



September 19, 2006

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: File Number S7 -12 - 06 -- Amendments to Regulation SHO

Dear Securities and Exchange Commission:

Zix Corporation (NASDAQ: ZIXI) ("ZixCorp" or the "Company") appreciates the opportunity to provide comment on the proposed changes to Regulation SHO.<sup>1</sup>

#### INTRODUCTION

ZixCorp has repeatedly appeared on (and off) the Regulation SHO list since the adoption of Regulation SHO. This has occurred even though the Company's overall reported short interest position, both in absolute numbers and as a percentage of its outstanding shares has declined.<sup>2</sup>

The Company believes these repeated appearances on the Regulation SHO list are undermining the confidence of the Company's investors in the integrity of the market for the Company's securities. Every time that the Company appears on the Regulation SHO list, the Company's investor relations department receives calls, emails, and inquiries regarding the matter. These investors are puzzled as to why the Company is continually re-appearing on the Regulation SHO list in the face of the decline in the Company's overall reported short interest position.<sup>3</sup> Many investors attribute the Company's frequent re-appearances on the Regulation SHO list to manipulative short selling and frequently demand that the Company "do something" about the perceived manipulative short selling. This perception that manipulative short selling of the Company's securities is continually occurring has undermined the confidence of many of the Company's investors in the integrity of the market for the Company's securities.

The Company believes that eliminating the grandfathering provision and generally tightening the rules relating to short selling is necessary to reduce the number of fails to deliver. The Company believes this will provide the Company greater

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<sup>1</sup> Release No. 34-54154, referred to herein as the "Proposing Release."

<sup>2</sup> For example, on December 15, 2005, the reported short interest was 4,960,163 shares with 49,096,187 shares outstanding (10.1%). On August 15, 2006, the reported short interest was 2,925,977 with 59,638,839 shares outstanding (4.9%).

<sup>3</sup> See note 2 above.

protection from manipulative short selling and help restore the confidence of the Company's investors in the integrity of the market for the Company's securities.

## ZIXCORP COMMENTS ON PROPOSED RULES

### Elimination of Grandfathering Provision

ZixCorp strongly supports the Commission's proposed rule to eliminate the grandfather provision in Rule 203(b)(3)(i) for all listed securities. The Company believes this will minimize the occurrences of the Company appearing on the Regulation SHO list and improve the confidence of many of the Company's investors in the integrity of the market for the Company's securities.

### Time To Close-Out Previously Grandfathered Fail To Deliver Positions

ZixCorp does not believe that any phase-in period is required as firms have been on notice that they will be required to close out previously-grandfathered fails. ZixCorp strongly opposes allowing more than 35 settlement days from the effective date of the new rules to close-out these previously grandfathered positions.

### Time To Close-Out New Fail To Deliver Positions

ZixCorp strongly supports the Commission's proposal that fail to deliver positions established after the effective date of the new rules be promptly closed-out. ZixCorp supports reducing the time period from 13 settlement days to 10 settlement days.

### Other Issues

The Commission has also requested comment on the following additional Regulation SHO issues:<sup>4</sup>

Commission Question: Is the current threshold level (one-half of one percent) too low or too high?

ZixCorp Response: ZixCorp believes that the current threshold level (one-half of one percent) should be modified to take into account the weekly/daily average trading volume for the threshold security. Establishing the threshold as a percentage of the number of the issuer's outstanding shares of stock does not provide sufficient protections for companies, such as ZixCorp, whose average weekly/daily trading volume is low relative to the number of its outstanding shares. For example, as of Sept 18, 2006, ZixCorp had 59,638,839 shares outstanding and an average daily trading volume of 141,255 shares over the previous four calendar weeks. Therefore, fails to deliver could account for over 10% of each day's trading volume for 21 consecutive trading days, or a full calendar month of trading, without triggering the current threshold level of 299,198

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<sup>4</sup> See generally pp. 14 to 18 of the Proposing Release.

shares. ZixCorp believes that this level of fails to deliver (without the protections of Regulation SHO afforded to threshold securities) could have a material negative affect on the Company's stock price, thus further undermining investor confidence in the integrity of the market for the Company's securities.

ZixCorp recommends that the threshold level be established as the lesser of (a) one-half of one percent of the issuer's outstanding shares or (b) "x" percent of the average weekly/daily trading volume over the preceding four calendar weeks.

If the Commission does not adopt this recommendation, then ZixCorp supports the current threshold levels. We strongly oppose increasing the levels.

Commission Question: Should firms be required to prohibit all short sales in a security by account before effecting any further short sales in that security if that account becomes subject to close-out of that security, rather than only requiring the account to pre-borrow?

ZixCorp Response: Yes. ZixCorp supports prohibiting all short sales in a security by account before permitting any further short sales in that security. Requiring a close-out of the short position by account provides an additional measure of discipline and fairness to the trading process to protect against potentially abusive short selling by the account in question. Requiring only a pre-borrow by the account or broker-dealer does little, in ZixCorp's view, to protect against potentially abusive short selling.<sup>5</sup> Furthermore, ZixCorp supports the Commission's proposal in its October 28, 2003 release pertaining to Regulation SHO that the registered clearing agency that processed the transaction refer the party failing to deliver to the NASD and the designated examining authority for such broker-dealer for appropriate action.

Commission Question: Should a mandatory "pre-borrow" requirement be imposed for all firms with respect to threshold securities whenever there are extended fails in a threshold security, regardless of whether or not that particular firm has a extended fail position?

ZixCorp Response: Yes. ZixCorp supports a mandatory "pre-borrow" requirement be imposed for all firms with respect to all threshold securities. Requiring a mandatory pre-borrow for all firms for all threshold securities provides an additional measure of discipline and fairness to the trading process to protect against potentially abusive short selling practices.<sup>6</sup> All firms may potentially have clients that engage in abusive short selling practices, and persons that engage in abusive short selling practices likely have accounts at a number of different firms. Regulating abusive short selling

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<sup>5</sup> This is particularly true if the Commission does not change the rules to prohibit a "source" from using the same shares to provide the locate to multiple parties. See pp. 15 to 16 of the Proposing Release.

<sup>6</sup> This rule change should be adopted in tandem with a rule change to prohibit a "source" from using the same shares to provide the locate to multiple parties.

practices requires a system-wide approach, which encompasses all firms and market participants. If an abusive short seller has an account at Firm A and Firm A is subject to the pre-borrow requirement, but Firm B is not subject to the pre-borrow requirement then the requirement on Firm A does little to impose discipline and fairness to the trading process since the abusive short seller can nevertheless continue the same abusive short selling activities without any pre-borrow at Firm B.

Commission Question: Should brokers be required to obtain locates only from sources that agree to, and that the broker reasonably believes will, decrement shares so that the source may not provide a locate of the same shares to multiple parties?

ZixCorp Response: Yes. ZixCorp supports requiring brokers to obtain locates only from sources that agree to, and that the broker reasonably believes will, decrement shares so that the source may not provide a locate of the same shares to multiple parties.<sup>7</sup> Permitting the same source to provide multiple locates unfairly facilitates potentially abusive short selling practices as the one source could serve as the sole source for a group of multiple persons – who are potentially acting in tandem and who are intent on engaging in potentially abusive short selling practices. Permitting one source to serve as the source for multiple persons permits a potentially infinite “artificial inflation” of the number shares that are available to be sold short.

This loophole in the system -- which can be readily exploited by abusive short sellers -- effectively obviates the requirement of the rule that a broker-dealer “have reasonable grounds to believe that the security can be borrowed...”<sup>8</sup> While the broker dealer seeking the locate may have reasonable grounds for believing the security can be borrowed,<sup>9</sup> the source of the locate knows that it cannot fulfill the loan of the security since the security has been promised to multiple parties.

Commission Question: Should aggregate fail to deliver positions be disclosed to provide for greater transparency?

ZixCorp Response: Yes. ZixCorp supports disclosing aggregate fail to deliver positions on a stock-by-stock basis and broker-by-broker basis. The public disclosure of aggregate fail to deliver positions would allow listed companies, such as ZixCorp, to know which of their market makers are the sources of the fails to deliver. In general, of course, greater transparency and broader dissemination of information improves the efficiency and integrity of the market. Specifically, ZixCorp believes that depriving listed companies of this information deprives them of potentially relevant and valuable information as they attempt to monitor the activity in their securities for evidence of improper short sales transactions. We at ZixCorp communicate with our market makers, the NASDAQ, and the NASD from time-to-time about trading activity in our stock. We

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<sup>7</sup> Similarly, the rules should be reviewed by the Commission and written to ensure that the lender of securities cannot loan the same securities to multiple parties.

<sup>8</sup> Reg SHO, §242.203(b)(1)(ii).

<sup>9</sup> This assumes, of course, that the broker seeking the locate is acting in good faith.

would want to know which of our market makers are the major source of fails to deliver in determining which of our market makers to contact if we have questions about trading activity and, further, we would want to know if a particular market maker is the source of significant fail to deliver positions when we do contact them.

### CONCLUSION

The Company believes that eliminating the grandfathering provision and generally tightening the rules relating to short selling is necessary to reduce the number of fails to deliver. The Company believes this will provide the Company greater protection from manipulative short selling and help restore the confidence of the Company's investors in the integrity of the market for the Company's securities.

If you have any questions regarding these comments, please direct them to the Company's General Counsel, Ronald A. Woessner, or the Company's Director of Investor Relations, Peter Wilensky.

Respectfully submitted,

ZIX CORPORATION