September 19, 2006

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

Re: File No. S7-12-06 - Amendments to Regulation SHO

Dear Ms. Morris, Commissioners and Staff:

This letter is in response to the Securities and Exchange Commission's ("SEC") request for comments on proposed amendments to Regulation SHO (the "Amendments"), which Amendments the SEC indicates are being offered to further reduce delivery failures and "naked" short selling. I am a corporate and securities lawyer in Raleigh, North Carolina.

Grandfather Provision

You first request comment on your proposal to amend Regulation SHO to eliminate the "grandfather provision." In short, the grandfather provision should be eliminated immediately, with no additional grace period for compliance, especially considering it will be six to twelve months or more before the SEC implements the Amendments in any event.

As you will recall, the grandfather provision was never mentioned in the SEC's 2003 proposal to create what became Regulation SHO, and the SEC never gave the public any opportunity to comment on it. Apparently the grandfather provision appeared after intense, direct private lobbying of the SEC by securities industry interests including, among others, the Securities Industry Association ("SIA"). One can only assume that those who profit from abusive and manipulative trading activities were offended by the thought of returning to their victims some of the money acquired through these illicit activities. It is disturbing that, while the comments and suggestions of the investing public were ignored in implementing the original Regulation SHO, the industry and its lobby were able to get direct access to the decision makers at the SEC and impose a provision that effectively gave the manipulators immunity from the financial consequences of their crimes.

Aside from the fact that the grandfather provision is immoral, without legal justification (*e.g.*, it specifically contradicts the 1934 Act's mandate to clear and settle trades promptly), and grossly unfair to the investing public who pay for the securities that the industry refuses to deliver, the SEC claims in the Introduction to the proposed Amendments (page 3) that "the majority of trades settle on time." Since the SEC is confident that Regulation SHO is working, and that the securities industry is now doing the right thing and settling most of its trades on time, it should be no problem to eliminate the grandfather provision immediately and remove the basis for so much criticism of the SEC. Certainly the SEC does not wish to continue the appearance of favoritism toward the securities industry that the grandfather provision conveys.

Options Market Maker Exception

The SEC requests comment on whether to modify the market maker exception to the close-out requirement of Rule 203(b)(3), which currently allows registered market makers to fail on delivery of short sales made to hedge options positions created before the victim security became a threshold security. As you note, as currently written "the exception does not require that such fails be closed out within any particular timeframe" (Section II.C of the proposed Amendments, page 7).

It boggles the mind of any non-biased sentient being that the SEC would have permitted this "market maker exception" as written in the first place—unless it is assumed that your sole intention was to protect and increase the profits of the securities industry, to the direct detriment of the investing public. Has it really occurred to the SEC that "large and persistent fails to deliver ***may*** have a negative effect on the market…." (emphasis added)? How long did it take options market makers and corrupt hedge funds to get together to exploit this exception to continue bear raids on threshold securities? Even the SEC knows that certain market makers have in the past rented their market maker exemptions to affiliated hedge funds to pre-short PIPEs.

It is a struggle to avoid sarcasm in commenting on this exception, so I will keep it simple. This exception should be eliminated altogether. Stop distorting prices by allowing one side of a transaction to cheat by creating artificial supply. The market will quickly adjust to prices more in line with economic reality, those who use options as an investment strategy will continue to do so (while those who use options and this exception to manipulate the market will have to find another scam), and the systemic risks to the market created by supply side price manipulation will go away. Since the reality is that the SEC will not eliminate the market maker exception—because the industry won't allow you close the candy store—the amendments proposed are the best the investing public is going to get at this time, so we will take it.

General Request for Comment

It is difficult to "provide empirical data to support [our] views and arguments" (page 27) because the SEC and the Depository Trust and Clearing Corporation ("DTCC") refuse to release any relevant data to the public. I seem to recall the laughable reason given for all the obfuscation is to prevent the disclosure of [somebody's] proprietary trading strategies. Does it concern anyone up there in Washington, D.C., and New York City that these trading strategies may well be manipulative and illegal? Is the securities industry really entitled to hide from the public—its victims—the mechanisms by which they are being cheated? Most of us know the real reason that DTCC is opposed to any sunlight on its activities is the fear of civil repercussions once the victims of their duplicity find out how the games work. If the DTCC can hide the truth long enough, the relevant statutes of limitations will run and they can avoid facing civil justice for their actions.

Thankfully, there is no need for empirical data, just use some common sense. Currently the SEC allows the securities industry (and those of their customers who are given improper access to the exemptions and privileges afforded the industry) to sell something that the seller does not own and has not borrowed. Supposedly this is good for the markets, in that it promotes "liquidity."

In the real world, to sell something that one doesn't own and has not lawfully borrowed is a crime. *De facto* electronic counterfeiting of corporate securities, which is what a naked short sale really is, is also a federal crime. When your industry friends fail to timely deliver securities sold to an innocent buyer, they are defrauding that buyer. And the buyer's broker (who is supposed to be in a fiduciary relationship with his customer) who does not tell the buyer that he has not received the securities paid for, or buy in the delivery failure on a guaranteed basis, even though the commission has been charged and collected and the purchase price has been removed from the customer's account, that broker is participating in the fraud. Mailing a brokerage statement that shows an account owner is the owner of a security, when in fact all he has is what the SEC calls an "entitlement" to receive that security from some unknown person at some unknown date in the future, is criminal mail fraud.

If the industry wants to sell securities "entitlements" rather than the securities themselves, then at least require them to set up a different mechanism for trading these "entitlements." Just have a separate market for these "entitlements," perhaps placing an "N" at the end of the normal trading symbol, so that the buyer can go out and buy the "entitlement" if that's what he wants. That way the "entitlement" buyer won't foolishly expect that his vote on shareholder matters will be counted, and the brokers and clearing firms won't have to feel guilty about disenfranchising those to whom they failed to deliver duly purchased securities. Then require timely delivery for real securities, those not properly labeled "entitlements." This would help remove the price distortions from the real securities, and those in the industry who want to market "entitlements" can do so legally.

The above said, here are suggestions to accomplish the stated purposes of Regulation SHO. It is a shame that I have to even type this stuff, but here goes.

1. Require an actual borrow prior to any short sale. Since the industry won't let the SEC do that, then at least forbid any clearing firm or other securities lender from lending any security to more than one borrower at a time. If you are only going to require a "locate," then once a security has been "located" for a short sale, require the holder/lender of that security to segregate it so that it can not be "located" for any additional short sales. Any other course of action is egregious fraud.

2. Have a specific time frame for a buy in for guaranteed delivery with respect to any long sale that does not timely settle, **and for all market maker naked short sales**. I suggest T + 3. In those rare instances where the seller can document in writing a legitimate reason for a delay, then provide for a reasonable extension, say T + 3 + 10. When a seller repeatedly has settlement failures for supposed long sales, then forbid any further sales by that seller absent actual possession of the security to be sold. Finally, if guaranteed delivery can not be obtained in a buy in, the buyer should be allowed to repudiate the trade at whatever price is better for him, the current price or the trade price, plus all commissions and fees refunded.

3. The seller for every securities delivery failure must be required to pay interest and other usual and customary borrowing costs on the settlement failure to the actual buyer of the securities. A legitimate short sale entails costs imposed on the borrower/seller. Why does the SEC encourage the illegal form of short selling by not imposing any cost on the perpetrator? If the clearing firms can handle sales proceeds, commissions, and SEC fees on transactions, they can easily handle interest and borrowing costs between the failing seller and the innocent buyer.

4. The SEC must get a handle on the ex-clearing problem, or it is going to bury the U.S. securities markets. Extend the requirements imposed on clearing firms under Regulation SHO to all brokers. Require the buy-side broker to buy in for guaranteed delivery all settlement failures that extend past the mandated settlement date.

5. To the best of my knowledge, the SEC has never acted to enforce Regulation SHO. You admit that you have been doing examinations of industry players, and that changes need to be made. It seems then that you must have found some violations of Regulation SHO. Why have there been no enforcement actions? And make the fine fit the crime. If they steal $100 million, don’t just fine them $1 million. Give one (1) warning, then thereafter take all the illicit profit, for every violation; for repeated violations, revoke their market maker exemptions.

6. Finally, the emphasis by the SEC in preventing “short squeezes” is entirely misplaced. For legitimate borrowers of securities for short selling purposes, the possibility of their loan being called in is a cost of doing business, which they take into consideration when deciding whether to make a short side bet. For naked short sales made in furtherance of legitimate market making operations, you at the SEC have stated that these will mostly be closed out the same day or at most within two to three days. But for those who abuse their market maker exemption to engage in or participate in a bear raid, and for others who through neglect or willful wrong behavior get “caught short” when their manipulation scheme backfires, why not let the market enforce

> discipline? Why does the SEC seek to protect these criminals? To hell with them. Just let them be squeezed, hopefully out of business. Then they will be replaced with more honorable market participants.

In conclusion, the public is losing hope that the SEC has the will to deal with these problems. There is much more confidence in the various State securities regulators, and in the United States Senate's Judiciary Committee (though very little in the Banking Committee, which at best appears clueless). The SEC needs to know that the current question out here in "flyover land" when an SEC investigation of a public company is announced is no longer "Did they do anything wrong?" but rather "Which hedge fund needed a hand with its bear raid?" Some are even speculating openly on which SEC employees will go to which Wall Street service firms, and when.

It is my hope that this time the SEC will craft a regulation that accomplishes its stated goals, restores some integrity to the U.S. securities markets, and protects the investing public from securities industry fraud.

Sincerely,

H. Glenn Bagwell, Jr., Esq.

Cc: Elizabeth Dole, U.S. Senate