The following article was written by GT McDuffy which appeared on the Seeking Alpha website on Dec. 4, 2008.

A Remedy for Short Selling Manipulation

There has been a ton of discussion over the years on the subject of short-selling manipulation in the stock market.

I've heard and read many opinions on this very serious matter, but there is, in fact, a sure-fire way to combat the problem, a cure that I have not yet seen discussed anywhere.

First off, this article is not, *per se*, about naked shorting, which in itself is a staggering problem and, I suspect, still highly rampant in the market place, even with the SEC's recently announced efforts to go after said illegal shorters.

This article, rather, tackles the issue involving a tactic that short-sellers use to pummel the price of a stock lower, which creates panic in long-position holders, and, in fact, convinces anyone interested in buying the stock to simply wait for a lower stock price to enter. Why would any rational "potential-long" buy higher in the face of a short-raid, if he or she can simply wait for the stock to first be pummeled- and THEN buy long.

I have heard a lot of talk about how killing the uptick rule was devastating for stocks, but, in reality- this was only part of the problem.

The real problem is that shorts love to "pin the bid," which is a manipulative technique whereby short-sellers don't first wait for a buyer to come to them at a higher level, say on the ask price, but, instead, they short directly on the bid price repeatedly (called "pinning") until the bid finally "caves in."

Shorts have learned that if they "tag-team" the bid in this manner, it will, undoubtedly, cave, and the resulting bid will be pushed lower, and then lower and then lower still. With the ask price lowering in tandem with a dropping bid price, exacerbated by other shorts on the ask going lower, longs now start to panic and lower their sell (ask) price even further. Many longs then start selling on the bid itself, and, eventually, the bid is also taken lower and lower as longs panic further, and potential buyers lower their bids in trying to buy as low as possible.

Obviously, shorts don't first speak with each other in coordinating a pin-attack, but, in stocks where there is a lot of short interest, and there are (were) many, it doesn't take much for certain shorts, whether fund traders or wealthier individual traders to initiate the pin process, and for other shorts to immediately recognize the attack under way, and then pile in.

One important additional component of the pin-the-bid technique is for shorts to first "load up" at as high as price as possible, then use additional funds available to them to then force the stock lower. In other words, these shorts make money off their "higher-priced" short positions, and then make additional money in relentlessly driving the stock lower.

The key to the latter is that once a pin attack is launched, as I said, long-position sellers panic PLUS those who are looking to buy long will lower their bids to ultimately buy long as low as possible. These two resultant "panic plus bottom-fishing" motives by longs snowballs the bid-pin/downward short manipulation process. In effect: the shorts manipulating the bid downward rely on their technique to cause the snowball, thereby the shorts don't have to do much work (or spend much money during the pin) to cause the stock to sink a lot lower than it normally would have.

And, then, of course, once shorts have made enough money, they begin to cover buy and take their profits.

So, what can be done to solve this problem, which, I believe is rampant in the market?

Simple:

1. Don't ban short-selling as you need short-selling to create a liquid trading market.
2. Don't just re-instate the "up-tick" rule.

Instead, do not allow shorting on the bid. Period.

I'll say it again. Do not allow shorting on the bid. Longs could sell on the bid. Shorts could cover buy on the bid. But shorts couldn't short on the bid.

It's simple. And it will resolve a ton of issues that relate to downward manipulation of the market.

Logically, if short-sellers wanted to operate ethically, they would not have a problem with this. Why? Because if a short-seller truly (and ethically) wants to maximize profit on a trade, he would want to place his short at as high a price as possible and then sell as low as possible. Why pin the bid when you can short at the ask or higher?

Indeed, if shorts were operating ethically, they'd want the longs to come up to them, and then rely on legitimate market forces at work, such as negative news, to fuel any sell-off.

But, since shorts rely heavily on tag-teaming a stock lower, which they could not do if they were not allowed to attack the bid, I am certain shorts would object to my simple proposal.

I would highly recommend that the SEC, Congress, and companies lobbying Congress against short-selling, such as Citigroup (C), strongly consider implementing this change. It will not result in stock prices being "higher than they should be," but it would allow for stocks to not be crushed without reason.

As for naked shorting, interestingly enough, such naked "phantom" shares might then, very well, be exposed by surveillance bots as the only short-sells that show up on the bid, as legitimate ones would be prevented from doing so at their source.

Thus, such naked bids could be isolated and dealt with immediately by enforcement.

You see, most members of the SEC, Congress and company executives don't trade, so they don't sit there looking at Level 2 on any given day watching this manipulation in real-time. It's so easy to spot.

Perhaps someone should be invited to Congress and set up a giant real-time trading screen for House members during market hours so they can be shown what goes on in the very stock market they say they want to fix and support. Then, bailout dollars-to-donuts-they'll have it fixed before you can say "Don't pin that bid, short fella."

Hope you all have Very Happy Holidays, even you shorts. Try not to tag-team the Turkey will ya?