin, President, Medinah Minerals Inc. (March 13, 2003); Jeff Hamel, President, Cashiers' Association of Wall Street, Inc. (March 18, 2003); Edward Hazel, Managing Director, Spear, Leeds & Kellogg (April 9, 2003); James Hendricks (March 8, 2003); Joseph Hoofnagel, Jr. (March 8, 2003); Gordon D. House (March 6, 2003); Tom Ittner, Director, National Financial Services LLC (March 17, 2003); Kent N. Jacobson, President and Chief Executive Officer, James Barclay Alan Inc. (March 7, 2003); Peter Johnston, Managing Director, Goldman, Sachs & Co. (March 24, 2003); Jack Kennedy (March 8, 2003); Will Kernen (March 8, 2003); Patrick Kirby, Director, Salomon Smith Barney (March 14, 2003); Donald D. Kittell, Executive Vice President, Securities Industry Association (March 11, 2003); Jeremy D. Kraus, Valesc Medical Specialists (March 4, 2003); Philip Lanz, Managing Director, Bear, Stearns Securities Corp. (April 11, 2003); Arthur Lee, Vice President, Banc of America Securities LLC (March 18, 2003); Joseph M. Liguori, Vice President, JP Morgan Securities, Inc. (April 14, 2003); Erick Lihme (March 8, 2003); Luiz Lima, Director, Americas Regional Service Center, Citibank North America, Inc. (April 22, 2003); Lori Livingston, President and Chief Operating Officer, Transfer Online, Inc, (March 5, 2003); Richard Mangiarelli, President and Chief Operating Officer, Cybertel Communications Corporations (March 5, 2003); John Masse, Executive Director, Morgan Stanley (May 21, 2003); Thomas J. Mazzarisi, Executive Vice President and General Counsel, JAG Media Holdings, Inc. (March 14, 2003); Joseph Meuse (March 5, 2003); Michael Moran, First Vice President, National Investor Services Corp. (March 11, 2003); Lawrence Morillo, Managing Director, Pershing LLC (April 3, 2003); John O'Brien (March 11, 2003); Thomas J.

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O'Hara, Department Leader, Edward Jones (April 15, 2003); John M. Osmanski (March 4, 2003); David E. Patch (March 4, 2003); Dave Patch (March 6, 2003); D. Patch (March 15, 2003); John L. Petersen, Esq., Petersen & Fefer, on behalf of Blue Industries, Inc. (March 12, 2003); Ernest A. Pittarelli, USB Warburg LLC (April 24, 2003); Robert M. Post (March 8, 2003); James E. Pratt, Esq., on behalf of Composite Holdings, Inc. (March 27, 2003); Joe Raia (March 11, 2003); Richard Reincke, Chief Operating Officer, Aegis Assessments, Inc. (March 3, 2003); Peter Richardson (March 8, 2003); John Rideout (March 12, 2003); Rodney J. Roncaglio (April 29, 2003); Robert S. Rondeau (May 20, 2003); Greg Rotman (March 14, 2003); David Salk (March 6, 2003); Henry F. Schlueter, Esq., Schlueter & Associates, P.C. (March 12, 2003); Robert J. Scott, President and Chief Operating Officer, The Auxer Group, Inc. (March 20, 2003); Joseph J. Selinger, Esq., Tobin, Carberry, O'Malley, Riley & Selinger, P.C. (March 14, 2003); Marshal Shichtman, Esq., Marshal Shichtman & Associates, P.C. (March 11, 2003); Scott Sieck (March 5, 2003); Steven Simonyi-Gindele, President and Chief Executive Officer, ID Superstore (March 17, 2003); Maurisa Sommerfield, Executive Vice President, Charles Schwab & Co., Inc. (April 15, 2003); Michael Sondow (March 4, 2003); Chris Spencer, Chief Executive Officer, Wizzard Software Corporation (March 11, 2003); Roger J. Steffensen (March 8, 2003); SuperVP (March 20, 2003); Kristie Thompson, President, SIA Customer Account Transfer Division (April 4, 2003); Larry E. Thompson, Managing Director and Deputy Chief Counsel, The Depository Trust Company (March 27, 2003); Leon Urbaitel, Chief Operating Officer, StockTransfer.com (March 6, 2003); Brian Urkowitz, Merrill Lynch (April 23, 2003); C. Michael Viviano, BNY Clearing (April 4, 2003); Geoffrey F. Walsh, Chief Operating Officer, Solution Capital (March 7, 2003); and William J. Winter, Senior Vice President, A.G. Edwards & Sons, Inc. (March 14, 2003).

FN4. As explained in further detail by many of the commenters opposing DTC's proposal, the issuers making these requests have alleged that their securities have been the target of manipulative short sellers.

FN5. See, e.g., Rules 2, 6, 9(A), and 9(B) of DTC's Rules.

FN6. DTC' s current procedures and this proposed rule filing do not apply to withdrawal requests submitted by issuers in situations where an issue which should not have been made eligible and deposited at DTC was inadvertently made eligible and deposited (e.g., securities restricted pursuant to Rule 144 or Rule 145 under the Securities Act of 1933). In such situations, DTC will continue its practice of working with the issuer and its participants to exit the security from DTC.

FN7. Supra note 3.

FN8. Letters from Aegis Assessments, Inc., H. Glenn Bagwell, Bruce Barrett, Bruce M. Barrett, Cristy Barrett, Jake Barrett, Blue Industries, Inc., Leonard W. Burningham (three letters), Composite Holdings, Inc., Kevin Cundy, Cybertel Communications Corporations, Dennis Dejose, Patricia Dowd Inc., Paul A. Ebeling, James Hendricks, Joseph Hoofnagle, Jr., Gordon D. House, ID Superstore, James

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Barclay Alan Inc., Jack Kennedy, Will Kernen, Erick Lihme, JAG Media Holdings, Inc., Medinah Minerals Inc., Joseph Meuse, John O'Brien, John M. Osmanski, David E. Patch, Dave Patch, David Patch, Robert M. Post, Joseph Raia, Peter Richardson, Rodney J. Roncaglio, Robert S. Rondeau, Greg Rotman, David Salk, Henry F. Schlueter, Robert J. Scott, Joseph J. Selinger, Marshal Shichtman, Scott Sieck, Solution Capital, Michael Sondow, Roger J. Steffenson, StockTransfer.com, SuperVP, Transfer Online, Inc., Valesc Medical Specialists, and Wizzard Software Corporation.

FN9. Letters from A.G. Edwards & Sons, Inc., Ameritrade, Inc., Banc of America Securities LLC, Bank Depository User Group, BNY Clearing, Cashiers' Association of Wall Street, Inc., Mark Cashion, Charles Schwab & Co., Inc., Citibank North America, Inc., Credit Suisse First Boston LLC, Edward Jones, First Clearing Corporation, Goldman, Sachs & Co., Ingalls & Snyder LLC, ING Financial Markets LLC, JP Morgan Securities, Inc., Merrill Lynch, Mizuho Trust & Banking Co. (USA), Morgan Stanley, National City Bank, National Financial Services LLC, National Investor Services Corp., Pershing LLC, Prudential Securities Incorporated, Raymond James and Associates, RBC Dain Rauscher, John Rideout, Salomon Smith Barney, Securities Industry Association, Securities Industry Association Customer Account Transfer Division, Spear, Leeds & Kellogg, State Street Corporation, Stearns Securities Corp., Sterne, Agee & Leach, Inc., Union Planters Trust & Investment Group, and USB Warburg LLC.

FN10. In addition to alleging that DTC facilitates abusive short selling, some of these commenters took issue with the Commission's regulation of DTC, broker-dealers, and other entities that the commenters believe are responsible for the problems associated with naked short selling.

FN11. Several of these commenters characterized the imbalance between the number of shares trading through short selling and the number of shares outstanding as an unregistered securities offering. Others characterized this imbalance as "counterfeiting securities." Letters from H. Glenn Bagwell, Blue Industries, Inc., James Henricks, ID Superstore, Scott Sieck, Solution Capital, and Michael Sondow.

FN12. 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.

FN13. Letters from Henry F. Schlueter, Joseph J. Selinger, and Marshal Shichtman.

FN14. 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,

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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.

FN15. Some commenters refer to allowing the transfer of certificated positions registered only in the name of the final beneficial owner as "custody-only trading."

FN16. 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.

FN17. Letters from Bruce M. Barrett, JAG Media Holdings, Inc., David E Patch, Henry F. Schlueter, Joseph J. Selinger, Marshal Shichtman, and Greg Rotman.

FN18. Letter from Henry F. Schlueter.

FN19. Letter from Marshal Shichtman. The commenter did not explain why he believed the transfer agent has an obligation to DTC.

FN20. Letters from H. Glenn Bagwell, Jr., JAG Media Holdings, Inc., John M. Osmanski, and David E. Patch.

FN21. Letters from JAG Media Holdings, Inc., John M. Osmanski, and David E. Patch.

FN22. Letter from Joseph J. Selinger.

FN23. Letters from JAG Media Holdings, Inc., David E. Patch, and Henry F. Schlueter.

FN24. Letters from JAG Media Holdings, Inc., David E. Patch, and Solution Capital.

FN25. Letters from Cristy Barrett, Jake Barrett, Joseph Meuse, David Patch, Joseph Raia, Joseph J. Selinger, StockTransfer.com, and Wizzard Software Corporation.

FN26. Letter from Joseph J. Selinger.

FN27. Letters from Aegis Assessments, Inc., Leonard W. Burningham, David E. Patch, David Salk, Joseph J. Selinger, Marshall Shichtman, StockTransfer.com, and Transfer Online, Inc.

FN28. 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

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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 block" to achieving STP or shorter settlement cycles.

FN29. Letters from A.G. Edwards & Sons, Inc., Ameritrade, Inc., Banc of America Securities LLC, Bank Depository User Group, BNY Clearing, Cashiers' Association of Wall Street, Inc., Citibank North America, Inc., Edward Jones, Ingalls & Snyder LLC, ING Financial Markets LLC, JP Morgan Securities, Inc., Merrill Lynch, Mizuho Trust & Banking Co. (USA), Morgan Stanley, National City Bank, National Financial Services LLC, National Investor Services Corp., Pershing LLC, Prudential Securities Incorporated, John Rideout, Salomon Smith Barney, Securities Industry Association, Securities Industry Association Customer Account Transfer Division, Spear, Leeds & Kellogg, State Street Corporation, Stearns Securities Corp., Sterne, Agee & Leach, Inc., Union Planters Trust & Investment Group, and USB Warburg LLC.

FN30. Letters from Ameritrade, Inc., Mark Cashion, Citibank North America, Inc., First Clearing Corporation, Merrill Lynch, Mizuho Trust & Banking Co. (USA), National Investor Services Corp., Pershing LLC, RBC Dain Rauscher, John Rideout, Salomon Smith Barney, Securities Industry Association Customer Account Transfer Division, Stearns Securities Corp., and Union Planters Trust & Investment Group.

FN31. Letter from Raymond James and Associates. According to this comment letter, Raymond James recently initiated a client certificate transfer fee as a disincentive to requesting a certificate. This fee, the commenter claims, has reduced certificate requests by 67% over the past two years.

FN32. Letters from Ameritrade, Inc., BNY Clearing, Mark Cashion, First Clearing Corporation, Mizuho Trust & Banking Co. (U.S.A.), National City Bank, National Investor Services Corp., RBC Dain Rauscher, John Rideout, and Union Planters Trust & Investment Group.

FN33. Letters from Ameritrade, Inc., BNY Clearing, Mizuho Trust & Banking Co. (USA), National City Bank, First Clearing Corporation, RBC Dain Rauscher, and Union Planters Trust & Investment Group.

FN34. Letters from First Clearing Corporation, Mizuho Trust & Banking Co. (USA), and John Rideout.

FN35. DRS allows a shareholder to hold a book-entry position in his or her own name on the books of the issuer. As a result, shareholders can enjoy the benefits of both holding their securities in a book-entry system and being a "named" shareholder on the issuer's record.

FN36. Letters from Banc of America Securities LLC, Edward Jones, Merrill Lynch,

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Pershing LLC, Prudential Securities Incorporated, RBC Dain Rauscher, Securities Industry Association Customer Account Transfer Division, Stearns Securities Corp., and Sterne, Agee & Leach, Inc.

FN37. Letters from Edward Jones, Pershing LLC, RBC Dain Rauscher, and Stearns Securities Corp.

FN38. Letters from A.G. Edwards & Sons, Inc., Banc of America Securities LLC, Prudential Securities Incorporated, and Securities Industry Account Customer Account Transfer Division.

FN39. Letter from Prudential Securities Incorporated.

FN40. Letter from A.G. Edwards & Sons, Inc.

FN41. Letter from Citibank North America, Inc.

FN42. Letter from John Rideout.

FN43. See e.g. Rules 2, 6, and 9 of DTC's Rules.

FN44. DTC also noted that none of the securities where the issuer is attempting to restrict the transferability of its shares bear any legend, conspicuous or otherwise, noting the restrictions.

FN45. 15 U.S.C. 78q-1(b)(3)(F).

FN46. 15 U.S.C. 78q-1(a)(1)(A).

FN47. 15 U.S.C. 78q-1(a)(1)(B).

FN48. 15 U.S.C. 78q-1(a)(1)(A)(i). Congress expressly envisioned the Commission's authority to extend to every facet of the securities handling process involving securities transaction within the United States, including activities by clearing agencies, depositories, corporate issuers, and transfer agents. See S. Rep. No. 75, 94th Cong., 1st Sess. at 55 (1975).

FN49. Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (October 3, 1983).

FN50. As a registered clearing agency, DTC is a self-regulatory organization and as such, must file with the Commission any proposed rule or rule change pursuant to Section 19 of the Act. 15 U.S.C. 78s(b).

FN51. Section 3(a)(27) of the Act defines the term "rules of a clearing agency." The Commission's role in the approval of such rules is described in Section 17A and Section 19(b) of the Act. 15 U.S.C. 78q-1 and 15 U.S.C. 78s.

FN52. DTC has informed the Commission that issuers of book-entry-only securities

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(i.e., some corporate debt and most municipal securities) enter into a contract with DTC whereby the issuer deposits their securities into DTC and DTC then credits the securities to the accounts of participants. See also note 55 infra and accompanying text.

FN53. See e.g. Rules 2, 6, and 9 of DTC's Rules.

FN54. See e.g. Rule 6 of DTC's Rules. All deposits, whether made by a participant or, in the case of book-entry-only securities, by an issuer must be credited to a participant's account at DTC.

FN55. See e.g. Rules 2, 6, and 9 of DTC's Rules.

FN56. See e.g. Rule 6 of DTC's Rules, By-Laws and Organization of Certificate.

FN57. Some commenters argued that because some issuers sign an Operating Agreement or Letter of Representation with DTC in order to make their shares eligible at DTC, they should retain the right to withdraw their securities. DTC has informed the Commission that as a general rule only those issuers who issue in "book-entry-only" form (i.e., certain debt and municipal securities where no certificate is available) sign an Operating Agreement with DTC. Furthermore, DTC's Underwriting Service Guide, which describes DTC's eligibility requirements and deposit process, makes clear that generally only issuers of book-entry-only securities must execute a Letter of Representation to make the securities eligible for deposit. Since most equity securities make certificates available, participants make most deposits of securities into DTC.

FN58. A short sale is generally a sale of a security that the seller does not own or as effectuated by the delivery of borrowed securities within the required settlement timeframe. Although the Commission notes that a "naked short sale" is not a defined term, it generally refers to where a seller sells a security without owning or borrowing the security and does not deliver when delivery is due.

FN59. DTC participants holding securities on behalf of a customer are generally obligated to act pursuant to their customers' instructions.

FN60. See Rhino Advisors, Inc. and Thomas Badian: Lit. Rel. No. 18003 (February 27, 2003); See also SEC v. Rhino Advisors, Inc. and Thomas Badian, Civ. Action No. 03 civ 1310 (RO) (Southern District of New York).

FN61. One commenter questioned how AT&T could choose to dematerialize but other issuers cannot choose to issue in certificated form only. AT&T is incorporated in the State of New York and trading on the New York Stock Exchange ("NYSE"). New York law permits companies to issue in book-entry-only and NYSE rules permit listed companies to not offer certificates provided the issuer is participating in DRS pursuant to NYSE rules. However, prior to AT&T dematerializing, the vast majority of AT&T's stock was immobilized at DTC in order to facilitate book-entry transfers at DTC. Only individuals holding certificates were practically

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effected by AT&T's decision to dematerialize.

FN62. We note that in the late 1960s and early 1970s, the securities industry experienced a "Paperwork Crisis" that nearly brought the industry to a standstill and directly or indirectly caused the failure of large number of broker-dealers. This crisis primarily resulted from increasing trade volume coupled with inefficient, duplicative, and extensively manual clearance and settlement systems particularly with securities certificates, poor records, and insufficient controls over funds and securities. Securities and Exchange Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92nd Cong., 1st Sess. 13 (1971). Congress held extensive hearings to investigate the problems and ultimately enacted the Securities Acts Amendments of 1975. Securities Acts Amendments of 1975: Hearings on S. 3412, S. 3297, S. 2551 Before the Subcomm. On Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 92nd Cong., 2nd Sess. (1972).

FN63. 15 U.S.C. 78q-1(e). See also supra note 46 and accompanying text.

FN64. Securities Exchange Act Release No. 32455 (June 11, 1993), 58 FR 33679 (June 18, 1993)(order approving rules requiring members, member organizations, and affiliated members of the New York Stock Exchange, National Association of Securities Dealers, American Stock Exchange, Midwest Stock Exchange, Boston Stock Exchange, Pacific Stock Exchange, and Philadelphia Stock Exchange to use the facilities of a securities depository for the book-entry settlement of all transactions in depository-eligible securities with another financial intermediary).

FN65. Securities Exchange Act Release No. 35798 (June 1, 1995), 60 FR 30909 (June 12, 1995)(order approving rules setting forth depository eligibility requirements for issuers seeking to have their shares listed on the exchange).

FN66. DRS provides an investor with the ability to register her securities in her own name on the issuer's records and to efficiently transfer by book-entry movements her securities positions to her broker. Using DRS, an investor can register a position directly with the issuer and can electronically move the position to a broker of choice for disposition within the current settlement timeframes as well as within any future shortened settlement cycle.

FN67. 17 CFR 200.30-3(a)(12).
Release No. 47978, Release No. 34-47978, 2003 WL 21288541 (S.E.C. Release No.)
END OF DOCUMENT

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EXHIBIT B

Release No. 47365, Release No. 34-47365, 79 S.E.C. Docket 1861
(Cite as: 2003 WL 329042 (S.E.C. Release No.))

S.E.C. Release No.

*1 Securities Exchange Act of 1934

SELF-REGULATORY ORGANIZATIONS; THE DEPOSITORY TRUST COMPANY; NOTICE OF FILING OF PROPOSED RULE CHANGE CONCERNING REQUESTS FOR WITHDRAWAL OF CERTIFICATES BY ISSUERS

File No. SR-DTC-2003-02

February 13, 2003

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), [FN1] notice is hereby given that on February 3, 2003, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") and on February 11, 2003, amended the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by the DTC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The purpose of the proposed rule change is to clarify that DTC will only honor requests for withdrawal of certificates submitted by its participants and not by the issuer of the securities.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, DTC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements. [FN2]

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Recently a number of issuers of securities have requested that DTC exit from the depository all securities of their issues ("Issuer Withdrawal Request" or "Issuer Withdrawal Requests"). The issuers have also advised DTC that they will refuse to reregister any securities into the name of DTC or its nominee, Cede & Co. These issuers have no legal or beneficial interest in the securities they are requesting to be exited from DTC. The securities at issue generally became eligible for DTC services at the request, or for the convenience, of DTC's participants who wish to utilize DTC's book-entry transfer system. The subject

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securities are held by DTC for the benefit of its participants.

DTC's current rules and procedures permit participants to submit withdrawal requests if they wish to withdraw their securities from DTC. However, DTC's current rules and procedures do not provide for DTC to comply with an Issuer Withdrawal Request without participants' instructions. Through the proposed rule filing, DTC is seeking to clarify the procedures that it will follow upon receiving an Issuer Withdrawal Request. Upon receipt of an Issuer Withdrawal Request, DTC will, among other things:

. Issue an "Important Notice" notifying participants of the receipt of the Issuer Withdrawal Request and reminding participants that they can utilize DTC withdrawal procedures if they wish to withdraw their securities from DTC.

*2 . Notify the transfer agent for the issuer 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, such as DTC's Operational Arrangements.

. Process in the ordinary course of business withdrawal requests submitted by participants and refuse to effectuate withdrawals based upon the Issuer Withdrawal Request.

Since this is a clarification of DTC's rules and procedures, 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. [FN3]

DTC believes that the proposed rule filing is consistent with Section 17A of the Act and the rules and regulations thereunder because it will promote the prompt and accurate clearance and settlement of securities transactions

(B) Self-Regulatory Organization's Statement on Burden on Competition

DTC does not believe that the proposed rule change will have an impact on or impose a burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

DTC has discussed the substance of this proposed rule change with various DTC participants and industry groups and has received favorable reaction.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-DTC-2003-03. This file number should be included on the subject line if e-mail is used. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549 Copies of such filing also will be available for inspection and copying at the principal office of the DTC. All submissions should refer to File No. SR-DTC-2003-03 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

*3 For the Commission by the Division of Market Regulation, pursuant to delegated authority. [FN4]

Margaret H. McFarland
Deputy Secretary

FN1. 15 U.S.C. 78s(b)(1).

FN2. The Commission has modified the text of the summaries prepared by the DTC.

FN3. The proposed rule filing is not applicable to securities that may not legally be held at DTC (e.g., securities restricted pursuant to Rule 144 or Rule 145 under the Securities Act of 1933).

FN4. 17 CFR 200.30-3(a)(12).

Release No. 47365, Release No. 34-47365, 79 S.E.C. Docket 1861, 2003 WL 329042 (S.E.C. Release No.)
END OF DOCUMENT

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EXHIBIT C

FILED

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...S WILSON CLERK

BY ___ DEPUTY

U.S. DISTRICT COURT DISTRICT OF NEVADA ENTERED & SERVED

SEP - 8 2003

CLERK, U.S. DISTRICT COURT

BY ___ DEPUTY

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA
RENO, NEVADA

GENEMAX CORP., a Nevada corporation,

Plaintiff,

vs.

KNIGHT SECURITIES, LP, a limited partnership, et al.,

Defendants.

CV-N-02-0509-ECR (RAM)

ORDER

We now consider defendants Knight Securities, L.P., vFinance Investments, Inc., Charles Schwab & Co., Inc., and Hill Thompson Magid, L.P.'s (the "Defendants") motion to dismiss (#30).[1] Defendants North American Institutional Brokers (#55), M.H. Meyerson & Co., Inc. (#63), Program Trading Corporation (#64) and Richard Alter (#72) joined in the motion to dismiss (#30). Plaintiff GeneMax Corporation ("Plaintiff") opposed the motion (#58), and the Defendants replied (#71).

[1] Defendants iClearing, LLC, Ameritrade, Inc. and Wm. V. Frankel & Co. also brought this motion but were subsequently dismissed by stipulation from this suit. (See ##83 & 101).

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BACKGROUND[2]

Plaintiff is a publicly traded company. Its shares of common stock are traded in the over-the-counter market under the symbol GMXX. Plaintiff alleges that the Defendants have engaged in unlawful "naked" short sales of GMXX stock to third parties not involved in this litigation. In making these sales, Plaintiff claims that the Defendants engaged in fraudulent and misleading conduct, which has artificially manipulated the price of the GMXX stock. This, Plaintiff concludes, has resulted in the stock's dilution and devaluing. Plaintiff does not allege that it either purchased or sold GMXX stock at a price affected by the Defendants' alleged conduct.

On November 21, 2002, Plaintiff filed a First Amended Complaint (#16) (the "Complaint") stating causes of action under Sections 9 and 10 of the Exchange Act of 1934, Section 12(a)(2) of the Securities Act of 1933 and the Racketeer Influenced and Corrupt Organizations Act. The Complaint also contains various state common law and statutory claims. The Defendants' Motion to Dismiss (#30) seeks dismissal of Plaintiff's complaint pursuant to Fed. R. Civ. P. 12(b)(6). For the reasons stated below, we conclude that the complaint should be dismissed.

STANDARD

A motion to dismiss under Fed. R. Civ. P. 12(b)(6) will only be granted if it appears beyond doubt that "plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Lewis v. Telephone Employees Credit Union, 87 F.3d 1537, 1545 (9th

[2] For purposes of this order, we take the allegations in Plaintiff's First Amended Complaint (#16) as true.

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Cir. 1996). The review is limited to the complaint, and all allegations of material fact are taken as true and viewed in the light most favorable to the non-moving party. In re Stac Electronics Sec. Litig, 89 F.3d 1399, 1403 (9th Cir. 1996). However, although courts generally assume the facts alleged are true, courts do not "assume the truth of legal conclusions merely because they are cast in the form of factual allegations." Western Mining Council v. Watt, 643 F.2d 618 (9th Cir. 1981).

Dismissal for failure to state a claim is proper only if it is clear that no relief may be granted under any set of facts that could be proved consistent with the allegations of the complaint. Argabright v. U.S., 35 F.3d 472, 474 (9th Cir. 1994). In other words, we must determine whether, if the factual averments of the complaint were proved, they would establish a cause of action. Id.; National Wildlife Federation v. Espy, 45 F.3d 1337, 1340 (9th Cir. 1995). All allegations of material fact are taken as true and construed in the light most favorable to plaintiff. In re Stac Electronics Sec. Litig., 89 F.3d 1399, 1403 (9th Cir. 1996). Review is limited to the contents of the complaint; if matters outside the pleadings are submitted, the motion to dismiss may be treated as one for summary judgment if the district court relies on the materials. Anderson v. Angelone, 86 F.3d 932, 934 (9th Cir. 1996); Allarcom Pay Television, Ltd. v. General Instrument Corp., 69 F.3d 381, 385 (9th Cir. 1995). On a motion to dismiss, "we presume that general allegations embrace those specific facts that are necessary to support the claim." Lujan v. Defenders of Wildlife, 504 U.S. 555, 561 (1992) (internal quotation marks and citation omitted). However, conclusory allegations and

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1 unwarranted inferences are insufficient to defeat a motion to dismiss.
2 In re Stac Electronics Sec. Litig., 89 F.3d at 1403.

3 **ANALYSIS**

4 **I. Section 9(e) of the Exchange Act**

5 Plaintiff's Third Claim for Relief alleges that the Defendants'
6 naked short sales of GMXX stock violated Section 9 of the Exchange Act
7 of 1934, 15 U.S.C. § 78i.

8 Section 9 prohibits a variety of activities that artificially
9 manipulate the price of securities. See 15 U.S.C. § 78i(a). Section
10 9(e) grants a private civil remedy to investors injured as a result
11 of such manipulative conduct. 15 U.S.C. § 78i(e). Individuals who
12 violate Section 9, though, are liable only to persons "who [] purchase
13 or sell any security at a price which was affected by such act or
14 transaction." Id.; 2 Thomas Lee Hazen, Treatise on the Law of
15 Securities Regulation § 12.1[4][A] (4th ed. 2002 & 2003 Pocket Part)
16 ("Section 9 requires that the plaintiff's injury arise out of the
17 purchase or sale of a manipulated security."). All others lack
18 standing to sue under Section 9(e).

19 The Complaint in this case does not allege that Plaintiff bought
20 or sold GMXX stock at a price affected by the Defendants' alleged
21 misconduct. For this reason, the Complaint fails to show that
22 Plaintiff has standing to sue under Section 9(e), and the Third Claim
23 for Relief alleging violations of Section 9(e) must be dismissed.
24 Lowe v. Salomon Smith Barney, Inc., 206 F. Supp. 2d 442, 445 (W.D.N.Y.
25 2002) (dismissing the plaintiff's claim under Section 9(e) because the
26 complaint did not allege that the security was purchased or sold at
27 a price affected by the alleged manipulation).
28

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Plaintiff's Section 9(e) claim is deficient for another reason as well. The GMXX stock at issue in this case is traded in the over-the-counter market. Section 9(e), however, applies exclusively to securities "registered on a national securities exchange." 15 U.S.C. § 78i. Courts consistently hold that the over-the-counter market does not constitute a "national securities exchange" within the meaning of Section 9. E.g., Cowen & Co. v. Merriam, 745 F. Supp. 925, 931 (S.D.N.Y. 1990) ("[C]ounts nine and seventeen of the complaint are dismissed because the Court finds that NASDAQ is not a 'national securities exchange' within the meaning of § 9(a)."). Consequently, the Complaint fails to state a claim pursuant to Section 9(e).

II. Section 10(b) of the Exchange Act and Rule 10b-5

Plaintiff's Third Claim for Relief also alleges violations of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5.

Section 10(b) makes it "unlawful for any person . . . [t]o use or employ . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). In accordance with this section, the Securities and Exchange Commission promulgated Rule 10b-5, which forbids any "artifice to defraud," any "untrue statement of a material fact," any omission of a material fact, or "any act, practice, or course of business which operates or would operate as a fraud or deceit . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5. As with Section 9(e) above, "[o]nly a purchaser or seller of securities has standing to bring an action under section 10(b) and Rule 10b-5." Binder v. Gillespie, 184 F.3d

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1 1059, 1066 (9th Cir. 1999) (citing Blue Chip Stamps v. Manor Drug
2 Stores, 421 U.S. 723, 749 (1975)).
3 Once again, because Plaintiff has not alleged that it was a
4 purchaser or seller of the GMXX stock involved in the alleged naked
5 short sales, it has not shown that it has standing to sue under
6 Section 10(b) and Rule 10b-5. Accordingly, Plaintiff's Third Claim
7 for Relief alleging violations of those provisions is dismissed. See
8 2 Hazen, supra, § 12.7[1] ("[F]ailure to plead facts demonstrating
9 compliance with the purchaser/seller standing requirement will result
10 in dismissal of the Rule 10b-5 claim.").
11 **III. Section 12(a)(2) of the Securities Act**
12 Plaintiff's Fourth Claim for Relief alleges that the Defendants
13 made improper misrepresentations and omissions regarding the GMXX
14 stock in violation of Section 12 of the Securities Act of 1933, 15
15 U.S.C. § 77l.
16 Section 12(a)(2) of the Securities Act creates a civil remedy for
17 material misstatements or omissions of fact in connection with the
18 sale or offer for sale of a security. 15 U.S.C. § 77l(a)(2). Only
19 certain individuals have standing to sue under this section, however.
20 First, a defendant who violates Section 12(a)(2) is liable solely "to
21 the person purchasing [the] security from him." 15 U.S.C. § 77l(a).
22 The courts have interpreted this phrase as imposing an explicit
23 requirement of privity between the plaintiff and defendant. Hertzberg
24 v. Dignity Partners, Inc., 191 F.3d 1076, 1081 (9th Cir. 1999).
25 Second, "a suit under Section 12 may only be maintained by a person
26 who purchased the stock in the [public] offering under the
27 prospectus." Id. at 1080 (citing Gustafson v. Alloyd Co., 513 U.S.
28

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561 (1995)); see also Stack v. Lobo, 903 F. Supp. 1361, 1375 (N.D. Cal. 1995) (explaining that a claim can be made under Section 12(a) "by those who purchased securities in a public offering and by those whose securities are traceable to the public offering"). This public offering limitation effectively prohibits suits pursuant to Section 12 "for transactions occurring in the after-market regardless of whether those transactions are privately negotiated or take place in the public markets." 1 Hazen, supra, § 7.6[2][A].

The Complaint in the present cause does not allege that Plaintiff purchased securities from the Defendants in a public offering. Rather, the improper conduct attributed to the Defendants stems from claimed naked short sales of GMXX stock to third parties in the over-the-counter market. Consequently, the Complaint fails to establish that Plaintiff has standing to sue under Section 12(a) of the Securities Act, and dismissal of the Fourth Claim for Relief is proper.

IV. RICO Claim

Plaintiff's Tenth Claim for Relief asserts that the Defendants have engaged in racketeering in violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968.

To state a civil RICO claim, a plaintiff must allege "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity (5) causing injury to [the] plaintiff's 'business or property.'" Ove v. Gwinn, 264 F.3d 817, 825 (9th Cir. 2001) (citing 18 U.S.C. § 1964(c)). Section 1961(1) expressly includes "fraud in the sale of securities" as a predicate act constituting racketeering activity. 18 U.S.C. § 1961(1). However, the civil remedy under RICO

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1 was restricted by the Private Securities Litigation Reform Act of
2 1995, Pub. L. No. 104-67, § 107, 109 Stat. 737, 758 (1995) (the
3 "PSLRA"). Now, "no person may rely upon any conduct that would have
4 been actionable as fraud in the purchase or sale of securities to
5 establish a violation of section 1962." 18 U.S.C. § 1964(c). This
6 limitation is inapplicable, though, "to an action against any person
7 that is criminally convicted in connection with the [securities]
8 fraud." Id.

9 Plaintiff argues that this amendment does not apply to its case
10 because the complaint alleges common law causes of action for fraud
11 and misrepresentation along with securities fraud claims. These
12 common law claims, Plaintiff asserts, constitute the predicate acts
13 for its RICO claim. Section 1964(c)'s language does not support
14 Plaintiff's argument.

15 In Howard v. America Online Inc., 208 F.3d 741, 749 (9th Cir.
16 2000), the plaintiffs argued that the PSLRA's RICO limitation did not
17 apply to their suit because they lacked standing to bring a securities
18 fraud claim. The Ninth Circuit noted that § 1964(c) "proscribes using
19 as a predicate 'any *conduct* that would have been actionable as
20 securities fraud." Id. (quoting § 1964(c)). It did not matter that
21 the plaintiffs could not in fact bring a securities fraud claim.
22 Rather, because the defendants' alleged conduct constituted securities
23 fraud the conviction requirement barred the plaintiffs' RICO claim.

24 As in Howard, Plaintiff here strenuously argues that the
25 Defendants' conduct constitutes securities fraud. Id. And, the same
26 alleged conduct forms the basis for Plaintiff's securities fraud and
27 common law fraud and misrepresentation claims. Consequently, the
28

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1 Plaintiff's fraud and misrepresentation claims "implicate 'conduct
2 that would have been actionable as securities fraud' and section
3 1964(c) bars their use as RICO predicates." Id. (quoting § 1964(c)).
4 As one authority explained, "[i]t would be a subversion of the
5 Congressional intent to permit a plaintiff to couch a RICO claim
6 involving securities in common law or wire fraud in order to
7 circumvent the conviction requirement." 4 Hazen, *supra*, § 22.3[2].
8 Therefore, Plaintiff's RICO claim must be dismissed.[3]

9 **CONCLUSION**

10 For the reasons outlined above, we find that Plaintiff's causes
11 of action based on (1) Section 9 of the Exchange Act; (2) Section 10
12 of the Exchange act and Rule 10b-5 promulgated thereunder; (3) Section
13 12(a)(2) of the Securities Act; and (4) the RICO statute, should be
14 dismissed pursuant to Fed. R. Civ. P. 12(b)(6). Because all of
15 Plaintiff's federal claims have been dismissed, we decline to exercise
16 jurisdiction over the remaining state-law claims and those claims are
17 also dismissed.

18 Finally, we note that plaintiff has requested leave to amend its
19 complaint to cure any deficiencies found by the court. (Plaintiff's
20 Opposition to Defendants' Motion to Dismiss (#58) at 30). Although
21 leave to amend is typically freely given under Fed. R. Civ. P. 15(a),
22 Plaintiff has offered no explanation as to how the complaint might be
23 amended to remedy the deficiencies addressed by this order.

24

25 [3] Although we need not reach these issues, we note parenthetically that the Complaint appears to be deficient in numerous other areas. For example,
26 it does not appear to plead the allegations of fraud with the particularity required by Fed. R. Civ. P. 9(b). Also, there is scant information
27 regarding the nature of the alleged enterprise that engaged in conduct violative of the RICO statute.

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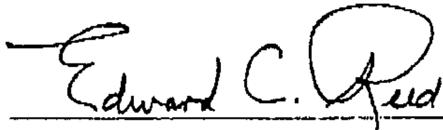
Consequently, based on the pleadings before us, we see no basis for granting leave to amend, and decline to do so.

IT IS, THEREFORE, HEREBY ORDERED that, as addressed above, the Defendants' Motion to Dismiss (#30) and the Joinders thereto (##55, 63, 64 & 72) are **GRANTED**. Plaintiff's First Amended Complaint (#16) is **DISMISSED** in its entirety as to the said Defendants.

IT IS FURTHER ORDERED that, in light of this order, the hearing set for September 15, 2003, on the Motion to Dismiss (#30) and the Joinders (##55, 63, 64 & 72) is **VACATED**.

DATED: September 5, 2003.



UNITED STATES DISTRICT JUDGE

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