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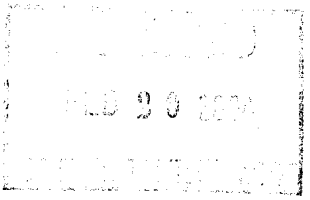

S7-23-03

February 13, 2004

Sent Via Federal Express
Jonathan G. Katz, Esquire
Secretary
United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Second Comment Letter of Greenwood Partners, LP on File No. S7-23-03; Exception to Proposed Rule 203 (locate and delivery requirements) for Short Sales Fully Hedged by Certain Public Company Issued Warrants and Rights

Dear Mr. Katz:

Saul Ewing LLP is pleased to submit this second comment letter on behalf of Greenwood Partners, LP ("Greenwood") on the above referenced filing.[1] In Greenwood's first comment letter, Greenwood recommended that the Commission amend proposed Rule 203 regarding "locate and delivery requirements" to provide for an exception from such requirements for short sales fully hedged by certain public company issued warrants and rights ("Bona Fide Hedge Exception"). Greenwood advised that the Bona Fide Hedge Exception is integral to capital raising for small companies, and is necessary to address particular challenges in borrowing securities of such companies by those such as Greenwood which support capital raising

[1] Letter to Jonathan G. Katz, Esq., Secretary, SEC, from William W. Uchimoto, Saul Ewing LLP, on behalf of Greenwood Partners, LP, dated January 5, 2004.

initiatives. Greenwood noted that the Bona Fide Hedge Exception is derived from a well-defined structure established in NASD Rules 3370 and 11830.

Summary and Purpose of Greenwood's Second Comment Letter

The purpose of this second letter is to examine, recount and refresh the Commission's record regarding the efficacy of the Bona Fide Hedge Exception in light of the substantial regulatory review process that already has transpired in promulgation and prolonged maintenance of the Exception. Greenwood also alerts the Commission that an academic study is underway by Walt Schubert, Ph.D., a professor of finance at LaSalle University in Philadelphia. Professor Schubert's preliminary view is that the Bona Fide Hedge Exception creates important small cap marketplace "benefits in the areas of volatility, price discovery and capitalization and, properly followed, the Exception cannot lead to short selling abuse since the short-sell position is at least fully hedged (delta neutral) by the long position in convertible securities."

History and Background of the Affirmative Determination Requirements (NASD Rule 3370) and the Specified Exceptions

In the fall of 1985, the NASD retained Irving M. Pollack, former Commissioner of the Securities and Exchange Commission, to conduct a comprehensive study of short selling practices in the over-the-counter securities market. Mr. Pollack submitted his study to the NASD in July 1986. See Irving M. Pollack, *Short-Sale Regulation of NASDAQ Securities*, July, 1986 ("Pollack Study").

Following the Pollack Study, on September 5, 1986, the Commission approved an NASD rule that, among other things, imposed an "affirmative determination requirement" upon customers, thereby requiring an NASD "member accepting a 'short' sale order from a customer to make an affirmative determination that it will receive delivery of the security from the customer or that it can borrow the security on behalf of the customer for delivery by settlement date." See SR-NASD-86-17, Release No. 34-23572 (September 5, 1986).

Thereafter, on July 12, 1990, the Commission extended the affirmative determination requirements to NASD members effecting short sales for their own account. The Commission also approved express exceptions from such member account trading requirements for transactions: "(1) [i]n corporate debt securities, (2) for bona fide market transactions by a member (A) in NASDAQ securities for which it is registered as a NASDAQ market maker, and (B) in non-NASDAQ securities for which it publishes a two-side quotation to an independent quotation medium, and (3) for transactions in fully hedged or arbitraged positions." (emphasis added). See Release No. 32-28186 (July 12, 1990). In approving the rule change, the Commission stated:

> [t]hrough its own enforcement and regulation programs, the Commission carefully and continually has monitored short sale trading practices. Where problems have been identified, the Commission has taken action and has approved NASD rulemaking initiatives designed to eliminate abusive practices. The Commission expects the NASD to develop an enforcement plan and to monitor complaints with the rule by member firms.

In approving the NASD's codified exceptions to the affirmative determination requirements, the Commission specifically determined that the proposed rule change, which included the Bona Fide Hedge Exception, was "consistent with the requirements of Section 15A(b)(6) of the [Securities Exchange] Act ... [by being] designed to prevent manipulation of the marketplace, to promote just and equitable trading rules and to protect investors and the public interest" ("Section 15A Standards"). Id.

History and Background of the Close-Out Rule (NASD Rule 11830) and the Specified Exceptions

The Pollack Study had called for an aggressive "mandatory buy-in requirement" for all transactions that were not settled within a certain number of days. Based upon overwhelming negative comments against such a rule, the NASD instead sought Commission approval of a "close-out" procedure for certain short positions in specific securities "ten days after the normal settlement date if delivery of securities has not occurred and an exemption from the close-out requirement is not warranted" ("Close-Out Rule"). See Release 34-32632 (July 14, 1993). The Commission approved the Close-Out Rule, now designated as NASD Rule 11830, on July 14, 1993. The NASD also determined that many exceptions were warranted in regard to the Close-Out Rule. In this regard, the final approval order provided that "[t]he rule applies to customer and proprietary short sales, but exempts 'bona fide' market making activities and short sales in which the resulting position is bona fide fully hedged or arbitraged." (emphasis added). Id. The Commission's approval order also expressly stated that "[a]ny short sale of a restricted security that results in a position that is fully hedged or fully arbitraged, also is exempt from the mandatory close-out requirement." The Rule was followed by a footnote citing an Appendix of "examples of what constitutes a 'bona fide fully hedged' or "bona fide fully arbitraged" position." Id.

In the same Commission order approving the Close-Out Rule, the Commission also approved new NASD guidelines "for the use of the exemption from short sale requirements for bona fide fully hedged and arbitrage transactions....[and stated that] the guidelines are for illustrative purposes and are not intended to limit the NASD's ability to determine the scope of the terms 'bona fide fully hedged' and bona fide fully arbitraged." (emphasis added). Id. These guidelines continue to appear in NASD Rule 3370(b)(5)(A), with guidelines covering warrants and rights appearing in NASD Rule 3370(b)(5)(A)(iii).

The Commission saw no public policy problems relating to short selling connected with bona fide fully hedged and arbitrage transactions. In this regard, the Commission's approval order expressly contrasted naked short selling with short selling in connection with hedged positions, and cited NASD statistics that short selling connected with hedged positions "accounted for less than 2% of the total shares of reported short interest...." Id. These findings are fully supported by the Pollack Study.

With the propriety of the Bona Fide Hedge Exception not in question, the Commission focused on technical issues regarding how the proposed new guidelines would impact upon the implementation of this Exception. Based on comment letters from A. Mackie & Co., Inc., and Herzog, Heine, Geduld calling for more liberal warrant guidelines, the Commission specifically focused on the guidelines for warrants. Following significant discussion in the approval order, the Commission embraced the NASD's proposed warrant guidelines, and rejected commentators' suggested guidelines based on an 1:1 hedge ratio that would include deep out-of-the money warrants, or a "hedging ratio." In rejecting a hedging ratio guideline, the Commission stated that "the stocks that are subject to the rule are for the most part thinly-traded, making calculation of a hedging ratio exceedingly difficult and imprecise...." and difficult to surveil. Id.

In the end, the Commission applauded the NASD's "attempt to balance the need to require delivery of the class of securities meeting the requirements of the rule with the 'desirable warrant hedging function.'" Id. The Commission then made an explicit determination of the consistency of the warrant guidelines with the regulatory premise of the Close-Out Rule. The approval order expressly stated that "[t]he Commission believes that the NASD's guidelines for the warrant hedging exemption strike an appropriate balance between allowing hedging without providing the means to undermine the close-out rule." Id.

In approving the exceptions to the Close-Out Rule, which included the Bona Fide Hedge Exception for warrants and rights, and the detailed interpretive guidelines, the Commission determined that such exceptions met the Section 15A Standards.

Recent Commission Affirmation of the Bona Fide Hedge Exception

The latest affirmation of the efficacy of the Bona Fide Hedge Exception, among other exceptions, is found in the Commission's recent order approving amendments to NASD Rule 3370. See Release No. 34-48788 (Nov. 14, 2003); approving SR-NASD-2001-85. The amendments extended affirmative determination requirements to non-NASD member broker-dealers, effective February 20, 2004. In the approval order, the Commission also approved amendments that:

> provide an exemption for certain proprietary orders of non-member broker/dealers. Specifically, Rule 3370(b)(2)(B) provides exemptions for, among others, proprietary orders of member firms that are bona fide market making transactions, or transactions that result in bona fide fully hedged or arbitraged positions. (emphasis added).

Id.

Once again, the extension of the Bona Fide Hedge Exception to the recent regulatory context, required Commission determination that such Exception is fully consistent with the Section 15A Standards.

Conclusion

Based on the Commission and the NASD's well-developed regulatory record to support the Bona Fide Hedge Exception, particularly as relating to warrants and rights treatment, Greenwood respectfully requests that the Commission incorporate such Exception to proposed Rule 203 of Regulation SHO. In the alternative and in light of the established regulatory record and positive findings thereon regarding this Exception and others, the Commission carries the burden of instituting a study and making specific findings to support any contrary action that would lead to the removal of the Exception that has been relied upon by Greenwood and the industry for approaching 14 years. In absence of such study and new findings, the Exception must be carried forward without disturbing the proper status quo.[2]

The Commission should also consider Professor Schubert's study on this important regulatory policy issue. We will assure that this study is forwarded to the Commission as part of the record of this rulemaking proceeding.

On behalf of Greenwood, we look forward to providing the Commission with further information to support the Bona Fide Hedge Exception to proposed Rule 203 under Regulation

[2] Upon judicial review, an agency that departs from a longstanding rule or policy will have its action reversed by a court if such action was not based on a "reasoned explanation." See Missouri Public Service Commission v. FERC, 337 F.3d 1066 (D.C.Cir. 2003) (U.S. Court of Appeals for the D.C. Circuit struck down FERC departure from agency's usual policy without agency specifying the nature of the action nor offering a reasoned explanation of action); Columbia Gas Transmission Corp. v. FERC, 628 F.2d 578 (D.C.Cir. 1979) (U.S. Court of Appeals for the D.C. Circuit struck down FERC decision to depart from a 25 year formula of cost allocation in gas pipeline charges for not providing reasoned explanation for departure); and Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (D.C.Cir. 1970) (U.S. Court of Appeals for the D.C. Circuit held that: "[a]n agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion it may cross the line from tolerably terse to intolerably mute.").

SHO. Please do not hesitate to call me at (215) 972-1888 if you have any questions or comments on either of our comment letters.

Sincerely,

SAUL EWING LLP

By: _____
William W. Uchimoto

cc: Chairman William H. Donaldson – sent via regular mail
Commissioner Paul S. Atkins – sent via regular mail
Commissioner Roel C. Campos – sent via regular mail
Commissioner Cynthia A. Glassman – sent via regular mail
Commissioner Harvey J. Goldschmid – sent via regular mail
Annette L. Nazareth, Esquire – sent via regular mail
Robert L.D. Colby, Esquire – sent via regular mail
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