April 11, 2007

Mr. Chairman,

The Securities and Exchange Commission is seeking to eliminate the price test restrictions of the short sale transaction based on a limited number of companies that were involved in a “Pilot Program” enacted in 2004 when regulation SHO was passed.

As part of this pilot program the SEC, and several economic scholars investigated the impacts the lifting of pricing restrictions had on the overall markets. Several of the comment memo’s presented with regards to this latest proposal have identified that the Pilot may not have been conducted in a process that effectively evaluated the true impacts the lifting of the pricing restrictions would have on our markets.

While I agree with the general assertions of those comment memos, I also feel that the Commission and those economic scholars the Commission engaged as part of this evaluation and conclusion missed some glaring obstacles in the pilot results.

Consider that each month SRO’s report the enforcement actions taken against member firms for violating securities laws. Many of the enforcement cases involve a minor fine to the firm for the involvement in compliance matters. Each month SRO’s report a proceeding where a member was in violation of short sale reporting requirements and where a short sale was marked as a long trade. In fact, right in the middle of the pilot period the NYSE appeared to have conducted an inspection of the short sale reporting process and found a significant level of “reporting violations” that could have significantly altered the pilot results.

Ref:

2/9/2006 NYSE v. Bear Stearns – Rule 342 Violation in failing to have adequate systems and compliance in short sales.

1/30/2006 NYSE v. Calyon Securities – Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Merrill Lynch Pierce Fenner - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Neuberger Berman - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. NF Clearing, Inc. f/k/a Fiserv Securities, Inc. - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. UBS Securities - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Wachovia Capital Markets – Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Charles Schwab and Co. - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. National Financial Services - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Pershing LLC – Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Piper Jaffrey - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Credit Suisse First Boston - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Goldman Sachs – Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Labranche Financial Services - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Lazard Capital - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Lehman Brothers - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Preferred Trade Inc. – Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Sanford & Bernstein - Rule 342 Market short sales as long sales

1/30/2006 NYSE v. Sunguard Global Execution - Rule 342 Market short sales as long sales

The NYSE Press release stated;

NEW YORK, January 31, 2006 – NYSE Regulation ("NYSE") announced today it has censured and fined 18 Member Firms and two former Member Firms a total of $5.85 million for failing to submit accurate electronic blue sheets containing trading information requested by the NYSE and other regulators, and for failing to establish and maintain appropriate systems and procedures for the supervision and control of this reporting requirement. In addition, the Member Firms agreed to validate their trade reporting processes and confirm the validations to the NYSE.

The inaccurate blue sheets were submitted over a significant period of time and resulted from deficiencies that were systemic in nature. <u>Inaccuracies included the reporting of short equity sales as long sales.</u> Additionally, some Firms continued to have ongoing deficiencies in blue sheet reporting even though NYSE Regulation alerted them to these problems.

Question: What impact did the systemic reporting issues of the short sale process have on the pilot program results?

Consider for example that a long sale does not have, nor will it have a price test restriction. Thus, any analysis where the empirical data is looking specifically at the execution of a short sale and how that execution impacts the marketplace would ignore each of these trades executed as long sales as to whether the intent of these specific trades was to specifically impact a market in a particular equity.

Since I have been reading the monthly enforcement proceedings of the NYSE and NASD (several years) I have never seen or picked up on a charge in which a firm was fined for trading in violation of the price test regulations. In the cases stated above in fact, no charges were placed on the firms for executing in violation of the price test. If so many firms over such an extended period in time are all in violation of the short sale reporting, what makes the regulators and the economic scholars dismiss the likelihood that the price tests were in fact being violated?

More concerning in all of this is that the firms identified above in the NYSE actions are not new to the industry. In fact several are the cornerstones to the business.

How are the most prestigious firms on Wall Street, in existence for decades, failing in compliance at the most rudimentary levels? Rarely is there an enforcement action where a long sale is market short but quite regularly a short sale is marked as long. This is not by coincidence.

It is my assertion that the Commission's pilot program and subsequent analysis is severely flawed by the lack of basic compliance procedures by as many as 20 firms during this Pilot phase. If the analysis excluded the direct data attributed to the specific trades that were mis-marked by the members than the analysis is missing a critical component.

Has the Commission considered that such compliance short falls were not in fact simple human errors but done with reason? If that reason was to impact a market and to do so by circumventing the price test and the detection of such activities than by eliminating such a requirement will only open the markets up to further possibilities of abuse.

The SEC has recently delayed a proposed change to the grandfather clause of Regulation SHO because of a few outlier comments seeking additional data. The fact is, the Commission recognized that the grandfather clause was impacting our markets and that investors and companies were being "victimized" while this clause remained in place. The Commission chose to delay actions anyways to insure the comment process was not open for challenge.

This is not a reform where "victims" are being created but instead a reform whereby the Commission seeks to create a more efficient process for the execution of a short sale. The benefits limited to only that small population of investors who actually trade our markets short.

I urge the Commission to therefore delay any actions to remove the pricing test restrictions until a more thorough analysis of the means in which a short sale is executed in our markets and the impacts such may have. The Commission must understand the underlying cause for a "systemic failure" in short sale reporting and whether those trades were executed in violation of price test restrictions and present the empirical data that supports the assertion that no impact to the markets took place. I also urge the commission to take a sampling of specific companies with heavy short interests and drill down as to how those short sales were executed during this pilot program as to whether micro bear raids were executed. That data should likewise be presented to the public for inspection.

The process of the analysis appears to be flawed and thus the proposed regulation should be postponed until such flaws are addressed.

Dave Patch