January 12, 2007

Ms. Nancy M. Moms
Securities and Exchange Commission
100F Street, NE
Washington D. C., 20549-1090

Ms. Norris,

As a follow-up to my previous memo regarding this proposal to eliminate the tick test/ price test, I would like to further emphasize the concerns the public has with regards to the regulations of market making activities as they pertain to this proposed and all other short sale regulations.

As now presented in several comment of the memos to the SEC, bear raids do in fact exist in our markets despite the assertions by the panel of "experts" the SEC created to evaluate this very rule change and despite the assertions of certain members of the Commission staff. Because the bear raid exists as a trading strategy of these markets, the SEC must keep every current tool in their arsenal active to slow down abuses until such time as real reform is considered and ultimately created.

Part of that arsenal, outdated as it is in today's trading environment, is the tick test/price test rule open for comments to eliminate.

Present guidelines to these rule may not have stopped the bear raid altogether, as illustrated in the prior examples provided, but it may be slowing some of the events down. Some traders on Wall Street may actually comply with the intent of the rule itself.

Some!

One of the reasons the tick test/price test restrictions have become outdated, for example, is because the SEC created an exemption to market participants in adhering to such sell side restrictions for the sake of adding market liquidity into every market environment including a declining market. Exempt from the tick test/price test restrictions are the market makers who can sell into a downtick or sell short below the previous price claiming exemption under bona fide market making activities.

"How much fraud are you willing to accept for Liquidity?" Commentary of former SEC Commissioner William Donaldson in a 2004 speech to the Federal Reserve.

Last summer, during a Securities Traders Association Conference NASD Vice President Tom Gira, voiced concern over a segment of market making activities and firms. Gira stated, "Our concern is that people are registering as market makers just to get the [short sale] exemption."

Gira further stated that the NASD is seeing market makers that quote normally on the offer, but use "stub" quotes on the bid. A stub quote is referring to a posted bid that is far outside of any recognizable market (i.e. a bid of $0.01 in a $100.00 stock). Market makers must make two-sided markets in their stocks, but the size of their spreads is not regulated. "Because of the removal of the excess spread rule," Gira said, "it is very easy to hide in the weeds and not contribute much."

Gira concluded that a true market maker is not "somebody who goes in the box and all they do is sell."

Today however, the SEC is not only looking to remove present short sale restrictions that have the intent to reduce sell side abuses, archaic as they may be, but the SEC is also failing to take appropriate

steps to beef up the exemption laws and enforcement activities against market members who are executing their own style of a market raid using present day exemptions to do so.

Question for the SEC: Has the SEC investigated whether short selling operations (investors/funds) financed market makers to set up shop to explicitly circumvent the short selling rules including the stock borrow and tick test/price test restrictions?

In 2005 the NASD bared Scott Ryan and his market-making firm Ryan and Co. for illegally shorting stocks on behalf of three hedge funds and using the market making exemption to orchestrate these short sales. The hedge fund managers later were later charged with trading on insider information and illegal shorting.

Question for the SEC: Has the SEC investigated the manner in which these short sales were executed, relative to the uptick/downtick and price test restrictions to determine whether the market making exemption to these guidelines aided in further investor damages?

While the NASD had taken these steps against Scott Ryan, many of his peers continue to remain in these markets, as stated by Tom Gira, and using short sale exemptions to manipulate securities.

The raid on any company that comes out with any type of potentially negative negative news is clear and decisive. Rarely is there any opportunity for investors to come out of a raid with any shred of investment left. During this activity, market makers with clients are executing the orders on behalf of their clients wishes but, other market makers without client orders will likewise see the frenzy of selling and use their bona-fide exemptions provided to “pile on” in the selling hoping to make quick profits.

It is what they do.

This “pile on” is the bear raid that was the concern when this law was created. Theoretically, in a declining market a market maker should be on the buy side and not the sell side since the liquidity in the market is sell side liquidity and what is missing is the buy side liquidity necessary to maintain order in the market. For this reason, market exemptions to market makers should not be in place during a declining market as there is no bona-fide liquidity necessary in a declining market.

Question for the SEC: Has the SEC carefully evaluated the market making activities in a declining market to insure that the exemptions provided relative to bona fide market making, including exemption to the present price test and locate requirements are not being used to manipulate our markets on behalf of the firm or a client using such a firms exemptions?

Of greatest concern in the elimination of this rule would be to those companies the economic studies highlighted as having the greatest impact, small less liquid business issuers, and thus those most likely to see the greatest levels of market making activities.

As the SEC pointed out previously, this rule was created some 70 years ago to address the concerns of a bear raid as seen during the crash of 1929. In these past 70 years the rules may not have changed but the markets around such rules have. Exceptions have been created that may in fact be aiding in the operating mechanics of the very fraud the laws intended to thwart.

Short selling, as a strategy is good for the capital markets because the short sale will provide for price controls where such controls would otherwise not exist. Short selling will furthermore add liquidity to the markets that allow for investor ease in moving in and out of a position.

But short selling into a declining market, where price restrictions are eliminated and where market makers have been given free reign to sell with impunity without restriction can only have negative impacts on the investing public. Trading such of this has no transparency and is protected by the regulators as it is identified as a “proprietary trading strategy”.

Consider that in the original SHO proposal of 2003 the SEC clearly identified that “More significantly, naked short sellers enjoy greater leverage than if they were required to borrow securities and deliver within a reasonable time period, and they may use this ***additional leverage*** to engage in trading activities that deliberately depress the price of a security.”

Market makers are provided the naked short exemption for bona fide market making activities and are provided these exemptions regardless of whether the market is a declining or advancing market. Thus, the SEC has provided legal grounds to deliberately depress the price of a security for leverage and profits. Elimination of this law will only increase those investors with this would be legal trading strategy.

In fact, in response to the Commissions consideration to eliminating the grandfather clause, market makers responded with concern stating "This [eliminating grandfather clause] is going to have a serious impact on our ability to make markets," Mark Madoff, co-director of trading at the family-owned Bernard L. Madoff Investment Securities.

Madoff’s comments imply that market makers rely on the leverage gained by naked short selling, and the delays in the settlement process that comes with such trades, to turn profits and minimize risk. Providing further leverage beyond settlement delivery by allowing the short selling (naked or otherwise) to take place into a declining market and into a down tick will be a recipe for disaster. What leverage is available today has just been increased at the expense of the issuer and the long investor.

As the Commission considers all the positive and negatives of this proposed reform, consider one last thing:

Wall Street is not stupid. The Commission clearly and publicly identified that this pilot was to test what would happen should these restrictions be removed. The Commission identified the issuers involved in the test and Wall Street was fully aware that such issuers trading activities would be under a high level of scrutiny.

Don’t think for a moment that playing nice for the short haul of the pilot was not considered such that longer term opportunities may not be obtained.

If you think Wall Street isn’t smart enough to find ways around your laws in order to violate the public’s interests, seriously consider Gira’s commentary. Investors are setting up shop as market makers to take advantage of the exemptions regulators created.

Rules must be updated to account for present market condition not eliminated.

Dave Patch