

Re: File Number S7-19-07
Comment on Proposed Amendment to Regulation SHO

Dear Sir or Madam:

Thank you for providing this forum to comment on the SEC's most recent proposed amendment to Regulation SHO.

By way of background, I am an attorney with 24 years litigation experience in business cases, many of them involving allegations of fraud and unfair business practices. I am also an investor in many growth stage corporations with relatively small market capitalizations. For the past two and a half years I have been intensely studying the confluence of events building up to what is now being recognized as a calamity threatening the world economy.

Naked Short Selling and Market Manipulation

It is very appropriate during these times for the SEC to be focusing on the widespread practice of illegal "naked" short selling of company shares and the inevitable illegal market manipulations that accompany this practice. This is exactly the kind of "get rich quick at the expense of everyone else" attitude emblematic of the present crisis.

Illegal short selling is a crime aimed at the heart of what has made American great: an entrepreneurial spirit, courage to take on risk, free markets that best allocate resources and our best educated, most dedicated citizens advancing innovation that improves the quality of life world-wide.

There can be no discussion of naked short selling that does not include illegal market manipulation. The two are inexorably tied because the naked short seller cannot afford under any circumstance to allow the share price to increase beyond its short position. Unlike a legal short seller who owns the shares being shorted and therefore takes a calculated economic risk by guessing wrong, the naked short who wagers unwisely faces instant ruin and quite likely, criminal prosecution, as he sustains a loss he cannot pay. Therefore, nothing can be left to chance.

Bringing Regulation SHO Up to Existing Anti-Fraud Statutes

With specific reference to the proposed changes to Regulation SHO, my views are as follows:

1. The Options Market Maker Exception clearly needs to be eliminated. This and the grandfathering exception doomed Regulation SHO to being ineffective from the beginning. This became clear almost immediately as the number of fails to deliver of virtually every threshold list company *increased* month by month.

2. As many have stated in the numerous well-reasoned comments posted herein, far more must be done to bring Regulation SHO up to the level of pre-existing anti-fraud statutes. As examples, the onus must be placed on broker-dealers to assure delivery by borrowing the shorted shares. Regulation SHO must require buy-in of delivery failures on the fail date plus one day. There should be public disclosure of the volume of outstanding fails and the identities of the individuals, funds and broker-dealers responsible for them.

Existing Anti-Fraud Statutes Gave SEC Enforcement Power

The truth be told, Regulation SHO has probably done more harm than good from the beginning by suggesting there can be exceptions made to laws prohibiting criminal fraud. Did the SEC really believe criminal fraud could be grandfathered? Did it mean to suggest that broker-dealers could be exempted from criminal fraud?

The CFA Institute, Centre for Financial Market Integrity drove home this point in recent comments it made to proposed, new SEC naked short selling anti fraud rules (File No. S7-08-08). The CFA Institute noted, in relevant part,

We find it curious . . . that the Commission is revisiting efforts to address naked short selling through proposing a new rule. As noted in the release, this practice is already prohibited under general anti-fraud rules. . . . We question the need to adopt yet another rule aimed at eliminating this practice, particularly when this proposal does little more than reiterate the associated problems and create an anti-fraud rule for this specific purpose.

While we support the elimination of naked short selling, we do not support the promulgation of yet another rule to address what Regulation SHO and the general securities laws have apparently failed to rectify. Instead, we recommend that the Commission reconsider its approach to addressing this issue. If general securities laws already cover fraudulent acts by a seller, the Commission already has the power to bring enforcement actions against sellers who act with an intention to deceive and should use those powers to halt these abuses.

I would add to the CFA Institute's comments, the Racketeer Influenced Corrupt Organizations ("RICO") statutes that have been in place for decades provide a powerful framework for prosecuting these crimes both criminally and civilly. The purposeful illegal short selling and market manipulation at the heart of these crimes necessary involve conspiracy among investors, fund managers, broker-dealers and even, quite like, members of the press. RICO provides for the recovery of treble damages and attorney feed in addition to criminal penalties.

Enforcement In Favor of a Special Class of the World's Largest Banks

Recent announcements by the SEC appear to reinforce the notion that the Commission believes it has the authority to exempt certain actors from liability for criminal fraud. In response to concerns about the possible collapse of Fannie Mae and Freddie Mac, the Commission announced it was beginning a program to ferret out naked short selling and market manipulation of their shares. Curiously, it then published a list of "protected" entities that including not only Fannie Mae and Freddie Mac, but also the world's largest banks and broker-dealers.

Are we to understand from this announcement that preventing criminal fraud against a handful of financial giants is an SEC priority, but preventing the same crimes against thousands of smaller public companies is not? Are these companies with market capitalizations in the tens of billions of dollars and access to the best legal teams in the world less able to fend for themselves?

New Exemptions of Specific Criminal Parties

The latest word we hear is that the Commission means to exempt market makers from its emergency enforcement action protecting the financial giants. Is the SEC telling us again there are select parties have the right to commit criminal fraud? With respect to the protected class of financial giants, is criminal prosecution a one-way street?

A History of SEC Non-Enforcement of Criminal Fraud Statutes

Sadly, there is evidence that the SEC has at least a decade-long history of ignoring the problems of naked short selling and related market manipulation, and of harassing and punishing companies that have taken the initiative to protect themselves. I would encourage anyone reading this commentary to review a document entitled "Recitation of Facts by General Counsel" prepared by Chris Gunderson, General Counsel for Universal Express, Inc. (formerly Packaging Plus Services, Inc.), which can be found at http://www.usxp.com/recitation_of_facts.pdf. This statement makes two important points: first, that actions against naked short sellers can, and have been, successfully prosecuted with outstanding results, and second, that the SEC appears to have been disinterested in and obstructive of past efforts to bring these criminal perpetrators to justice.

The fact is, there has been widespread discussion for years among private sector commentators about the problem of naked short selling and market manipulation, the consistent forms it takes and effective methods for bringing guilty parties to justice. What has been lacking has been any contribution to these discussions by the SEC or other federal enforcement agencies.

Today's Perpetrators May Believe They Are Immune from Prosecution

In the view of many commentators, there exists now a generation of white-collar perpetrators for whom fraudulent, naked short selling and market manipulation is part of their daily work routine. They do not even "get" that what they are doing is criminal. Their managers, who probably know that what they are doing is illegal, believe themselves to be immune because they have never seen any of the colleagues prosecuted.

Effective Prosecution Would Avoid Need for Emergency Action

Had the SEC, the Justice Department or the FBI been enforcing existing laws there would be no need for the SEC to issue an "emergency order" aimed at protecting Fannie Mae, Freddie Mac and the newly identified special class of financial giants. Large entities would be on notice that they faced financial ruin if they engaged in these practices. Their shareholders and investors would be vigilant to make sure their investments were not being threatened by reckless actions of management.

Effective Prosecution Would Avoid Need to Exempt Players

In my view, the SEC's continual practice of exempting large players from its enforcement actions may well stem from its realization that since these practices have become so entrenched, including the largest participants in enforcement actions could pose a threat to the international financial "system." There is an example I heard of where a company realized the extent of the problem of naked short selling because at its annual meeting, there were 20% more shares voted on than there were shares outstanding.

In a case like that, I understand that unwinding the illegal short position could entail buying upwards of 50% of the company's shares during a time when the share price would necessarily be skyrocketing. As mentioned earlier, the illegal short cannot afford to have the share price rise above its short position. The illegal short would go instantly broke and the only remedy would be a criminal prosecution of the offender. The "long" would lose the benefit of his investment and have nothing more than a cause of action against a bankrupt entity.

A Roadmap to Prosecution Exists

I have already discovered a wealth of public domain material produced about illegal short selling and how to combat it. In addition, it appears there are many qualified individuals willing to speak publicly that have extensive experience prosecuting the offenders. Therefore, it seems the SEC (or any other enforcement body) already has in place a roadmap of how to proceed should it choose to do so.

Jim Puplava, on his Financial Sense Online site, has made available copies of an amazing six-part broadcast series he did between May 24, 2008 and June 21, 2008, entitled the "Crime of the Century." They are available free of charge at

<http://www.financialsense.com/metals/crime/main.html> along with helpful written materials.

Listening to them you discover it seems relatively easy to spot the episodes of market manipulation as they occur, identify past manipulations and with subpoena power, follow the paper trail directly to the perpetrators. You also get the sense there may be a wealth of former and current Wall Street players willing (if not eager) to educate prosecutors and point them directly to the individuals most responsible.

Dr. Patrick M. Byrne, Chairman and CEO of Overstock.com has obviously become an expert on fighting these practices while trying to save his company from ruin. His name often comes up as a person ready, willing and able to help map out an approach for prosecuting these criminals. Attorney Chris Gunderson of Universal Express, Inc., mentioned earlier, has obtained jury verdicts in the millions of dollars against them.

Jim Cramer, the hedge fund manager-turned financial commentator last year publicly spoke about the common methods used by the hedge fund industry to manipulate markets and make sure they profit from both long and short positions. Admitting that much of what he was describing is illegal, Cramer stated, “you do it anyway because the SEC doesn’t understand it.”

Conclusion

Having learned so much about naked short selling, illegal market manipulation and the ways it can be combated I am astounded that organizations such as the SEC have not been parading the offending parties before us in handcuffs while announcing major, wide-reaching prosecutions. These cases involve billions if not trillions of dollars of ill-gotten gains from crimes that do immeasurable damage to the American people. There appears to be no difficulty demonstrating that the crime took place or linking the perpetrator to the crime. This is done by examining records preserved at major financial institutions as part of their required document retention policies.

Inaction could possibly be explained by an agency having insufficient staff or budget to prosecute these offenses; however, I am not aware of any declaration by the SEC or any other enforcement agency that it is being held back by insufficient resources. If this were the case, I am quite sure there would be enormous public support for providing additional resources given the enormous damage being inflicted.

In short, there appears to be an extraordinary opportunity staring at any individual or agency willing to dedicate resources to ferreting out the illegal short sellers and market manipulators that are the focus of this discussion. Furthermore, there appears to be no need to wait to begin these prosecutions until Regulation SHO has been modified or a new statute has been enacted, for the necessary laws have always been on the books to fully prosecute the responsible criminals.

Whichever agency ends up taking the lead on these prosecutions will undoubtedly garner widespread public support and emerge as the dominant enforcement body in the banking and securities field. Tragically, we are in an era where many Americans will lose their jobs, homes, life savings and pensions as the result of misconduct at the highest levels of private banking and investment. The public will demand justice and whoever delivers it will gain the loyalty and trust of generations to come.

Sincerely,

Richard Belfanti
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Attorney, Investor and Concerned Citizen