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Summary of Remarks of Steven G. Nelson, Chairman and President of Continental Stock Transfer & Trust Company, Before the Southern California Investment Association on October 2, 2004

INTRODUCTION

Continental Stock Transfer & Trust Company ("Continental") is pleased to be a sponsor of the Southern California Investment Association, and appreciate the opportunity to address the bi-monthly Association meeting.

Problems Associated with the Recent Influx of "Naked Short Selling and Bear Raids"

As many of you are aware, there have been, over the last several years, numerous instances of "bear raids," i.e., "naked short selling" in a coordinated fashion by affiliated market makers and brokers to attack the stock of a designated issuer. This coordinated short selling has been effective and successful over and over again in savaging the stock of both worthy and unworthy public companies. The bear raiders are assisted in their manipulation by the repeated lending and re-lending of margin securities among brokers, often with the complicity of DTC. While DTC is apparently prohibited from lending and re-lending securities under their charter, recent deposition testimony in pending litigations suggest that this practice has been rampant. There are pending class action lawsuits against both the raiders and DTC relative to scores of different stocks and the billions of dollars lost in market capitalization.

Indeed, it has been rumored for many months on various internet sites that NBC's *Dateline* has prepared an extensive piece on this entire issue. While it was apparently near finalization months ago, it has apparently been held up, either for political reasons, or other reasons. It is expected to be broadcast in the forthcoming weeks. Stay tuned.

The response of issuers who have been subject to these bear raids has been to try and "flush out" the bears by forcing them to certificate their ownership positions. In this endeavor, issuers have employed various artifices, including reverse mergers, reverse splits, stock dividends, etc. When these proved ineffective, some ingenious issuers enacted bylaws which precluded the registration of their certificates in the name of a depository, such as DTC. These issuers voluntarily delisted from DTC and the DTC FAST program and attempted to force each brokerage firm to separately certificate their positions. It was their feeling that by removing shares from the uncertificated, electronic DTC system that the naked shorts would be required to buy in their shares.

Unfortunately, when the "800 pound gorilla" at DTC became aware of this emerging trend, they felt that these potential delistings were a threat to their ongoing business. Moreover, of course, DTC is owned by all of the large banks and brokers, and, therefore, has a certain affinity for the brokerage community side of this argument. In typical fashion, DTC went straight to the SEC to complain about these issuer delistings. DTC's argument was that such delistings, with the related increases in certificated shares, was inconsistent with the SEC's longstanding goal of promoting the immobilization and dematerialization of physical stock certificates.

In fact, DTC filed for a rule change in February, 2003, the effect of which was to make it illegal for issuers to themselves voluntarily delist from the DTC FAST program. The SEC approved the rule change in June, 2004, over the objections of many commentators who took the position that the proposed rule would tend to promote bear raids and thereby reward market manipulators at the expense of issuer victims.

In quarterly meetings between the STA Board and the Commission, the Commission seemed unpersuaded by this argument, and instead seemed to conclude that the issuer targets were unworthy companies who were ripe for the picking. In essence, the Commission was opting for an economic Darwinism in approaching this issue.

Earlier this year, the Commission passed new rules designed to more effectively regulate short sales; but the effectiveness of the rules is open to question. Amazingly, the Commission has also formulated rules which will penalize issuers who seek to delist their shares from a depository and will make it illegal for any transfer agent to handle the securities of any such delisted issuer. Accordingly, unless the new SEC rules prove effective, it is unlikely that the issuer targets themselves will be able to formulate an effective strategy to combat such bear raids.
If you require further information in this area, or wish to express your views, please let me know so that I can provide you with the appropriate contact information at the SEC.

Legal Issues Facing Small Public Companies

It is our experience at Continental that small public companies face a number of troublesome legal issues on a recurring basis relating to their transfer agent and their outstanding stock. In the first instance, it is important to note that almost all such issues revolve around Article 8 of the Uniform Commercial Code (Article 8) which has been adopted by all fifty states. Article 8 regulates issuers and equates the obligation of issuers with those of its transfer agent under Section 8-407.

In our experience, there are three basic areas which present litigation exposure to public companies:
1. The failure/refusal by an issuer to remove restrictive legends;
2. The issuance of unlegended restricted shares, and
3. Adverse claims.

The overriding principal that appears in many of these cases is that enunciated in Article 8, to the effect that restrictions not reflected on the face of a certificate are ineffective against a good faith purchaser for value. That is what Article 8 states, and this principal creates troublesome issues in the three basic areas outlined above.

With regard to the failure or refusal of an issuer to remove a restrictive legend, the relevant case law (*Bender vs. Memory Metals* and *AST vs. Pantheon*) make very clear that an issuer cannot itself, or through its counsel, hold up a restricted transfer by refusing to issue an opinion for no good reason. If an issuer engages in a delaying tactic or refuses an opinion for no good reason, the transfer agent should, under relevant case law, put the issuer's feet to the fire and demand, in writing, the grounds for their refusal. Failing receipt of such grounds, the transfer agent may be forced to rely upon the opinion of the presenter's own counsel and will, in all likelihood, effectuate the transfer without the approval of the issuer.

Similarly, issuers often face problems when they seek to impede transfer of securities which do not bear a restrictive legend, but which the issuer feels are subject to restrictions. This may arise in the case of unvested shares, or it may relate to shares which were previously issued to finders, or other vendors, who the issuer now contends did not provide their promised services. The relevant case law makes it very clear that the transfer agent has no alternative but to transfer shares presented in proper transfer order in these circumstances. The issuer cannot impede such a transfer and must, instead, commence a lawsuit to perfect its claim.

Finally, the same type of analysis usually applies in the case of an "adverse claim," particularly where the issuer itself attempts to impede the transfer of shares by suggesting that the issuer is entitled to the shares, or that the shares were never previously earned and issued. *Bender vs. Memory Metals* makes it very clear that an issuer cannot be an adverse claimant and must always maintain its neutrality with regard to its shareholders. In such circumstances, the general rule applies that restrictions not on the face of a certificate are ineffective against a good faith purchaser for value. In order for the issuer to establish that the presenter is not a good faith purchaser, the issuer will, in all likelihood, be forced to commence a litigation. What is clear is that the transfer agent will not be able to hold up the transfer and the issuer will then be forced to sue for damages after the fact, unless they are able to obtain a temporary restraining order or preliminary injunction before the requested transfer is effectuated.

In this area, there are two basic rules which apply to issuers and transfer agents alike:
1. Don't hold certificates in your possession when they have been presented in proper transfer order. If you do, you will be subject to fluctuations in the market, which are likely to be very costly.
2. "No good deed goes unpunished." Neither the issuer, nor its transfer agent, should make promises that they cannot keep when dealing with shareholders, as they will often come back to haunt you. If in doubt, the transfer agent should demand that the adverse claimant obtain a surety bond or court order, and, failing that, the transfer agent and issuer can attempt to interplead a contested proposed transfer. However, be forewarned that in many cases an interpleader action does not cut off liability for a transfer agent or the issuer.

Accordingly, it is clear that small public companies are continuously facing numerous legal issues which can often create serious litigation exposure. The typical response of small public companies is to try and get their transfer agent to restrict the flow of securities, not realizing that this exposes both the issuer and the transfer agent to significant liability. The far better course, absent an appropriate legal reason to delay a transfer, is to permit the transfer to go through and thereafter obtain damages through the courts.

Specialized Services Offered by Continental to Small and Medium-Sized Companies

Continental is a family-owned, privately held transfer agent now celebrating its 40th year in business. We represent more than 1,100 public issuers, aggregating more than 1.5 million shareholder accounts.

All of our operations are located in downtown Manhattan, New York City within several blocks of the NYSE, NASDAQ, and The Depository Trust Company ("DTC"). We employ approximately 100 people whose average experience exceeds fifteen years in the business. Continental specializes in servicing small and medium-sized issuers and handles issuers all over the country, including numerous companies in Hawaii and scores of issuers in California.

While there are literally hundreds of stock transfer agents located around the country, the industry has consolidated dramatically in the past twenty years so that there are only ten or less significant agents left. Most of the large bank agents have decided to exit the business over the past two decades. None of the large agents have headquarters west of the Mississippi; and the result is that many issuers in this area are represented by stock transfer agents who are small, inexperienced, and not of the highest caliber. In particular, most of these smaller agents are not fully automated, do not offer internet shareholder servicing to shareholders and issuers, and are not electronically hooked into the DTC FAST System which allows for electronic transfers via DWAC's of option exercises, originally issued stock, etc.

Continental has, in the past several years, focused its attention on the West Coast, and on California issuers in particular. We believe that this area is under-served in the transfer agent industry and we are committed to offering a level of service that is simply unavailable on the West Coast from our other competitors, large and small.

While Continental currently handles a number of large high-profile issuers, such as Southwest Airlines Co., Energizer Holdings, Inc., Denny's Corporation, Pioneer Natural Resources Company, etc., our core business is for small and medium-sized issuers. In particular, we have handled more than 800 public offerings in the past fifteen years, which have included WebEx Communications, Inc., Leapfrog Enterprises Inc., Peet's Coffee & Tea Inc., Corcept Therapeutics, Inc., DOV Pharmaceuticals, Inc., iVillage, Inc., The MacReport.net, Inc., Juno Online Services, Inc. and NetRatings, Inc. We have been able to provide these companies greater IPO expertise, coupled with seamless execution in a fully electronic environment.

Continental is a member of the Securities Transfer Association ("STA"), and I sit on the Board of Directors and have chaired the Legal Committee of the STA. In doing so, I have used my background as a lawyer who has worked in a large Wall Street firm, and as a federal prosecutor. The STA meets quarterly with the Securities and Exchange Commission ("SEC") to stay abreast of pending regulatory changes, which now include proposed transfer agent regulations which will be released for comment shortly. These proposed regulations will have a significant impact on the transfer agent industry, particularly with regard to insurance and capital requirements for small, inexperienced agents. As a result, many of these agents will be forced to either adapt or to sell their businesses.

What Could a Transfer Agent Do for a Small Company – Either Private or Public?

In general, a transfer agent handles all shareholder recordkeeping functions, and in doing so, basically takes over the entire interface between an issuer and its shareholders. This role encompasses facilitating issuance of stock certificates, keeping shareholder records, paying cash and stock dividends, sending out mailings to shareholders, as well as handling the entire annual meeting, from the initial mailing of proxy materials through tabulation and attendance at the annual meeting. What we, at Continental, have found out over the past several years is that many small issuers, mostly private and looking to go public, have a great deal of difficulty handling their shareholder records at these early stages. They typically do not possess in-house shareholder relations expertise, and, therefore, much of the recordkeeping and interface are typically defaulted to outside company counsel. Generally, outside counsel is not expert in keeping shareholder records and charges lawyer or paralegal time to handle what should be a far less costly enterprise. They simply do not possess the software and systems to handle these records and the result is that the issuer is poorly served.

In particular, Continental has developed a program where small companies, both private and public, can have their shareholder records maintained in a digitized, uncertificated environment. Instead of having certificates sent out to shareholders, which will later have to be called in for recapitalizations, legending, and/or CUSIP changes after a public offering, the program at Continental offers to send periodic statements to shareholders reflecting their holdings. At the same time, all of the shareholder records are kept at Continental and are adjusted to meet the requirements of reverse splits, forward splits, lock-up agreements, etc.

There are many advantages to this digitized, uncertificated recordkeeping environment. In the first instance, it avoids the issue of lost certificates, which are time consuming and expensive to replace. Shareholders are often resentful when they are faced with the 2% cost of bonding a replacement through a surety company. Moreover, particularly when an IPO is impending, time is of the essence, and these transactions divert the attention of both shareholders and key issuer personnel.

Secondly, when splits are effectuated, or there are simultaneous conversions of preferred stock, notes, or warrants at the time of the public offering, these types of transactions can be effectuated immediately without the need to call in certificates and handle the paperwork in each such exchange.

Finally, if 144 legends or lock-up legends need to be affixed to certificates or shareholder records, this can be done far more easily in an uncertificated environment at the time of the public offering. Once the IPO has been consummated, the agent can easily issue certificates with appropriate legends and a CUSIP number to all shareholders requesting a physical stock certificate.

In conclusion, uncertificated shares are a great answer for small companies, particularly those looking to go public. The cost of keeping these records through a fully automated transfer agent is small (probably $200-$300 per month for pre-public companies), and the result is an absolutely safe environment with easy shareholder replacements, instantaneous recapitalizations, and a fool-proof method of taking care of restrictions to allow for issuer control. Moreover, with a fully integrated and automated agent such as Continental, the issuer and its shareholders can have Internet access to their records, which would allow for downloading of information at the desk of the individual shareholder, investor, or issuer. The foregoing analysis leads to the conclusion that if you are a small public issuer looking to go public, you should get yourself a fully automated transfer agent in the early stages, and, of course, make sure it is the right transfer agent, i.e., Continental.

Continental Stock Transfer & Trust Company stands ready to assist you in providing cutting-edge services and expertise, which are simply unavailable elsewhere in this market. We appreciate the opportunity to appear before the SCIA, and look forward to many years of our continued sponsorship of this exceptional organization.

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