April 29, 2009

Securities and Exchange Commission
100 F Street NE
Washington, DC

RE: File Number S7-08-09, Amendments to Regulation SHO

Chairman Schapiro, Members of the Commission Staff,

Regarding the origination of the Uptick rule some 70 years ago, Larry Harris, Fred V. Keenan Chair in Finance stated:

> *"These rules were brought in in response to concerns about bear raids, which are largely pretty infrequent and, as a consequence, are <u>not likely to be easily identified</u> even in the excellent study that was set up by the Commission."*[1]

And while Mr. Harris testified before the Commission of his findings from the 2004 pilot study, it is this short dialogue, more than any of the other hours of dialogue registered, that set the expectations for what we will really learn from the presentations on that day in September 2006. Bear Raids are "not likely to be easily identified even in the excellent study that was set up".

Without capability to detect a bear raid, how did any of the economists speaking on behalf of their pilot studies come to validate with any confidence their conclusions? To what degree of certainty do we know that these hand picked professors of finance were not looking squarely into the eyes of a bear raid, imbedded deeply within the data provided, and simply missed the signals invalidating their conclusions? Clearly Mr. Harris offers us no assurances his research did not overlook such events as he clearly admits he couldn't find the proverbial needle in a haystack. The quality of data he was provided for analysis lacked the necessary detail to know where to begin to search for that needle.

There is significance to this issue and it comes down to diligence and want. Does the SEC want to understand this problem and if so, is the Commission staffed with individuals with the diligence and desire to get to the truth wherever it may lie?

Personally, I believe that answer is no. I believe that for some reason the Commission has sold short the integrity of the markets for the rights to unmitigated liquidity. In making this decision the Commission has intentionally derailed any regulatory changes that would slow down liquidity even if doing so were to improve investor protection and market confidences. This proposal set forth for public comment is simply more of the same smoke and mirrors crafted by cagey individuals whose intent it is to placate the members of Congressional oversight because they have to. The desire to address the problem is simply not there.

Speaking before the prior roundtable conference on the Uptick Rule Pilot Program Chairman Cox quipped:

> *"But one thing that we will never keep short, ever shortchange is economic analysis, and that's the reason we're having this discussion today."*[2]

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[1] Larry Harris. Fred V. Keenan Chair in Finance September 15, 2006 Comments to Pilot Program
[2] Chairman Chris Cox Opening remarks September 15, 2006 Roundtable on Uptick pilot program.

And yet for decades, and as Mr. Harris alluded to in his presentation, the Commission has continued to shortchange the public on the data necessary to properly evaluate these market events. This proposal for public comment does not provide the raw data for others to evaluate, instead this proposal provides the public a shopping list of options and requests the public to conduct the necessary studies required to substantiate one option over another.

The problem, the public does not have the subpoena power to obtain the resolution of data necessary to make such an informed analysis. The public is limited in their data gathering and thus ill-equipped to provide an informed response to these options. It is the Commission that has this authority and it is the job of the Commission to argue points based on such studies.

Will the May 5, 2009 Roundtable conference bring change or more of the same? Will the 'studies' to be presented at this Roundtable include detailed data that can be used to make informed decisions or will more information be presented in a nice neat package with a red bow wrapped around it by the selective credentialed people chosen by the SEC so that the public doesn't have the opportunity to question the quality of the product hidden underneath the wrapping?

- Was there evidence that the market in Bear Stearns and Lehman was impacted in any way by present short sale policies? To what level of detail did the SEC even look (trade tickets, manner of trade execution, order splitting and use of single locate for multiple orders, trade impact on bid depth, etc….)
- What were the market conditions in Morgan Stanley that led the SEC to initiate the September 2008 ban on short sales?
- How effective have market makers been in stemming downside sell-offs as compared to exemptions they undertake to mitigate unusual upside volatility (naked short exemptions)? Perceptions would show that a company is much more likely to lose 50% or more of its market cap in a rapid sell-off than it is to rise 50% due to a sudden influx of volume. Is there a reason for this anomaly and what part does short selling and market makers play in this?
- How do the markets correlate trading activities based on short interest? Does the SEC see a differentiation in trade technique (sales on downtick, market making activity, price volatility, etc….) between markets with low short sale volume and a market with heavy short sales volume?
- Given a lack of pre-borrow regulation on short sales, is there a distinct differentiation between a 'day trade' short sale execution and that of a short sale executed as a long term strategy? Do SEC studies even drill down to such resolution?
- Is the 'day trade' short sale executed in a more hostile manner into the market than that of a longer invested short trade and what impact does that trade have on bid quality and overall longevity of price efficiency? Clearly the 'day trade' needs to turn the market quickly while the longer invested short sale is not interested in intra-day market activities.
- To what level has the SEC analyzed the activities of market makers when comparing heavily shorted markets to lightly shorted markets? Is there a disparity in how liquidity is offered by market makers between the two market types? Are market makers less likely to hold a bid in a market heavily biased with short selling? Are market makers more likely to execute into the bid or downtick on some stocks more than others based on short volume activity?
- How does the bid depth change during a collapsing market and what impact do sales taken into the bid have on the bid depth?

The public needs data to make informed decisions and over the past 5 years the SEC has actively denied the public access to the specific information required to make that work.

"Access is denied to the responsive records, including memoranda and e-Mails (approximately 4,203 pages entirely), all of which are prepared by and/or for the use of the Commission, form an integral part of the Commission's predecisional process…."[3]

What this FOIA denial identifies, and the many others I have received over time identify is that the information the Commission uses to formulate their opinions and decisions is not information they choose to make available to the public. The Commission chooses to leave the public at a disadvantage in order to dismiss their opinions in the process. Ultimately the public, without subpoena power to obtain trade data, is left to put faith in the opinions of Commission employees who may be *"less candid in expressing their views"* should their names be part of public disclosure of information.

Personally, I learned long ago that the value of a person and a person's opinion was in placing ones name on ones work. Those who hold back opinion because they would have their name associated with that opinion can not really be that confident in the opinion they are making. The fact that those within the SEC responsible for gathering the evidence, and presenting opinion on the evidence gathered, feel the need to hide behind this policy the Commission has created rings of conflicts of interest.

Uptick Rule, Pre-Borrows, and Investor Safety

So where does the SEC intend to take all of this? To date the SEC's ability to create a workable solution to short sale policies has been a colossal failure spending more than a decade in concept releases and rule making reforms only to find themselves reeling in criticism. In good times the criticisms came from lesser known personalities but in more dire times such as where we stand today the criticism has reached levels of more recognized names. CEO's of Large Banks and Blue Chip Companies now talk openly about short sale abuse once relegated to smaller market CEO's. Hedge Fund managers now openly speak against the abuses when in the past it was the nameless retail investors who complained about bad policies and market abuses.

At the present time the SEC continues to be lacking in publishing any real studies to speak of that can show us the light at the end of the tunnel on this subject. There is an upheaval in market confidence and short sales, for right or wrong, is certainly a central part of that upheaval.

Sears Holding CEO Eddie Lampert:

"…the level of "naked" short selling of our shares was significant. The activity can be measured by the number of shares sold short as disclosed twice monthly by the NYSE and Nasdaq as well as by the reported number of instances of failure to deliver securities by short sellers to purchasers of Sears Holdings stock… The sale of property (shares in a corporation) that a seller does not own and can't deliver (naked short selling) is an affront to property owners, and a <u>destroyer of confidence and trust</u>."[4]

Economist Perrie Ellis

"There is a desperate urge to avoid all risk" and investors are opting to "step back and wait for the smoke to clear,"[5]

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[3] FOIA Denial on request for OEA data: http://investigatethesec.com/drupal-5.5/files/FOIA%2009-03058.pdf
[4] Eddie Lampert, Chairman Sears Holding Corp. February 2009 Memo to investors
[5] Pierre Ellis, senior economist at Decision Economics

CNBC Commentator James Cramer:

> *"We will not have peace in the markets until [the uptick rule] is restored,"*[6]

This proposal and the options the SEC offers is not the stand alone solution the public and the US capital markets need.

Circuit Breakers are the equivalent of closing the barn door after the animals have all left the barn.

On April 28, 2009 Dendreon Corp (NASDAQ DNDN) experienced a well timed market raid. Dendreon is a biomedical companies focused on gaining FDA approval of a drug to fight the disease of Prostrate Cancer. Dendreon has for years been a major target of short sellers and has frequently spent time on the Regulation SHO threshold security list.

On April 28, 2009, just prior to a public conference on the results of their Phase III Trial data the stock was targeted for a bear raid. In a matter of 70 seconds the stock collapsed from $25.00/share to $7.50/share and had recovered to $11.00/share before the NASDAQ could halt trading. With nothing but positive news, the stock resumed trading after hours (where the professionals play) at $26.00/share.

Investors who had placed stop loss orders well below the prevailing market were sucked out of their positions at a huge loss. And this bear raid, it was reported to be in place more than an hour before it happened on a Yahoo message board.

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[6] Jim Cramer Blame the Bear Raids http://www.cnbc.com/id/23728522

And as predicted in this message it did happen, the stock did lose 50% and more in 70 seconds, and the raid did in fact take place at the predicted time - 12:30 CST (1:30 EST)

Dendreon Corporation (DNDN) - Quote Info

Search : in Dendreon Corporation (DNDN) Search

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Re: HIGH PROBABILITY MASSIVE BEAR RAID 12 30 pm central today

< 28-Apr-09 01:30 pm >

ALERT UPDATE told u massive bear raid and expect stock cut in half at 12 30 cental today urged u to sell short @ 24 +

stock halted @ 12 bux after hitting low 7 and change

monthaphumc...

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- Based on the speed in which the market declined, would the circuit breaker the SEC proposes have saved those investors caught in the raid? Certainly restrictions in future short sales would not have much of an impact as the market corrected itself after hours but during the event there were long investors who lost significant money.
    - One investor claimed he put a stop loss in at $16.50 and the sale was executed at $8.00 based on the speed of the decline and the manner in which the trade was executed. That investor had no way of re-entering the market anywhere near his sell point due to the trade halt and the after hours gap back to $26.00
- What initiated the raid on Dendreon and to what extent did the lack of an Uptick rule play in that activity?
- Would any of the analysis into short selling and the uptick rule, under the conditions used by the SEC and their hand picked group of economists, have picked up on this activity as a red flag or would this particular event been lost as noise in the bigger picture under analysis? If this event was lost in the noise than the SEC should rethink the value of their analysis.
- What part did a lack of a mandatory pre-borrow have on this trade activity? Were the trades that initiated the massive sell off executed under a locate policy by short sellers who intended to close out the trade by close of business to avoid a borrow requirement and avoid the possibility of a settlement failure? Were the trades that initiated this selloff executed by investors long the stock but short the beneficial ownership implying that the selloff was not by individuals with the beneficial rights to initiate such a selloff?
- Dendreon had a short interest of greater than 20% so to what extent did the flaws in the locate policies (allowing for multiple locates on common shares) an aid sellers in this rapid strike event?
- To what part did the market makers play in this event? Where were the market makers who were responsible for maintaining liquidity during a period of unusual trade volume? The SEC has offered these market makers leeway to sell naked, and on the downtick for liquidity and yet in this case the market makers stepped aside instead of maintaining price efficiencies.
- Finally, how many more of these examples exist out there, at degrees smaller and greater than this one, that have gone undetected by the regulators as they were being explained away as price discovery?

Now clearly these are questions posed based on gut feel and not actual data but that is because the public does not have access to such data. There is no requirement for daily short sale reporting so that yesterday's trade volume in Dendreon could be compared against the level of short selling in that volume. There is likewise no reporting of market making activity relative to volume trading. Only the SEC has access to this information so only the SEC can respond to those questions and provide the public with the proper insight on what causes these activities.

Of course there could be other possibilities out there including the possibility that this was a scheme orchestrated with the options market to profit on options positions held on the way down and then back on the way up. Again, only the SEC has access to such data so it is impossible for the general public to decipher and make informed decisions regarding.

With the market as it stands it is clear that no one step will resolve this issue. The SEC has an interim final temporary rule that imposes hard close on settlement failures that has extended past the public comment period and a majority of responses request a more stringent mandatory pre-borrow provision to be considered on all short sales so that the settlement failure is not standard practice but an anomaly. The mandatory pre-borrow would also eliminate the possibility of 'day trade' raiding of stocks.

This proposal, without changes to the short sale process becomes nothing more than window dressing. If this proposal becomes a standalone event it will fail and when it fails to correct the problem those who commented against this Uptick rule will use it as their validation that this change was not warranted to begin with as they did when lobbying for it's removal. The uptick rule is a speed bump at best.

As for the market making exemptions and rules allowing market makers the rights to sell naked short into a bid and into a downtick, I agree with the Commission in that this should not be continued allowable practice. The role of the market maker must be carefully scrutinized over how much of their activity today is good for a market vs. self serving and harmful. How do market makers inject liquidity into a market and to what extent does their future trading activity protect their booked positions as opposed to maintaining proper price discovery regardless of where their personal investment rests? If market makers are not objective in trade after taking up a long or short position in a prior trade than they can do more damage than good.

If market makers are there to create an orderly market:

- Why didn't the market makers protect against the raid in Dendreon?
- Why didn't the market makers protect against the drop in Apple last year when the false story was published about Steve Jobs hospitalization?
- Why didn't the market makers protect the Airline sector when the 3-year old story of a United Airline Bankruptcy suddenly resurfaced as new news and collapsed the entire sector by more than 20%?
- How much selling under the exemption does a market maker engage in (for profit) when they see these markets collapsing as they do?

Let's hope this is the last time we are called upon as investors in the US Capital Markets to address short sale policies. These persistent corrections to past failures are an inefficient use of Commission resource and have clearly been a black eye over the confidence people have in the markets and our regulatory leadership.

In conclusion:

> *"If you look at the history of enforcement actions at the SEC, the number of actions to deal with pump and dumps vastly, vastly exceeds the number associated with bear raids. Bear raids are very uncommon."*[7]

Based on what we have learned to date, this could just as easily be an argument against the resolve of the Commission to seek out and enforce Bear Raids as it is a statement about the magnitude of pump and dumps in comparison. As a short seller himself we would also expect Mr. Harris to formulate this opinion.

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[7] Larry Harris. Fred V. Keenan Chair in Finance September 15, 2006 Comments to Pilot Program