Overstock.com, Inc.
6350 South 3000 East
Salt Lake City, UT 84121
Phone: (801) 947-3100
Fax: (801) 947-3144

VIA ELECTRONIC SUBMISSION AND OVERNIGHT MAIL

October 1, 2007

Ms. Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: Comments on Proposed Amendments to Regulation SHO
Rel. No. 34-56213; File No S7-19-07

Dear Secretary Morris:

I would love to run a rental car company where I didn't have to pay for the cars. So imagine I take a job as a car mechanic performing maintenance on the city's fleet of vehicles, and used this access to run a rental car counter out of the back of the lot. Rumors of my misdeed abound, but I deny them. The city government catches on and moves to shut off my access. Now I switch tactics, pointing out how much more costly it is going to be for me to run my rental car company if I have to start paying for the cars. Presumably, someone would have the wit to point out that my moral views had become hopelessly scrambled.

As this comment letter will show, this same renting-out of a privilege granted by government for altogether different ends has been practiced by options market makers, and this same scrambling of moral views is evinced in the comment letters submitted by Citigroup Derivatives Markets Inc.[1], The American Stock Exchange, the Boston Options Exchange, the Chicago Board Options Exchange, the International Securities Exchange, the Options Clearing Corporation, NYSE/Arca, and the Philadelphia Stock Exchange ("the Options Exchanges")[2], the Securities Industry and Financial Market Association ("SIFMA")[3], and on behalf of UBS Securities LLC[4] (collectively "The Options Market Makers"). The SEC granted options market makers access to an exception

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[1] Charles Mogilevsky, Citigroup Derivative Markets Inc., "RE: Amendments to Regulation SHO (File No. S7-19-07)," http://www.sec.gov/comments/s7-19-07/s71907-273.pdf (September 14, 2007).
[2] The American Stock Exchange et al, "Re: File No. S7-19-07," http://www.sec.gov/comments/s7-19-07/s71907-285.pdf (September 19, 2007).
[3] Ira D. Hammerman, SIFMA Senior Managing Director and General Counsel, "Re: Release No. 34-56213; File Number S7-19-07," *http://www.sec.gov/comments/s7-19-07/s71907-297.pdf (September 27, 2007).* SIFMA is an organization that advertises itself as "a powerful voice of the securities industry" (see http://www.sifma.org). While technically not an options market maker, because SIFMA's letter parrots many of same themes of the other option market makers' comment letters, this comment letter includes SIFMA among the Options Market Makers.
[4] Gerard S. Citera, Chadbourne & Parke LLP, "Re: Securities Exchange Act Release No. 56213; File No. S7-19-07," http://www.sec.gov/comments/s7-19-07/s71907-271.pdf (September 13, 2007).

from a regulation governing everyone else (just as, in the example above, political authority granted me access to the city's fleet of cars in order to provide a service): the options market makers misused that access (just as, in the example above, I misused my access by renting those vehicles out), while denying that by doing so they were imposing costs on other market participants. The SEC is considering removing the options market makers' access to the exception, and now the Options Market Makers are decrying the harm their business model will suffer if they have to assume costs whose existence not long ago they denied (just as, in the hypothetical example above, I might complain about how much tougher it would be to run a rental car company if I have to start paying for the cars). Though one has to admire their *chutzpah*, there is no reason to concede to their perfidy.

The Options Market Makers object to the SEC's proposed amendments to eliminate (or even to narrow) the options market maker exception in Regulation SHO. The Options Market Makers abuse the options market maker exception to transfer costs away from participants in the options market and onto unwitting participants in the equities market. This loophole lets options market makers write checks on other peoples' checking accounts; unsurprisingly, the Options Market Makers want to keep it. However, in their desire to do so the Options Market Makers have made numerous false and misleading claims regarding options market liquidity, market depth, efficiency, and the true nature of options hedging activity.

Liquidity

The Options Market Makers claim that the SEC's proposed amendments to Regulation SHO would restrict or eliminate the ability to hedge options positions in hard to borrow and threshold securities, and thus reduce liquidity. They make no distinction in their analysis between liquidity that may support healthy market activity and liquidity that borders on institutionalized fraud in the markets.

Citigroup Derivative Markets Inc. writes, "[w]hile the Commission's stated goal of 'requiring that all failures-to-deliver be closed out within a reasonable time period' is worthy, CDMI believes that the elimination of the OMM exception will have the opposite effect by reducing liquidity in both the threshold security and the overlaying option, to the ultimate detriment of the investor."[5]

Gerard S. Citera of Chadbourne & Parke writes on behalf of UBS Securities LLC, "[o]n the fringes, certain firms may determine not to be a market maker in any options. This would have a negative impact on cost of hedging, liquidity, depth of the market and spreads in the option markets. If these results are realized, the cost of this new rule would greatly outweigh any potential benefits to the market."[6]

[5] Citigroup Derivative Market Inc., page 1.
[6] Gerard S. Citera, Chadbourne & Parke LLP, page 7.

The Options Exchanges add, "[a]s we have asserted in the past, we are convinced that the result of eliminating the options market maker exception in Regulation SHO is likely to be more limited or non-existent options market maker liquidity in current and future threshold securities."[7]

Ira D. Hammerman writes for SIFMA, an organization whose members clear for the Options Market Makers, "many firms oppose the complete elimination of the options market maker exception, in that it is believed such action could have drastic impacts on the liquidity of the options market for Threshold Securities, and other securities which may become Threshold Securities in the future."[8]

Through the statements above, the Options Market Makers tacitly admit that the SEC correctly identifies a relationship between options market making activity in hard-to-borrow equities and settlement failures:

> "We are concerned that persistent fails to deliver will continue in certain equity securities unless the options market maker exception is eliminated entirely. We believe that fails to deliver resulting from hedging activities by options market makers should be treated similarly to fails to deliver resulting from sales in the equities markets. The ability of options market makers to sell short and never have to close out a resulting fail to deliver position, provided the short sale was effected to hedge options positions created before the security became a threshold security, runs counter to the goal of similar treatment for fails to deliver resulting from sales of securities and may have a negative impact on the market for those securities."[9]

The Options Market Makers claim that the benefit of added liquidity to some investors outweighs the cost of delivery failures to issuers and other investors. Put another way, the Options Market Makers want the right to provide liquidity to customers *even in situations where large and persistent delivery failures will result.*

At the very least, that sentiment is contrary to the Securities and Exchange Act of 1934, which states, "[t]he prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors."[10]

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[7] The American Stock Exchange et al, "Re: File No. S7-19-07," http://www.sec.gov/comments/s7-19-07/s71907-285.pdf (September 19, 2007).
[8] SIFMA, page 14.
[9] Securities and Exchange Commission, Release No. 56213, http://www.sec.gov/rules/proposed/2007/34-56213.pdf (August 7, 2007).
[10] Securities Exchange Act of 1934, Section 17A, "National System for Clearance and Settlement of Securities Transactions," http://www.sec.gov/divisions/corpfin/34act/sect17a.htm.

While the ability to sell short is an important price discovery mechanism in modern securities markets, unlimited liquidity in the form of naked short sales by options market makers that never settle can drastically distort prices and destroy value. In economic terms, prices are a mixture of utility, scarcity and risk. "Unlimited liquidity" is the Options Market Makers' code for "*no scarcity.*" The truth is that, while the SEC values liquidity, it has long recognized that unlimited liquidity can be used as leverage to purposely depress a market.[11] As former SEC Chairman William Donaldson once remarked, "'[h]ow much fraud are you willing to tolerate for liquidity?' I think the answer is zero."[12]

Curiously, Citigroup adds that "the elimination of the OMM exception will have the ... effect [of] reducing liquidity in ... threshold securit[ies]."[13] That statement is belied by the staggering growth in equity trade volume.[14] In fact, just today, a Citigroup representative described similarly explosive growth in equity options:

> "From 1973, when listed options started, until 2004, we passed one million options contracts in a year. It only took two years later to get to two billion contracts. So that's the amount of rapid growth we are seeing. And as of today, that volume, two billion, has already been exceeded so far this year. Year-to-date volume growth, when you look at the options market versus the equity market, through June the stock market volume was up 2.2%, options industry volume was up 25%. If you look at options versus futures, just through July, options up 31%, futures up 23%. And that options number just kept accelerating in August, even with all the volatility, options year-to-date through August up 37.5%. If you look at it, stock market volume year to year percentage changes, 2004 up 5.5%, options industry up 30%; 2005, stock market volume up 3.6%, 2005 [options volume] up 27%. In 2006, when the stock market volume was up almost 13%, the option volume was up almost 35%. So, again, we see a tremendous amount of growth in the listed options business. It is largely being institutionally driven at this point, there doesn't seem to be any let up going forward."[15]

Clearly, equity and equity options liquidity are not dependent on options activity and should not be threatened by the proposed elimination of the options market maker exception. Behind their

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[11] Securities and Exchange Commission, Proposed Rule: Short Sales; Release No. 34-48709; File No. S7-23-03, http://www.sec.gov/rules/proposed/34-48709.htm (October 29, 2003).
[12] David Wighton, "Donaldson laments US chiefs' lack of ethical leadership," *Financial Times* (September 20, 2004).
[13] Citigroup Derivative Markets Inc., page 1.
[14] Depository Trust & Clearing Corporation Annual Reports for 2001–2006 report DTCC clearance totals of $250 trillion in 2001, $973 trillion in 2003, $1.1 quadrillion in 2004, and $1.5 quadrillion in 2006 representing a six-fold increase over the five year period. See http://www.dtcc.com/.
[15] Comments by Kevin Murphy, Managing Director, Citigroup Global Markets, Inc., SIFMA Institutional Brokerage Conference, Grand Hyatt, New York, NY (October 1, 2007)

bromides about "liquidity," then, what is it that the Options Market Makers really seek to protect?

Options Market Making in Hard-to-Borrow and Threshold Securities

In hard-to-borrow securities, the equity options market and the stock loan market operate in parallel. Consider an example in which a short seller wishes to short X shares of ABC stock. The short seller learns that the cost to borrow ABC is high or even, that there is none available (i.e., the cost is infinitely high). In that situation, the short seller may go to an options market maker and purchase puts on X shares of ABC r. There is nothing wrong with buying puts in lieu of shorting; both are important price discovery tools. But the options market maker may then hedge the long position by naked shorting X shares of ABC. In hard-to-borrow securities, it is possible that the options market maker will *never* locate ABC stock to deliver. Accordingly, the Options Market Makers have interpreted the exception in Regulation SHO to mean that they may fail-to-deliver *in perpetuity*.

The options market maker may simultaneously sell X shares of ABC as a hedge against his put: if the buyer of those X shares is the same agent who is buying the puts, then the transaction is a "married put." Trading in threshold securities is punctuated by these married puts.[16] In a 2003 Interpretive Release, the SEC defined a married put as, "the purchase of an option to sell (i.e., a put option) a certain number of securities at a particular price by a specified time, bought contemporaneously with the same number of underlying securities."[17] The SEC goes on to say that it "is concerned about the abusive use of married puts ... Some strategies may involve the *manipulative sale of securities underlying a married put as part of a scheme to drive the market* price down and later profit by purchasing the securities at a depressed price."[18]

With both the puts and the long inventory, the short seller can then sell the ABC share entitlements into the market to drive down the price and exercise the puts deep in the money. Not surprisingly, the share entitlements "created" by the options market maker have been known by various names, such as "bullets," "ghost bullets," "bullet trades," and "slam dunks" for the powerful negative effect they can have on stock prices.[19] The fact that these trades have acquired a nomenclature should be a sign to the SEC that these manipulative practices have become open, notorious and institutionalized. Abuse of the options market maker exception deserves the serious regulatory attention embodied in the proposed rule change.

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[16] See Appendix to Patrick M. Byrne, Chairman and CEO of Overstock.com, "Re: Comments on Proposed Amendments to Regulation SHO," http://www.sec.gov/comments/s7-19-07/s71907-130.pdf (September 10, 2007).
[17] SEC Interpretive Release, Commission Guidance on Rule 3b-3 and Married Put Transactions, Release No. 34-48795, http://sec.gov/rules/interp/34-48795.htm (November 21, 2003).
[18] Ibid.
[19] Ibid, footnote 9.

The Options Market Makers may defend the sale of married puts as *bona fide* market making activity. But in threshold and hard-to-borrow securities, it is clear that the married put is simply a mechanism to create synthetic stock loans (and short positions) without limit. "Even viewed in the most favorable light," writes the SEC, "these married put transactions appear to be nothing more than temporary stock lending agreements designed to give the appearance of a 'long' position in order to affect sales of stock in a manner that would otherwise be prohibited."[20]

The SEC also characterizes married puts by "the repeated use of a 'facilitator' that sells both the puts and the 'long' position (often by selling the stock short to the counterparty)."[21] In that case, the facilitator is the options market maker. And as payment to the options market maker for facilitating what is, effectively, a stock lending arrangement, a "fee" is paid on the put options. As the SEC has stated:

> "The options are not priced in accordance with a standard options pricing model, e.g., the Black-Scholes option pricing model, that takes into account volatility of a securities return, the level of interest rates, the relationship of the underlying stock's price to the strike price of the option, and the time remaining until the option expires. Instead, the options are priced to ensure that transaction is netted out between the parties with the payment of a flat fee to the facilitator for the service, i.e., a lending fee."[22]

Consequently, the annualized cost of buying married puts in the equity options market will approach (negative) rebate rates in the stock loan market. In other words, prices in the two parallel markets approach equilibrium.[23]

Market Depth

The Options Exchanges claim that the proposed amendments to Regulation SHO would make it difficult for option market makers to make markets. The Options Exchanges cite a study by the Vodia Group to support that claim:

> "The analysis concludes that repeal of the options market maker exception would result in "a net reduction in all outstanding equity and index options contracts of 2.5% and a reduction of 87.7% in outstanding options contracts for hard to borrow underlying securities."[24]

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[20] Ibid, footnote 20.
[21] Ibid.
[22] Ibid, footnote 18.
[23] The options market maker exception may have the unintended consequence of depressing legitimate stock loan borrow rates by providing a questionable yet effective alternative to traditional stock lending.
[24] AMEX et al. See also Vodia Group, "Impact of Reg SHO Options Market Maker Exemption on Options Liquidity," http://www.vodiagroup.com/pdfs/Reg_SHO_Options%20Exemption.pdf (September 17, 2007).

In other words, the Options Exchanges admit that those 87.7% of contracts were written in hard-to-borrow securities, where an options market maker wrote puts and *failed as a result*. This is one of those situations where one is hard-pressed not to say, "Gentlemen, that is not *your* point, it is *our* point." Such providing "liquidity" to short sellers is not "market making" so much as "selling phantom shares."

Efficiency

The Options Market Makers claim that the options market maker exception is necessary for market efficiency. Citigroup writes, "Short selling by OMMs is a tool used by OMMs to manage risk in a manner that ensures that the markets for options and the securities to which they relate remain efficient."[25] In truth, the options market maker exception is an inefficient government subsidy[26] that favors options market makers and short sellers over retail investors and issuers.

The value investor Benjamin Graham often characterized the stock market's daily activity as a "voting machine."[27] Why should a small and sophisticated group of market participants be allowed to cast a theoretically infinite number of votes, especially in threshold securities? Perhaps it is no surprise that the Options Market Makers and the firms who clear for them are politically unified and influential, while retail investors and issuers tend to be politically dispersed and less influential.

The options market maker exception leads to further equity market inefficiencies in the trading of threshold securities by disrupting the close out process of failed trades. One example is the problem of "long fails" associated with the sale of shares that were never initially delivered. The naked short hedge executed by options market makers can saturate the offer in an equity market. When the buyers of those share entitlements sell, new long failures-to-deliver may be created that further warp settlement.

Perhaps unintentionally, the SIFMA comment letter supports the position that the options market maker exception is inefficient and disruptive. SIFMA writes:

> "Market makers, not their clearing firms, have the information necessary to determine whether their activities are covered by the options market maker exception. If responsibility for compliance were to rest with the clearing firm, then in effect the clearing firm could need to understand, among other things, the market maker's strategy and hedging positions, including its view of factors such

[25] Citigroup Derivative Markets Inc., page 3.
[26] Peter Chepucavage of Plexus Consulting in Washington, DC, correctly characterizes the options market maker exception as a government subsidy. He adds that, if options market makers were required to continue to seek shares to cover fails, then the options market maker exception might be justified. But the current rule requires no effort and is, essentially, welfare. Furthermore, that subsidy is transferred to purchasers of puts in threshold securities.
[27] Benjamin Graham, *The Intelligent Investor*, HarperCollins (1949).

> as options volatility used by market makers in making hedging decisions. In light of this, it would simply not be practicable, or possible, for a clearing firm to review every single trade executed by each of the potentially numerous market makers for which it clears to ensure such activity was consistent with bona-fide market making activity, and hedging pre-existing options positions. Clearing firms should instead be able to reasonably rely upon a firm's designation as a market maker by the AMEX, CBOE, and/or another exchange in determining whether the market maker's short position was bona-fide hedging its options exposure."[28]

Yes, it could be quite difficult to distinguish between legitimate hedges and those strategic and speculative trades merely disguised as hedges. At the very least, it might be costly for the SEC, an SRO audit committee, or a clearing firm to investigate and decide whether abuse was taking place. *This argues for elimination altogether.* In its amended form, Regulation SHO should provide simple guidelines that encourage market efficiency, not compliance chaos.

Alternatives to Elimination

The Options Market Makers uniformly object to elimination of the options market maker exception and some favor proposed Alternative 1, which would impose a 35-day closeout period for option market maker failures-to-deliver:

> "Alternative 1 would require that open fails that result from short sales by an options market maker that were effected to establish or maintain a hedge before the security became a threshold security be closed out within 35 consecutive settlement days of the date on which the security becomes a threshold security. This alternative would provide additional time for options market makers to maintain an existing hedge, so that hedge positions could be managed or closed out in a relatively orderly fashion."[29]

The more likely scenario is that the 35-day window afforded options market makers to fail would simply create opportunities for sophisticated market participants to employ complex derivative strategies to roll failed positions from one period to the next. For example, the American Stock Exchange LLC recently disciplined Scott and Brian Arenstein of SBA Trading for abusing the options market maker exception through the fraudulent use of married puts and reverse conversions. The judgments describe, in detail, how the Arensteins used FLEX options, a semi-custom derivative product traded on the CBOE and the AMEX, to roll failed positions:

> "In order to avoid being bought-in Respondents entered into a series of transactions that circumvented Respondents' obligation to actually deliver

[28] SIFMA, footnote 29.
[29] AMEX et al, page 4.

> securities to close out their short position pursuant to Reg SHO. Specifically, Respondents, utilizing the services of a floor broker, executed a series of complex transactions that appeared to close out their fail to deliver position by purchasing securities of like kind and quantity... In an example of one type of such a transaction, Respondents executed a buy-write using a one-day FLEX option that had the effect of temporarily resetting the buy-in date... Respondents repeatedly engaged in these or other types of transactions after receiving a Reg SHO Buy-In Notification from their clearing firm and these transactions caused the buy-in date to be reset. These transactions were executed approximately every 13 settlement days until the options positions either expired or were closed out. This course of conduct enabled Respondents to maintain impermissible short positions in a number of Reg SHO threshold securities for extended periods of time."[30]

The current language of Alternative 1 provides no guarantees that similar techniques will not be employed to circumvent a new 35-day close out period for the Options Market Makers.

Furthermore, the Options Market Makers' express a desire for the SEC to grandfather existing failed positions and create special exceptions for long term options contracts:

> "The Commission is also proposing that any open fail position currently excepted from the close out requirements of Regulation SHO because it was established under the options market maker exception be closed out within 35 consecutive settlement days of the effective date of the proposed amendments to Regulation SHO. Adoption of this proposal will impose high costs on those options market makers who have relied on the options market maker exception and who will now have to close out fails that may have been open for months or years. It will fall particularly hard on those options market makers who have open fails in LEAPS. We suggest that the Commission permit a longer close out period for open fails held in reliance on the options market maker exception in LEAPS. We suggest that, at a minimum, fails associated with LEAPS positions be permitted to remain open until the option positions expire or are liquidated."[31]

A LEAP is a long-term equity option contract, sometimes written with an expiration date two or more years in the future. Thus, the Options Market Makers are asking that failures-to-deliver associated with any outstanding LEAP contracts be permitted to remain open (in some cases) for years, regardless of nature of those failures-to-deliver or the circumstances in which they were created. Such a result is unacceptable. Such a request is also inexplicable, if these failures are

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[30] Disciplinary Panel, The American Stock Exchange LLC, In the Matter of Scott H. Arenstein and SBA Trading LLC, http://www.amex.com/atamex/regulation/discipline/2007/SArensteinSBA_Decision_072007.pdf (July 20, 2007). Interestingly, Scott Arentsein engaged in fraudulent options market making in Overstock.com stock. See Carol S. Remond, "AMEX Nabs 2 For Reg SHO Abuse; 1 Traded Overstock," Dow Jones, August 1, 2007.
[31] AMEX et al, page 5.

not having an effect on prices in the equities market. In short, the Options Market Makers are speaking out of both sides of their mouths.

Conclusion

The Options Market Makers make a series of sweeping objections to the SEC's proposed limitations to the options market maker exception in Regulation SHO. The Options Market Makers claim that the ability to naked short without first locating stock is "absolutely necessary for option market makers to function in the market."[32] Delivery failures that may result are viewed as an unfortunate yet necessary outcome in the quest to provide options liquidity.

However, the claim that elimination of the options market maker exception would drastically reduce the number of outstanding contracts in hard-to-borrow securities is a *de facto* admission that the equity options market has become a substitute for the stock loan market in those securities. The Options Market Makers feel that short sellers should have an unlimited ability to "rent" the options market maker exception when there is no stock available to borrow or borrow costs are high.

Thus, the Options Market Makers confirm the point that the options market maker exception is a government subsidy that favors a select group of privileged and sophisticated market participants. The options market maker exception distorts prices and destroys value, yet handsomely rewards those who abuse it. It is no wonder the Options Market Makers are so opposed to its elimination.

The assertion that "the proposed amendments are unnecessary, redundant to existing regulation, unduly burdensome, and inefficient"[33] is wrong. Consider the case of Citadel Investment Group LLC, a new entrant into the options market making sector. One trade group writes, "If the success of Citadel is any indication, then the transition of funds into market makers will have profound ramifications for the options markets. Citadel is already the largest liquidity provider on the ISE and they've made substantial investments in the PHLX and BOX."[34]

In a public SEC Memo, Josephine Tao of the SEC's Division of Market Regulation summarizes a 2007 meeting with Citadel regarding proposed amendments to Regulation SHO:

> "On December 19, 2006, members from the Division of Market Regulation met with Matthew F. Andersen, John C. Nagel, Daniel Dufresne, Adam C. Cooper, Mathew Hinerfeld of Citadel Investment Group, L.L.C. to discuss the proposed Commission amendments to Regulation SHO. *Citadel stated that it rarely uses*

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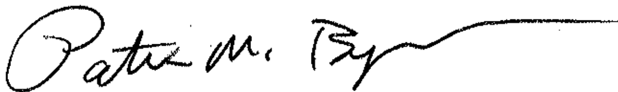
[32] Chadbourne & Parke LLP, page 7.
[33] Ibid, page 1.
[34] Mark S. Longo, "Hedge Funds Invade the Options Markets," *The Options Insider*, http://www.theoptionsinsider.com/industry/?id=127 (February 8, 2007).

> *the grandfather and options market maker exceptions to Regulation SHO because it has implemented procedures to close out fail positions prior to the 13th consecutive settlement day.* Therefore, Citadel had no comments on the proposed amendments."[35]

If Citadel, one of the largest options liquidity providers, does not need the options market maker exception to create market liquidity, then this is not an issue of market efficiency or liquidity, but rather an issue of timely settlement.

The options market maker exception is merely a crutch for failing business practices and a fig leaf for abusive manipulation via naked short selling. The SEC should act quickly to eliminate it entirely.[36]

Respectfully submitted,



Patrick M. Byrne
Chairman and Chief Executive Officer

Enclosures

cc: Christopher Cox, Chairman, U.S. Securities and Exchange Commission
Paul S. Atkins, Commissioner, U.S. Securities and Exchange Commission
Roel C. Campos, Commissioner, U.S. Securities and Exchange Commission
Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission
Annette L. Nazareth, Commissioner, U.S. Securities and Exchange Commission
Robert L. Colby, Acting Director, Division of Market Regulation, U.S. Securities and Exchange Commission
John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission

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[35] Josephine Tao, SEC Division of Market Regulation, Memorandum Re: Proposed Amendments to Regulation SHO; File No. S7-12-06; Meeting with Citadel, http://sec.gov/comments/s7-12-06/s71206-423.pdf (12 January 2007) (emphasis added).

[36] Overstock continues to believe that in addition to the elimination of the options market maker exception, two additional reforms are necessary: (1) The SEC should require that before any seller can short sell a stock, that seller must either possess the stock (and have the right to sell it) or have entered into a bona fide contract to borrow the stock in advance of the sale; and (2) The SEC should amend Regulation SHO so that the aggregate volume of fails to deliver is reported daily for each threshold security, including failures-to-deliver that occur within the DTCC and outside the DTCC in "ex-clearing" transactions. See Patrick M. Byrne, pages 2-4.