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Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-12-06

Ladies and Gentleman:

Millennium Partners, L.P. ("Millennium") is grateful for the opportunity to comment on the Securities and Exchange Commission's (the "Commission") recent proposed amendments to Regulation SHO.[1] By way of background, Millennium is a multi-billion dollar private investment company, or hedge fund, that engages in a significant amount of U.S. equity trading. Millennium is a multi-strategy hedge fund, which means that it employs a variety of trading strategies, including various model-based arbitrage strategies and strategies involving fundamental analysis. Many of these strategies involve short selling, and Millennium devotes significant resources to monitor short sale rule compliance. As a hedge fund market participant actively trading in the U.S. equity markets, we believe that Millennium has an especially informed perspective from which to comment on the proposal.

General Comments on Short Sale Regulation

Our general view, which forms much of the basis of our specific comments below, is that market rules should be fair and uniform across all markets and, to the extent feasible, should allow market participants quick and unfettered access to the liquidity available in the market centers. We also believe that market rules should be uniformly enforced. Regulatory arbitrage based upon differences in rules or in their enforcement should not be a factor in the profitability of a particular trade or strategy or of a trading firm generally. Rather, success should result from

[1] SEC Release No. 34-54154 (July 14, 2006).

diligence and research, calculated and measured risk taking, and strong management and risk controls, all in accordance with applicable law and the highest standard of conduct.

In addition, as an active market participant, we rely heavily on the strength of the markets' infrastructure. As such, we believe that the clearance and settlement function underpinning our markets should be efficient and transaction settlements should occur timely whenever possible. Millennium recognizes that systemic market disturbances, whether resulting from a breakdown in the clearance and settlement process or otherwise, could adversely affect our business. Accordingly, rules that strengthen the securities markets' processes, which in our view include provisions of Regulation SHO, further our goals and business objectives.

With respect to short sale regulation generally, we believe that short selling enhances liquidity in the market and should not be curtailed unnecessarily. Of course, all short selling should occur in full compliance with applicable rules, and such rules should be designed to minimize fails in the marketplace to ensure the efficient clearance and settlement of transactions. In this regard, as discussed more fully below, we support the Commission's proposal to tighten up the Regulation SHO close-out provisions.

While there are other areas of short sale regulation not addressed in the proposal that are ripe for guidance and action by the Commission, we would like to take this comment opportunity to commend the Commission's adoption of the pilot program to study the usefulness of the tick and bid tests and we urge the Commission to act as promptly as possible in its review of the pilot data and in proposing changes to the current regulatory scheme. To the extent the Commission, upon review of the pilot data, determines that short sales should remain subject to a price test in some form, we urge the Commission to establish a uniform price test applicable regardless of the market center where the short sale is executed. With respect to the tick/bid tests themselves, we believe they should be eliminated. It is intuitive to most market participants that particularly highly liquid stocks are at little risk of the "bear raids" that the tick/bid tests were designed to curtail, and any benefits to investors and the market that the tick/bid tests provide are outweighed by the harmful inevitable reduction of market liquidity. The tick/bid tests impede the ability to trade quickly and efficiently and, accordingly, we urge the Commission to remove these requirements, at the very least for highly liquid stocks. We believe eliminating the tick/bid tests with respect to such securities would achieve the goal of providing quick and unfettered access to the markets, would provide additional liquidity in the markets, and would not compromise the investor protection concerns underlying the basis for the restrictions. In addition, in today's financial markets, there are a large number of ways to effect short sales, or their economic equivalent, while avoiding tick/bid

test implications, including trading on swap, trading after hours and trading in markets (including overseas markets) not subject to tick/bid compliance. In our view, this has opened up an opportunity for regulatory arbitrage which should be eliminated.

Responses to Specific Requests for Comment in the Proposal

1. **Proposed Elimination of the Grandfather Exception.** In our view, the close-out requirement of Regulation SHO furthers the sound goal of encouraging more timely settlement of trades by eliminating the ability of parties to fail-to-deliver on a long-term basis. By extending the close-out obligation to grandfathered fails, clearing firms will be obligated to clean up long-term fails of threshold securities regardless of when the sale was made. This proposed change will prevent those very persons whose fails led to a security meeting the threshold test from failing to deliver in perpetuity. We support this proposal.

2. **Reduce the Close-Out Period.** We believe that the number of days a fail should be allowed to persist should be reduced. The ten day period suggested by the Commission in its example should be more than adequate for a regular trade to settle.

3. **Allow Market Participants to Close-Out Fails Directly.** Regulation SHO does not dictate the manner in which clearing firms close out failed positions and, subject to contractual restrictions, clearing firms can effect close-outs in any account held by the firm even if such account did not contribute to the fail (*e.g.*, instances where the seller properly arranged in advance to borrow the security from its clearing firm). We believe that this structure is unfair and that there should be rules or guidelines governing the manner in which clearing firms close-out customer accounts under Regulation SHO. In this regard, Millennium believes that clearing firms should be required first to close-out those customers who failed to deliver without arranging in advance to borrow securities from the clearing firm. Furthermore, Millennium believes that market participants should have the ability to close out their own fails or borrows when a clearing firm has a buy-in obligation resulting from fails. It is fundamentally unfair for a market participant to be unnecessarily subject to the pricing imposed by the clearing firm, especially where the market participant has not contributed to the fail. If the market participant is able to close-out the fail at a lower price than the clearing firm, then there is no reason for Regulation SHO to not provide for this direct market participant action. A one or two day period of notice prior to buy-in would accomplish this end without unduly affecting the Commission's goals.

4. **Exchange Traded Funds ("ETFs") Should Be Subject To Different Requirements.** ETFs are often used by market participants as broad-based hedging investments, and do not trade in the same manner as regular equity securities. Specifically, ETF sellers can create ETFs to settle sales to the extent they have the underlying basket of securities to create such ETFs. This gives an ETF seller an option that should logically allow that participant to bypass the locate requirement, to the extent the underlying basket is available. Thus, we believe Regulation SHO should not require a locate be performed with respect to short sales of ETFs provided the seller has (or reasonably believes it can obtain) the underlying component securities of an ETF in time to create the ETF for settlement plus a reasonable time thereafter (*e.g.*, within ten days of settlement). It should, however, remain incumbent upon the seller of an ETF who does not perform a locate to follow through with the creation to the extent necessary to avoid a fail to deliver and subsequent buy-in. If the Commission decides to permit sellers of ETFs additional latitude in this regard, such relief should be crafted in a way that does not adversely affect other market participants who have successfully sold and then delivered hard to borrow ETFs (*i.e.*, it should not be the case that a clearing firm buys-in an ETF seller who borrowed the ETF to deliver on time while another ETF seller who did not borrow the ETF is permitted to fail without being bought-in). We suggest that the Commission amend Regulation SHO to require clearing firms to close-out first those customers who have failed to deliver without arranging to borrow the security from the clearing firm beforehand.

5. **Rule 144 Sales Should Not Be Subject To Buy-Ins.** Millennium believes that fails resulting from Rule 144 sales should be treated differently than regular fails. If a market participant sells a security under Rule 144, but is unable to deliver at settlement solely as a result of the time it takes to remove the legend on the security, the buy-in provisions under Regulation SHO should not apply since the seller owns the position and intends to deliver as soon as the legend removal issues are cleared up. This process differs significantly from ordinary US equity market transactions, where we believe that an extended settlement period is not warranted. We believe that market participants should not be penalized for a settlement failure caused solely by a delay in removing a restrictive legend in connection with a Rule 144 sale.

6. **Definition of Threshold Security Should Not Be Revised.** Millennium believes that, at this point in time, the criteria for threshold securities are satisfactory. The combined threshold list currently contains approximately 275 names, which is a significant improvement since the list was first compiled in 2005. If the Commission is able to demonstrate, through empirical data, that the markets would not be adversely affected by expanding the threshold category, then such a change might be justified to further reduce fails and

enhance the clearance and settlement process. However, the Commission has not provided significant evidence in this regard (at least that it has made publicly available) and, in our view, expanding the threshold category may cause unnecessary market disruption.

7. **Account-Level Close-Outs Should Be Required.** As indicated above, often when a fail occurs a clearing broker will allocate buy-in liability across all short accounts, without being required to consider the accounts ultimately causing the fails. Millennium believes that this methodology is fundamentally unfair. If a customer effects a short sale in a stock in accordance with applicable requirements (*e.g.*, by borrowing the security from its clearing broker) and does not contribute to a fail and another customer causes a fail in the same stock because the customer did not arrange in advance to borrow the security from its clearing firm resulting in a forced buy-in at the clearing level, we believe that the consequences of the forced buy-in should be borne solely by the customer who caused the fail by not arranging in advance to borrow the security. Accordingly, we suggest that clearing brokers be mandated to track trades and fails to specific accounts, and assess the buy-in liability accordingly. Systems limitations at the clearing firm level should be considered in connection with implementing such a requirement, but ultimately should not be justification for unfair treatment to customers who act in compliance with applicable short sale requirements and are not the ones contributing to fails.

8. **No Mandatory Pre-Borrow Requirement.** Millennium is aware that there are those who advocate imposing a pre-borrow requirement on all short sales. Millennium, however, opposes any such requirement and supports the locate requirement as it exists under the current Regulation SHO (subject to our suggestion in Response 9 below regarding locates). The onus of clearing and settling trades should not be borne by investors, but rather by the market intermediaries that are directly responsible for facilitating executions and the clearance and settlement process. By shifting the burden of meeting clearance and settlement requirements through the mandate of pre-borrows, the result will be increased costs of execution on those who must pre-borrow and delays in access to the market for market participants. Therefore, we believe the existing Regulation SHO locate requirement is appropriate, and the responsibility of ensuring locates and settlement and the elimination of fails should rest primarily on the broker-dealers involved in these processes, not on market participants themselves.

9. **Clarify Requirements Governing Locates.** Millennium believes that Regulation SHO should be amended to define more specifically what constitutes a satisfactory locate and the criteria to follow in providing locates. In our view, broker-dealers who perform locates should be under an obligation

to perform due diligence on the source of any possible locate that such potential lender (whether another broker-dealer or another lender such as an agent lender bank) has a reasonable system in place to track its provision of locates on an intraday basis and decrement inventory when necessary such that it does not "over-provide" locates, especially when a security is hard to borrow. We do not believe that there needs to be specific decrementation provisions under Regulation SHO, but some other reasonable form of accounting for locates should be recommended. In our view, clarifying the requirements governing locates should not unduly harm liquidity (if at all), but will have the effect of providing more certainty in the locate process and making the locate criteria more uniform.

10. **No Additional Disclosure of Fail Information.** Millennium believes that the current practice of disclosure of threshold securities by the SROs is sufficient. We do not discern a justification for any further disclosure of information relating to fails. We do not believe that the disclosure of additional fail information, especially disclosure of fail positions of individual market participants or even at the clearing firm level, will decrease net fails. In our view, participant-level disclosure of fails would be potentially harmful to market participants and would not serve an apparent and identifiable market purpose.

11. **Borrowings Should Be Permitted In Lieu of Close-Outs**. Customers should be able to borrow stock to settle fails rather than being closed-out. If a borrow is available, a choice of either borrowing the stock or buying it to satisfy the close-out obligation will result in the same end of eliminating the fail. Where a borrow is available, in our view, it does not appropriately advance the goal of reducing fails by requiring clearing firms to buy-in their customers when a cheaper, and more efficient, method of settlement through a borrow can accomplish a similar result.

12. **Maintain the Options Market-Maker Exception for Locates and Study the Costs of Eliminating the Exception from the Close-Out Requirement.** Millennium recognizes the importance of the market-maker function and the fact that market-makers add liquidity. It is for this reason that Millennium supports the exception from the locate requirement under Regulation SHO for bona-fide market making activity. With respect to the options market-maker exception to the close-out requirement, we recognize that removing this exception would to some extent increase the cost of trading options for market participants (thereby reducing liquidity in the options markets). Accordingly, we urge the Commission to further study this cost aspect before eliminating the options market maker exception.

13. **No Affirmative Determination for Long Sales.** Millennium believes that there should be no affirmative determination requirement for long sales. The existing provisions under Regulation SHO effectively mandate timely settlement of long sales, and there is no apparent benefit from extending additional regulatory burdens to long sales. Doing so, in our view, would unnecessarily slow down and reduce market access, would be inconsistent with the goal of fostering liquidity, and would not serve any regulatory need.

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We very much appreciate the opportunity to submit our comments and to provide our suggestions in this rule making process. We expend significant resources on ensuring short sale compliance, and we are committed to full compliance with applicable rules. We hope, however, that the Commission will consider our views in formulating its conclusions on this very important Regulation and initiative. If you have any questions or if you would like to discuss these suggestions, please feel free to contact us.

Respectfully submitted,

Simon Lorne
Vice Chairman, Chief Legal Officer

Martin Schwartz
Chief Compliance Officer

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Annette L. Nazareth, Commissioner
The Hon. Kathleen L. Casey, Commissioner
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