Amendments to Regulation SHO
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With respect to the effects that artificial barriers to short selling have on the securities markets, I would refer the Commission to the testimony of Owen Lamont, Ph.D., in front of the Senate Judiciary Committee in late June of this year and to his academic paper "Go Down Fighting: Short Sellers vs Firms".

I first became aware of the so-called "naked short selling" problem in late
2004 when I encountered an article written by an "internet" journalist who stated that "naked short selling" was responsible for the bankruptcy of thousands of companies and the loss of trillions of dollars of investors'
capital. Intrigued by such a claim, I sought examples of companies who had been victimized by this practice. Since late 2004, I have examined the financials of scores of companies supposedly damaged by "naked short selling". In all of my research, I have found a consistent trend that seems to occur again and again, with few exceptions, with every company where it's been claimed that "naked short selling" has been a destructive force.

That trend I've discovered is that a company will raise capital, then the company will recklessly burn through the capital they've raised. Managements and promoters will draw lavish salaries, stock grants, benefits, and other fee income. Then, when the company's capital has been exhausted, the company will blame its problems on "naked short selling". Some of these companies have been quite successful in convincing their shareholders that "naked short sellers" are reponsible for their losses. In fact, many of those victimized shareholders, and at least one promoter of such a company, have taken the time to write comments on the proposed Amendments to Regulation SHO that now appear on the SEC website. Their names are recognizable to anyone who follows the comments left on numerous internet message boards about this "problem".

There are three recent examples of companies and a manager that have been the subject of SEC regulatory action where investors remain convinced that the problem with their investments rests with "naked short selling". CMKM Diamonds, a clear-cut example of a vehicle that Urban Casavant used to dump hundreds of BILLIONS of shares of worthless stock on naive investors, attracted over 40,000 investors, many of whom remain convinced that their losses are the result of "naked short selling". Many of these investors continue to remain confident in CMKM Diamonds as a company, and Urban Casavant as a manager, despite the fact that CMKM Diamonds wasn't even preparing or submitting their required financial filings as these investors were buying their shares.

Recently revoked Eagletech, another company whose delinquency in preparing and submitting required financial filings extended for years, managed to make itself the topic of a prime-time television show's expose on "naked short selling" and garnered the support of hundreds of shareholders who insisted that "naked short selling" had destroyed the company. Very few people took the time or the trouble to read

Eagletech's last 10Q that they filed. Had they done so, they would have found a company that had racked up $18.3 million of operating losses. Of those losses, $15.6 million were attributable to general & administrative (management) expenditures. This "development" stage company spent less than $720 thousand on capital equipment and $313 thousand on R&D. This clearly is another example of a company that was built to clean out shareholders, yet many Eagletech investors to this day blame "naked short sellers" for their losses.

Gary Valinoti, previously chief of Jag Media, was quite vocal in allegations that "naked short selling" was hurting his company. The company even stated, in their 10KSB for 2004 that, as a risk factor, "THE VALUE OF YOUR INVESTMENT IN JAG MEDIA COULD DECREASE DUE TO NAKED SHORTING OF OUR COMMON STOCK."

Last September, we discover that Mr. Valinoti was quietly, and illegally, dumping large portions of his stake in Jag Media. Jag Media also followed the previously mentioned trend of raising capital, and burning capital, as management drew handsome salaries while the company whithered on the vine.

Despite numerous allegations leveled at "naked short selling", there has never been a company whose stock was artificially depressed by "naked short selling". The market has numerous mechanisms in place to prevent a stock from becoming "artificially depressed". A private buy-out is all that's necessary to address the problem of a stock price that might become "artificially depressed". There is even an example of a company, supposedly harmed by "naked short selling", that used the illusion of a private buy-out to hype their stock and dump shares on naive investors. Global Links was the topic of a sensational story last year where Robert Simpson supposedly purchased all of the outstanding shares of the company. Unfortunately, owning all of the Global Links common stock didn't constitute a "buy-out" as a super-voting class of preferred shares was held by insiders that assured control could not be wrested from their hands. Mr. Simpson was probably well aware of this issue of preferred shares before he bought those shares and filed what should have been considered a fraudulent Form 3 as he played a similar game with a company where he was the CEO: Zann Corp.

The stories about the victimization of inexperienced shareholders by managers and promoters who use the "naked short seller" as a tool to divert blame for their misbehavior are quite fascinating and obviously the driving force behind the campaign to get Regulation SHO adopted in the first place and to now get it amended. They have led to a situation where the SEC must choose between bad policy or bad politics.

The main purpose of a free market is to serve as a price discovery mechanism. Everything else is subordinate to this purpose. Unfortunately, many unsuccessful investors don't like the consequences of their poor, or non-existent, approach to investment analysis. And so they seek to alter the price discovery mechanism. It is part of a phenomena I discovered years ago. If a mediocre investor buys a stock and it goes up, it's because he's a genius. If the stock he buys goes down, it's because the market is manipulated and something about the market needs to be "fixed".

Regulation SHO, in its original form, is a hindrance to price discovery.
The Amendments to Regulation SHO will make the regulation an even greater hindrance to price discovery. Therefore, one would have to conclude that it is very bad policy to adopt these amendments or even, for that matter, to permit Regulation SHO to remain in effect.

However, Regulation SHO is as much, if not more, a political problem than a policy problem. Most reasonable investors have no need for it. Good investors that seek, acquire, and study the current financial filings of the companies that interest them do not buy shares in companies like CMKM Diamonds, Eagletech, or Jag Media. Those investors who conclude that the poor results of their bad investment decision-making are signs of market manipulation will never be safe from the likes of a CMKM Diamonds, Eagletech, or Jag Media. Sadly, it is these naive and misinformed investors who lobbied the most for Regulation SHO, and who have lobbied for these amendments, that stand to lose the most from these bad policies. Neither Regulation SHO nor these proposed amendments will turn bad investments into good investments.

So, do you continue to enable the activities of the Urban Casavant's, Rodney Young's, and Gary Valinoti's of the world at the expense of inexperienced, naive investors? Unfortunately, from a political perspective, you probably have to permit these flawed amendments to take effect.

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