March 14, 2007

Mr. Chairman,

Today, March 14, 2007 you spoke before a group of reporters at the US Chamber of Commerce Summit regarding the recent SEC actions against Goldman Sachs and the firm's involvement in naked short selling abuses. Your comments were specifically "that is an important case and it reflects our interest in this area".

This is a very disingenuous comment in light of the delays in this proposal and worse, the recent memo posted regarding the SEC's communication with the NASD.

The issue of the grandfather clause has been a point of contention with investors and issuers since the clause was first made public on June 23, 2004. Nowhere in the public comment period of the original Regulation SHO proposal was a grandfather clause identified as an option for comment and nowhere in the guidelines handed down by Congress under the '34 act was acceptable settlement delays allowed. In fact, all of the Congressional guidelines for trade settlement used the language of "prompt" and "accurate" to define their expectation for performance.

In the March 12 memo posted on this site by the SEC Division of Market Regulation [Josephine Tao] it is identified that the Division of Market Regulation only recently attempted to seek the comments of the NASD regarding this issue. The request to the NASD for analysis was February 1, 2007 and is 5 months POST the closing of the comment period and 7 months POST the initial proposal submitted for public comment.

These periods of delay are not periods considered consistent with "interest in this area". These are delays associated with callous disregard for the implications this clause has on the marketplace.

More concerning, the NASD data gathered and discussed under their comment memo to the SEC attached in the March 12 filing reflects data that is extremely limited and outdated based on the duration for which SHO has existed. Seeking information regarding settlement failures from January 2005 to August 2005, now that we are in 2007, is not reflective of gathering the necessary data to make any reasonable conclusions.

Ironically the NASD data, while outdated, also reflects the inaccurate portrayal of the SHO performance conducted and submitted by the SEC Office of Economic Affairs Analysis provided under this proposal:

From the NASD Memo, they investigated 148 unique securities with greater than 40 of the150 available days on the threshold list since SHO had been in existence per SEC request. The results identified that:

For 90 unique issues, fails to deliver in the NSCC system existed prior to the security becoming a Regulation SHO Threshold security. Since the fails to deliver in these securities remained in place for all or part of the review period, it appears that these positions <u>may have been</u> exempt from the close out requirement of Regulation SHO under the "grandfathering" provision contained in SEC Rule 203(b)(3)(i).

I am not sure what "may have been" means in a conclusive argument such as this unless it implies that the NASD never really dug deeper into why these fails existed instead rationalizing the results.

The NASD also cited that 58 companies that were on the list on January 10, 2005 when the first list was published were also on the list on August 11, 2005 which was the period in question.

In contrast, the SEC OEA stated under analysis that:

99.2% of the fails that existed on January 3, 2005 are no longer outstanding as of March 31, 2006.

The NASD data implies that a significant level of the companies that remained on the list for a persistent interval of time did so due to the grandfathering rule and that the grandfathered fails were not being closed out effectively for the first 150 days of the SHO performance period.

With the NASD memo being ambiguous relative to the companies involved, of the 90 firms on the list for greater than 40 trade days, a maximum of 22 could use the options exemption as justification for the extended length of fails. As stated below.

For 22 unique issues, 1) fails to deliver in the NSCC system existed prior to fie security becoming a Regulation SHO Threshold security and remained in place for all or part of the review period; and 2) fails to deliver in the NSCC system were held by a one or more member firms <u>are known to provide clearing services for registered options market makers</u>. It appears that these positions <u>may have been exempt</u> from the close out requirements of Regulation SHO under the "grandfathering" and/or bona fide options market maker exemptions as defined in SEC Rules 203(b)(3)(i) and 203(b)(3)(ii).

What does the NASD mean by “One or more of the clearing firms are known to provide clearing services for registered options market makers”? Does this mean the fails were not scrutinized as options exempt fails but instead rationalized based on the fails existing at our largest clearing firms? The secondary comment of “may have been exempt” implies that specifics were not actually gathered.

By this analysis, a minimum of 68 companies remained on the threshold security list with a fail to deliver level exceeding a minimum of 0.5% and exceeding a minimum of 40 trade days (13X Normal Trade Settlement) and did so with no other legal justification other than the “grandfather rule” to justify the significant duration of delays.

This is hardly an example of 99.2% grandfather settlement performance.

Now I recognize that the gap between the NASD evaluation period (Aug. 11, 2005) and the OEA Analysis (March 31, 2006) is different but:

1. These are the differing periods for which the SEC requested information and,
2. The change is coincident with the findings of the NYSE enforcement actions where several Wall Street firms were fined for improperly closing out grandfathered fails. I spoke to the NASD regarding this enforcement action and they admitted that the NASD would not take action for a regulatory violation already enforced by a separate regulator.

Question: Why has the SEC waited so long to gather nearly 2-year old information from the NASD?

Seeking information from two significantly differing evaluation periods violates the standards used in a controlled analysis making any conclusions made laden with errors. The SEC Division of Market regulation being forced to interject assumptions in a dynamic market to satisfy the voids and, as has been demonstrated repeatedly, the SEC seems ill-qualified to come to satisfactory conclusions.

If I recall the NASD, in a public rule proposal submitted before the Commission in March 2004 requested that the Commission tighten up the settlement process by forcing all trade settlements within 10 days post the normal settlement period. The NASD requested that language be incorporated that specifically identified that broker dealers and clearing firms could not use “cost as a justification” as to why these fails existed post the 10-day window.

Question: Where do Members of the Commission stand on this issue?

As it turns out, in January 2007, and before the Division of Market Regulation sought the input of the NASD on this matter, Commissioner and former director of Market Regulation Annette Nazareth identified that the grandfather clause was a cautionary provision introduced into the markets as a good faith first step but that the provision had outlasted it’s effectiveness and that removal could be accomplished without adverse market impacts.

These opinions are paralleled by former SEC Attorney Peter Chepucavage who was one of the team members that created regulation SHO and sat in the team meetings where the grandfather provision was drafted.

So again the question, if a member of the Commission staff is identifying that the grandfather clause was an INTENDED cautionary first step, and that the clause has outlived that purpose, why is it that the Division of Market Regulation continues to delay a proposed solution instead seeking near 2 year old data – outdated as it is?

To conclude this dissertation on the SEC’s conflicting commentary and actions, today the SEC fined Goldman Sachs $2 Million for failing to detect naked shorting violations from 2000 – 2002. In the settlement filed, the settlement failures in the system were simply ignored going undetected at both eth firm compliance levels as well as at the regulatory levels. Today, as evident by the language in the NASD memo, fails are not being carefully scrutinized but instead rationalized. “Could be” is not a conclusive answer it is an assumption. In the case revealed today Goldman Sachs “assumed” the clients had the shares to sell and their assumptions were wrong.

The Commission is increasing coming under fire for the conflicts the agency has with the Wall Street firms and the lobbying firm that represents these firms [SIFMA]. The latest SEC memo put forth under this comment section illustrates the conflicts between “taking seriously” and responding effectively to investor issues.

I urge you to cease this farce and respond accordingly with the laws you have promised to state regulators, state legislature, and the investing public. There is no excuse for these further delays outside or your willingness to allow the persistence of fraud to exist.

Investors have a legal right to the delivery of product sold under the guidelines of the ’34 Act.

Dave Patch