Dear Ms. Schapiro and fellow Commissioners,

I offer this chapter from my 9th book on abusive naked short selling for you to consider in your legislative efforts. I've reviewed the video tapes and transcripts from the recent roundtable on short selling and despite some sincere effort on your parts I still am convinced that you are missing the sense of urgency in the plights of U.S. corporations whose share prices are **currently** being manipulated downwards via their share structures being poisoned with massive amounts of yet to be bought in FTDs.

Not one word in the entire 2 days was uttered in regards to the totally unregulated black hole on Wall Street in which to hide FTDs namely via "ex-clearing arrangements". We need for you to appreciate the concept of a "security entitlement" and how UCC Article 8 mandates that "entitlement holders" whose share purchases never got delivered still have all of the right in the world to sell that which they purchased. We need for you to appreciate the "ultimate paradox" cited below and the inherent "counterfeiting/replicating" phenomenon associated with even legal short selling.

It was very troubling that the GAO reported that according to an SEC staff member 99.9% of FTDs have been done away with. How can you claim that without acknowledging all of the FTDs sitting in "ex-clearing arrangements? This misrepresentation of the truth made it easy for the Goldman Sacks rep. to warn the SEC Commissioners not to over-regulate while just chasing down that last tiny 0.1%.

Further we need for you to realize that "corporations" came first and only later came the desire to trade shares of corporations on markets. Yet today Wall Street insiders have totally thrown under the bus the very concept of doing business as a "corporation" predicated on "one share, one vote" and a finite number of shares "outstanding" and in its "float" of readily sellable securities. I'd like to thank Commissioner Walters for at least attempting to hold some feet to the fire.

I hate to be the bearer of bad news but your concept of how wonderful legal short selling is needs to be corrected so that those in favor of the totally corrupt status quo cannot cite all of these theoretical benefits of short selling that must not disturbed during the promulgation of new rules. Thank you for your consideration of these concepts. **–**Dr. Jim DeCosta

CHAPTER 33: REVISITING THE CONCEPT THAT LEGAL SHORT SELLING INVOLVING A LEGITIMATE "PRE-BORROW" IS SUCH A WONDERFUL THING; BUT FOR WHOM?

Dr. Jim DeCosta

Everybody is now aware of the absolutely insatiable greed we see on Wall Street. In no particular subsection of Wall Street is this greed more readily identifiable than in the short selling arena. After 29 years of studying the discipline of abusive naked short selling (ANSS) I think I finally figured out a way to educate investors and any interested regulators and SROs as to **HOW** Wall Street has been systematically siphoning off the investment funds of U.S. investors taking "long" positions in stocks. There are 3 steps involved. Step 1 is to misrepresent the benefits of theoretically legal short selling. Step 2 involves whenever the topic of abusive naked short selling (ANSS) comes up change the topic back to legal short selling and rehash the misrepresentations thereof. Step 3 involves flooding the share structure of U.S. corporations targeted for destruction with readily sellable share price depressing "security entitlements" via either refusing to deliver that which you sell or acting in concert with others to accelerate the inherent "counterfeiting/replicating" phenomenon associated with otherwise legal short selling. In fact as the "ultimate paradox" teaches us it gets much worse than that.

THE ULTIMATE PARADOX: All readily sellable share price depressing "security entitlements" which are induced to be "issued" with each and every failure to deliver (FTD) and each and every NSCC SBP (stock borrow program) "borrow" that occurs on Wall Street lead to the crediting of a readily sellable share price depressing "long position" to the account of the purchaser "entitling" the account holder to resell that which he purchased even if that which was sold to him never got delivered and even if that sold to him never existed in the first place.

MISREPRESENTING THE BENEFITS OF LEGAL SHORT SELLING

The common arguments cited by Wall Street insiders expounding the benefits of **legal** short selling are that it provides "pricing efficiency" (the pricing of a security reflecting all of the available information in the market), enhanced "price discovery", liquidity, hedging opportunities, a deterrent to "pump and dump" manipulations and a tightening of the "spread" between the highest bid and lowest offer. Not so mysteriously the proponents of **abusive naked short selling** (ANSS) which is a form of a particularly heinous "fraud on the market" when queried about ANSS crimes will predictably shift gears and cite the (theoretical) benefits of legal short selling. Five of the six supposed benefits cited above are myths and the "tighter spreads" claim is true but diagnostic of the fraudulent behavior occurring because of course the sellers of real or nonexistent shares are going to crowd the highest bid in order to gain access to the funds of less financially sophisticated investors without ever having to deliver that which one sold. In the absence of an "uptick rule" they'll not only crowd the bid they'll mercilessly bang away at it.

So what's the big deal if the underlying premises for how wonderful short selling is are off base? The problem is that the legislation drafted in Reg SHO and its various amendments was predicated on not being too strict as to interfere with the beneficial aspects of short selling. If that underlying premise is off base then the resultant legislation is going to be too soft and not provide any truly meaningful deterrence to these thefts. The skyrocketing of the FTDs in the share structures of both Bear Stearns and Lehman Brothers **after** Reg SHO and several of its amendments became effective clearly illustrates this point.

There is no doubt about the fact that "legal" short selling is a wonderful thing but the question becomes for whom. It is definitely "wonderful" for the Wall Street insiders that earn otherwise unavailable commissions, prime brokerage fees and interest not to mention the deriving of rental income from the renting of shares from margin accounts that they didn't have to purchase. One must keep in mind that the broker/dealers that loaned money to their clients that use margin accounts are making a healthy return on that loan that basically can't be defaulted upon due to the shares acting as at least 200% collateral. Yet the investor cutting a check for at least half of those shares and being exposed to 100% of the downside risk receives none of the rental income for the renting out of that which she or he purchased albeit partially with borrowed money.

The big winners on Wall Street in relation to **legal** short selling are the custodian banks, the executing brokers, the prime brokers, the custodial and non-custodial lending agents, the tri-party agents and the hedge funds that direct about $11 billion per year in fees and commissions to the Wall Street "professionals" acting in these roles that are willing to break the greatest amount of rules on behalf of the financial interests of the hedge fund manager willing to direct "order flow" in their direction on a quid pro quo basis.

The big losers in **legal** short selling are the shareholders of the corporations whose shares are being essentially "counterfeited/replicated" during even the theoretically "legal" short selling process involving a legitimate "pre-borrow". Why is this? It's because the clearing firm of the purchaser of those "pre-borrowed" shares that has no idea that they were borrowed has as their new "legal owner" all of the right in the world to rent out **that very same parcel of previously rented shares** to yet another short seller, and then another, and then another ad infinitum.

In this little "Ponzi scheme" the most recent buyer of the "multiply-rented" and impossible to identify (due to "anonymous pooling" and "dematerialization") parcel of shares becomes its "legal owner". All of the intermediate purchasers of that very same "multiply-rented" parcel of shares become "security entitlement holders". Unfortunately for the shareholders that co-own a corporation these "security entitlements" essentially "issued" during every single loan allow their "entitlement holders" to sell these "security entitlements" as if they were legitimate shares which they are anything but.

The beneficiaries of theoretically "legal" short selling don't like to bring up the point that even "legal" short selling has victims i.e. every shareholder of the corporation whose shares are being sold short. Theoretically **legal** short selling depresses share prices below the intersection of an unmanipulated supply variable and unmanipulated demand variable. Since "manipulation" involves the tweaking in your favor of the supply and demand variables that determine share prices then yes **legal** short selling results in the "manipulation" of share prices downwards to artificially lowered levels. This "manipulation" is, however, not necessarily of a "criminal" nature because for that you need the intent to defraud.

Perhaps the question that begs to be asked is if it is "legal" to target a U.S. corporation and the jobs and services it provides for destruction and then organize a group of co-conspiring parties aware of this "counterfeiting/replicating" nature of even theoretically "legal" short selling and thereby **intentionally** induce the "manipulation" of their share price downwards by flooding their share structure with the readily sellable and therefore share price depressing "security entitlements" that are essentially "issued" with each and every legal "pre-borrow" executed.

The answer is contained in the text of Rule 10b-5 which is the all-encompassing "Anti-fraud rule" of the 34 Act which expressly forbids the utilization of any artifice or contrivance to defraud another party during the sale of securities. I would assume that the line is clearly crossed during the targeting phase and the subsequent sharing of the target's identity followed by the lining up of co-conspirators agreeing to act in concert. Clearly, simple short selling done by a single party to cash in on an anticipated decline in share prices is no crime but it still depresses share prices to artificially low levels and boy do short sellers ever understand this phenomenon.

The proponents of short selling, whether legal or illegal, will counter with the argument that those shareholders with "long positions" may have benefited by buying shares cheaper than they otherwise would have been able to due to this injection of "liquidity" short sellers generously provided and the associated tightening of the spreads between the bid and the ask that short sellers do indeed provide. This argument has merit. The counter to that argument, however, is that when the shareholder wants to sell his "long position" he has to compete with short sellers also seeking buy orders to sell into and the visibility of buy orders by the Wall Street insiders typically doing the short selling is vastly superior as they have "first dibs" on all buy orders they see. Note the similarity to "flash orders" wherein certain Wall Street parties are preferentially given "first dibs" on acting on an order.

The reality is that the "long" investors living on "Main Street" don't even break even in regards to this theoretically beneficial "injection of liquidity" but the "Wall Streeters" make a killing via fees, commissions and rental income and the prognosis for the bet being placed by short sellers being enhanced by the mere method of placing the bet. Why? Because each "borrow" results in the creation out of thin air of a readily sellable share price depressing "security entitlement" being invisibly credited to the margin account of the "beneficial owner" whose shares were unknowingly loaned. Who would have ever thought that this nearly universally agreed upon benefit of legal short selling is totally one-sided?

Theoretically "legal" short selling depresses share prices which is a "measured" blessing when you're buying shares but a "measured" curse when it's time to sell shares. If a lot of co-conspirators are short selling in concert then the two "measureds" cancel out and the share price depressant effect of all of those extra readily sellable share price depressing "security entitlements" result in marked share price depression and the "long" investors losing money. I think this concept of "**abusive** legal short selling" involving targeting and acting in concert needs to be recognized and understood. It makes sense that nobody ever addresses it because nobody ever addresses the share price depressant effect of **legal** short selling due to this inherent "counterfeiting/replicating" phenomenon.

I also think that people need to appreciate the continuum involved in these attacks on U.S. corporations referred to as "bear raids". In the early post-targeting phase the amount of shares legally borrowable is often plentiful i.e. often in the "easy to borrow" category and each "pre-borrow" is relatively inexpensive especially when interest rates are low. As the "bear raid" progresses the shares become "hard to borrow" i.e. expensive to borrow due to simple supply and demand machinations.

This is often when cost conscious criminals simply refuse to execute an expensive pre-borrow and **intentionally refuse** to deliver that which they purchased. They know with 100% certainty that the NSCC management (their employees) that have acquired 15 of the 16 sources of empowerment to execute buy-ins will unconscionably plead to be "powerless" to do so. This is referred to as abusive naked short selling or ANSS with the NSCC management acting in the capacity of an enabler/facilitator of these thefts.

Empirical studies have always revealed that it is not prudent to invest in corporations with large "declared" short positions. It's because their share structures have been previously poisoned with these invisible to the investor share price depressing "security entitlements". It is a myth to picture large preexisting short positions as representing future buying. This is because the **naked** short positions are not tallied in a "declared short position" and if a corporation has a huge declared short position it probably also has a significant naked short position because of the "hard/expensive to borrow" nature of their shares.

There are various rules of thumb to use to estimate a naked short position based on certain multiples of the size of the "declared" short position. I prefer to look at the age of the "bear raid" via studying trading patterns while keeping in mind that for the most part abusive naked short sellers never, never, never cover unless forced to and therefore naked short positions simply grow by accretion through the years. Why would you ever cover if the NSCC management with a monopoly on the sources of empowerment to buy you in pretends to be "powerless" to buy you in and all you have to do at the DTCC is collateralize the monetary value of a failed delivery obligation. These collateralization requirements are easily lessened by simply continuing to naked short sell thereby driving share prices and collateralization requirements constantly lower. This results in the flow of an investor's funds to the naked short seller despite his continuous refusal to deliver that which he sold. You'd have to be insane to ever cover a preexisting naked short position and that's why they're still out there.

One has to realize that all of the "derivatives" that Wall Street has conjured up over the decades whether it be put options or credit default swaps harm the holders of "long positions" in the underlying equity but as expected they do create huge cash flow for their often brilliant Wall Street inventors. Do you recall the tremendous abuses perpetrated by theoretically bona fide options MMs working in concert with abusive naked short sellers? The question arises as to where Wall Street got the statutory authority to create contrivances based on an underlying equity (a "derivative" of that equity) that does damages to the owners of the underlying equity and changes the very nature of the corporation under assault. This is especially offensive to the purchasers of shares that bought in **before** the derivative was approved for trading.

The Wall Street insiders benefiting from short sales are currently arguing that a mandated "pre-borrow" is too expensive and it will diminish this wonderful "liquidity" they generously provide while placing their negative bets against a corporation. That argument rings a bit hollow when you realize that to a "long" investor this "liquidity" is a two-edged sword that nets out to a net negative. Please remember that whenever you hear the "L" word (liquidity) recall that it is only wonderful for the Wall Street insiders doing the short selling and collecting those fees. It is a total curse for "long" investors.

The opponents of "pre-borrows" argue that the clearing firms will have to fund the pre-borrow on T+0 while the investor's funds won't be available until T+3. They'll cite the lie contained in the May of 2009 GAO report on Reg SHO that 99.9% of FTDs have been eliminated. They'll mysteriously forget to mention the 800-pound gorilla in the room namely the "black hole" to hide FTDs known as "ex-clearing arrangements" which have become the hiding place of choice for FTDs since Reg SHO became effective in January of 2005.

Since Reg SHO only addresses the FTDs held in "registered clearing agencies" like the DTCC "ex-clearing" arrangements entered into by co-conspiring clearing firms have become a popular way to illegally circumvent the Section 17 A congressionally mandated "prompt settlement" of all securities transactions. To this very day the SEC, the DTCC and FINRA pretend to be "powerless" to address "ex-clearing" crimes since they are theoretically of a "contractual law" nature and these fine institutions only work with "securities laws". That's an interesting argument to proffer namely that breaking the securities laws by entering into bogus "contractual" relationships has nothing to do with securities laws. Actually Rule 15c6-1 (a securities law contained in the '34 Exchange Act) expressly forbids the intentional stalling of the "prompt settlement" of a trade.

"Ex-clearing arrangements" basically amount to two corrupt clearing firms "pairing up" off to the side of the DTCC and agreeing to not demand delivery of the shares owed for delivery by one party to the other in exchange for them forgiving the delivery debts of the counter-party. In essence, one party says to the other that you can sell nonexistent shares to my clients and refuse to deliver that which you sold if you extend the same courtesy to me. In one abusive naked short selling case currently involved in the litigation process a nice paper trail is available to show how these "ex-clearing arrangements" are entered into sometimes in an on- and sometimes in an off-balance sheet manner.

Short selling abuses date back to the 1600's in Europe but the acceleration of short selling abuses has a historical origin dating back to when the DTCC "dematerialized" all paper-certificated shares into electronic book entry shares theoretically on a 1-for-1 basis. Due to the “anonymous pooling” of electronic book entry shares held in “street name” at the DTCC one can no longer identify the owner of the specific parcel of shares that is being loaned out to warn him that he lost not only his “ownership” title but the right to resell that which he purchased. This didn’t happen when shares were held in a paper-certificated format as the paper certificate needed to be tendered.

As far as this wonderful “injection of liquidity” argument I suppose that proffering the argument that buying low and selling even lower is at least better than buying really high and selling really low. As far as flooding the share structure of a corporation with the readily sellable share price depressing “security entitlements” resulting from each and every theoretically **legal** “pre-borrow” adding to “pricing efficiency”; give me a break. Since when does the intentional manipulation of the “supply” of that which must be treated as being readily sellable add to “pricing efficiency”? In a “zero sum” game like Wall Street where do you think the fees being aimed at the Wall Streeters in the short selling game are coming from? They match to a penny the losses of the “long” investors. These fees and commissions are coming from the tilted playing field they’re fighting to maintain by proffering that “pre-borrows” will be too expensive, too cumbersome and necessitate all kinds of technological advancements. Gee, I hope it doesn’t put a dent in those year end bonuses. In reality “long investors” would love to absorb any extra costs associated with re-leveling the playing field.

Anything short of a “firm decrementing pre-borrow” in this “dematerialized” tilted playing field world we live in represents insanity. Try to recall the speech that Dennis Nixon, CEO of International Bank of Commerce gave at the recent “roundtable” on short selling. His bank has strung together 136 consecutive quarters of profitability yet his shareholders lost 30 years worth of profits in a recent well-organized abusive naked short selling “bear raid” wherein his corporation’s FTD levels went absolutely through the roof. Keep in mind that “legal” short selling does not result in the generation of FTDs but it does result in share price depression. Recall the “continuum” aspect of short selling cited above wherein (theoretically) legal short selling attacks blend in seamlessly with abusive naked short selling attacks as securities become expensive to borrow.

Ironically shortly before his passionate plea the Goldman Sacks representative quoted the recent GAO study on the efficacy of Reg SHO which cited an SEC staff member telling the GAO that 99.9% of FTDs have been eliminated. How did I miss that study?

Several of the panels in this 2-day “roundtable” discussed the mysterious lack of transparency in our lending system and how different short sellers were paying vastly different “rebate spreads” (rental rates) on the same issuer’s shares. Why does the DTCC, the hedge fund community and the lending community all insist on operating in a “black box” manner? All of the panelists agreed that it’s time to create some transparency in the lending business.

In the case of the lending community do you think this desire for secrecy might have something to do with trying to keep investors from learning that on Wall Street even theoretically "legal" short selling involves the lending of an impossible to identify (due to "anonymous pooling" and "dematerialization") parcel of shares in a dozen different directions **simultaneously** while all 12 lenders derive rental income from renting the very same impossible to identify parcel of shares? The SEC can't shine a light on this cesspool known as the securities lending business without risk because it will only further diminish the already anemic levels of investor confidence in the integrity of our clearance and settlement system and further highlight just how asleep at the wheel the regulators and the SROs have been.

The solution to this mess need not involve going back in time 40 years when "dematerialization" took place and institute a "re-materialization" program. One must realize that the T+4 or T+6 "purchase or borrow" solution in the new rule 204 still allows for these corrupt "multiple borrows" and 4 or 6-day "pulse-like" attacks.

The Goldman Sacks representative for Panel #1 of Day 2 at the recent roundtable made an interesting observation when he stated: *"Only a small percentage, estimated to be less than 5%, of all locates result in the need to borrow. Consequently, pre-borrows would needlessly drain supply from the securities lending market, which will result in reduced liquidity"*.

I think this seemingly aberrational statistic is in part due to the prevalence of "pulse-like" attacks made **within** (intra-settlement period attacks) the Rule 204 mandated "purchase or borrow" by the pre-opening of T+4 or T+6 for bona fide MMs mandate. You attack on T+0, T+1, T+2 and the morning of T+3 and then you cover as the bottom is falling out of the market. A theoretically "bona fide" MM gets an extra 2 days (T+4 and T+5) to tee off on the market. In the absence of an "Uptick rule" you can trip a lot of stop loss orders and induce a lot of panic selling by U.S. investors trying to circumvent catastrophic losses during these two time periods. These attacks attempt to "shake the tree" to force any weak-kneed investors that can't risk catastrophic losses into panic selling. **Does this reality not address the need and not the lack of a need for a mandated firm decrementing pre-borrow as claimed by the Goldman Sacks rep so concerned about this wonderful "liquidity" that ends up being a net negative for U.S. investors as described above?**

There needs to be a financial penalty for FTDs that provides truly meaningful deterrence in a language that Wall Street understands-MONEY. How about treble (triple) damages? I commend SEC Commissioner Ellisse Walters that made the observation that you'd have thought that with all of the resources available to Wall Street they would have developed lending protocols that are fair to both the investors and the securities intermediaries in these markets. She was exactly right and the explanation to this non-mystery involves the fact that Wall Street does not want the corrupt status quo changed one iota. Do you still think that a "firm decrementing non-counterfeitable pre-borrow" is overly burdensome on these Wall Street insiders in this type of environment?

As a favor to the U.S. citizens that you are congressionally mandated to provide "investor protection" to the next time you at the SEC hear a Wall Street insider refer to this wonderful **<u>"liquidity"</u>** that short sellers provide could you please do whatever it takes to make a light go off in your brain and realize that this person's intent is to reroute the funds of the investors relying upon your vigilance into their wallets through the use of deception i.e. fraud.

Let's take a look at a fictitious U.S. corporation "Acme". Acme has 100 shares "outstanding" and a readily sellable "float" of 40 shares. This readily sellable "float" represents the "supply" of shares that interacts with the "demand" for shares to determine the share price of Acme through the "price discovery process. Let's assume "Buyer Bob" wants to buy 2 shares of Acme through his margin account on 50% margin. Buyer Bob cuts a check equal in value for 1 share of Acme and his broker loans an equal amount of money to Bob to buy the other share. His broker charges him a handsome interest rate. Bob's broker gets "legal ownership" of both shares to collateralize the loan. As the legal owner of the shares and since Bob signed off on a margin agreement Bob's b/d has all of the right in the world to loan those 2 shares to a short seller who then sells short the 2 shares. Bob's clearing firm will be handsomely compensated for making this loan.

The "legal ownership" of Bob's two shares now gets transferred to the new buyer and Bob's margin account is credited with 2 readily sellable share price depressing "security entitlements". The "supply" of that which is readily sellable in the share structure of Acme is now 42 readily sellable shares plus readily sellable share price depressing "security entitlements". Since the "demand" variable remained fixed the share price of Acme by definition will drop down a notch because of this increase in the "supply" of that which is readily sellable.

This "new" corporation with 100 shares "outstanding" and 42 readily sellable "share like units" making up its float has a slightly lower prognosis for success due to its "float" being artificially increased 5%. If the float would have gone up by 5% associated with the corporation's sale of securities then at least it would have that much extra cash in its coffers.

The DTCC participating clearing firm of the broker/dealer of the new owner of Bob's shares as the new "legal owner" (remember the purchaser is only the "beneficial owner") has all of the right in the world to loan them to yet another short seller who then sells them to a new buyer. It will be handsomely compensated for making that "loan". The "supply" of that which is readily sellable within the share structure of Acme is now 44 units and the share price ticks down yet again. This is now a vastly different corporation than the one that Bob invested in since the "float" of that which is readily sellable has gone up a full 10% with no offsetting cash "consideration" being paid into the coffers. Note that no "abusive naked short selling" has occurred and no FTDs have been generated. We've only witnessed this generous "injection of liquidity" associated with legal short selling.

What would have happened if Bob would have borrowed the 50% of the purchase price from the local credit union, used his house as collateral instead of the 2 shares he purchased and bought them through his "cash" account? Bob still would be paying interest on that loan but the “supply” of readily sellable Acme shares/security entitlements would be back at the original 40 units and the share price would be a couple of notches higher. Perhaps Bob isn’t even credit worthy but his broker doesn’t care because he can always sell those 2 shares of Bobs if he can’t come up with any margin call. In that case Bob’s credit unworthiness is borne by all of the shareholders of Acme and his being sold out will drop the share price yet that much more.

If Bob went to his credit union Bob’s broker would be out those interest earnings as well as that rental income and it wouldn’t be as popular with the hedge fund community needing those loans to effect their goals of taking advantage of any share price decreases. That $11 billion in annual expenditures by the hedge fund community is divided up amongst those that accommodate the financial interests of the hedge fund manager.

The question arises as to who gave the Wall Street insiders the right to alter the Acme Corporation and artificially manipulate the “supply” variable of Acme upwards in order to gain interest income, rental income and probably an enhanced level of order flow from hedge funds appreciative of these loans needed to execute their game plan involving establishing a short position and then monetizing it via intentional share price depression?

Wall Street refers to this phenomenon as the **beneficial** injection of liquidity and the SEC, SROs and the investment community have bit into that misrepresentation hook, line and sinker. Beneficial to whom? Is making it ultra easy for investors to leverage up buy more shares than they can afford a good idea from a risk management point of view? Are these types of activities fair to the 15,000 or so corporations trading on our markets and the perhaps 10,000 shareholders of the average corporation domiciled in the U.S.?

It’s clever how the Wall Streeters and especially the DTCC will misrepresent to the investing public that at least the number of Acme shares “outstanding” didn’t increase. They’re correct but it is not the number of shares of Acme “outstanding” that interacts with the “demand” variable to determine share prices. The “supply” variable that interacts with the “demand” variable consists of that which by law must be treated as being readily sellable and this includes the mere “security entitlements” that are essentially “issued” during each “borrow” that takes place on Wall Street.

At the recent short selling “roundtable” the CEO of the International Bank of Commerce, Dennis Nixon, noted how easy it is for Wall Street to “issue” readily sellable share analogues yet the typical U.S. corporation must jump through all sorts of hoops and hurdles to “issue” registered shares when they raise money. A corporation’s “prospectus” will clearly define each and every tiny little grain of sand worth of risk inherent in an investment in a corporation yet the SEC, the SROs and the DTCC refuse to inform prospective investors of the “boulder of risk” represented by the share price depressing “security entitlements” residing at the DTCC, in “ex-clearing” arrangements, held offshore, sitting at trader’s desks, etc. There are no commensurate registration procedures associated with short selling lending activity. That would impede the injection of all of this wonderful “liquidity”. This lack of transparency needed to cover up past frauds results in U.S. investors being relegated to be buying a “pig in a poke” every time they invest in our markets. The most egregious of these hiding places for FTDs is in the “ex-clearing” arena.

Other questions arise as to the diminished voting power associated with the purchase of all of those non-voting “security entitlements” issued due to the inherent “counterfeiting/replicating” nature of Wall Street loans. When cash dividends are distributed which investors will get the preferential tax treatment of the limited amount of “qualifying dividends”? The IRS has made it clear that in the case of the Acme’s of the world there will only be 100 1099’s available for preferential tax treatment. How about the SIPC insurance issues that don’t cover “security entitlements”? How do these inherent “counterfeiting/replication” issues get swept under the rug every day on Wall Street? Shouldn’t each loan of shares be accompanied by an investor being told that he lost his ability to resell his securities so that the Acme Corporation is not altered and their “float” remains at 40 units?

This is all about Wall Street versus Main Street. Wall Street is smarter than Main Street when it comes to sophisticated market issues that they deal with on a daily basis. For Acme the concept of doing business as a “corporation” with 40 shares in its readily sellable “float” had to be thrown under the bus in order for the Wall Streeters to cash in. These markets have been hijacked by those entrusted to act as “securities intermediaries”.

SO WHAT’S THE SOLUTION?

The solution is so obvious that the lack of it being implemented up until now is nothing short of criminal. The basis for the solution is this fact: UNTIL the archaic FTDs **currently** poisoning the share structures of surviving U.S. corporations unfortunate enough to have been targeted for an attack by these criminals are removed via mandated buy-ins the SEC and the SROs will be FORCED to continue to oversee U.S. investors being led to the slaughter via buying shares in corporations that may have already been all but preordained to die an early death. It’s going to take a cathartic event possibly being induced by Congress. If nothing else the victims of these crimes have a lot more voting power than the fraudsters perpetrating them. This is a very black or white situation. Either it’s the corrupt status quo for years to come or it’s a wholesale cleaning up of the wild, wild, west and the rescuing of corporations hanging on by a thumbnail.

The ’33 Act mandates that investors be made aware of all “material” facts in regards to an investment in a corporation. There is nothing more “material” to an investment in a corporation than the knowledge of the preexistence of an astronomic level of unaddressed FTDs artificially manipulating its “float” up while weighing down on its current share price, its future share price and its prognosis for success.

It doesn’t matter where the FTDs are being housed whether it be in “ex-clearing arrangements” which the SEC and SROs have all of the power in the world to regulate but refuse to or whether they're being held at trading desks or offshore via the interfacing of other countries' depository systems with our DTCC. How can there even be a discussion about the appropriateness of **forcing** those that have continuously refused to deliver that which they already sold to finally do so in order for the purchasers of that which they sold to finally receive that which they purchased? Until this one time day of reckoning occurs the SEC and the SROs will simply continue to sweep these matters under the rug. Did we learn anything from Bear Stearns and Lehman Brothers and the insane utterances that the SEC and the SROs have been forced to proffer?

In the spirit of Reg FD (full disclosure) and the 1933 Securities Act ("The Disclosure Act") prospective investors in a U.S. corporation by law must have access to not only the number of shares "outstanding" as represented on a 10-K but also the number of readily sellable shares and/or readily sellable "security entitlements" that combined form the "supply" variable that interacts with the "demand" variable to determine share prices. This would include:

1) The "float" of readily sellable legitimate shares
2) The number of "security entitlements" resultant from "legal" short selling involving a "pre-borrow"
3) The number of "security entitlements" resulting from FTDs held in "ex-clearing arrangements"
4) The number of "security entitlements" resulting from the natural "counterfeiting/replicating" of securities associated with holding shares in an "anonymously pooled" format
5) The number of "security entitlements" held due to FTDs held at trading desks from the "desking" or "b/d internalization" of buy orders
6) The number of "security entitlements" resulting from FTDs being held offshore
7) The number of "security entitlements" resulting from FTDs sitting in foreign depositories that are allowed to interface with our DTC

In essence, the information needed represents the differential between that which is represented on all monthly brokerage statements as being "held long" by a b/d versus the number of paper certificated shares in existence as referenced by a transfer agent's official "record of ownership". This information is extremely easy to access for any unconflicted regulator or SRO because all purchasers of securities whether delivered or not will receive a monthly brokerage statement from their clearing firm "implying" that their "securities" are being "held long".

From a price discovery and share price point of view a corporation's share structure and readily sellable "float" defines the corporation. It is what it is and artificial changes made to the "supply" variable should not be permitted because they change the very substance of the corporation from an investor's point of view. Artificial changes to the "float" result in artificial changes to share prices. What corrupt Wall Streeters have learned is that corporations like sandcastles are much easier to destroy than to build. Jobs are much easier to take away than they are to provide. These Wall Street insiders that commit these crimes don't build anything. They destroy things via leveraging their superior knowledge of the corrupt playing field corporations are forced to develop on.

The money that drives this corrupt cycle of back scratches, primarily that of the hedge funds, when acting in an unregulated environment can cause massive damages with little or no risk to the perpetrators of these frauds. The intentional destruction of corporations by options MMs and those directing them order flow has a new name; it's now called "hedging". The intentional manipulation of share prices downwards in order to access a portion of that $11 billion in annual expenditures of the hedge fund community is now referred to as "the beneficial injection of liquidity".

The refusal of the SEC, the SROs and the financial media to acknowledge the role of abusive naked short selling in the near demise of our entire financial system attests to how critical it is to continue to cover up these frauds lest U.S. investors learn that many of their investments in especially development stage corporations never had a chance. By far and away the majority of FTDs are now located in the ETF and penny stock sectors. ETFs have a certain "create and redeem" process inherent in their structure which explains their prominence on FTD lists. Regardless of their prognosis for success development stage penny stocks are looked upon as being relatively defenseless and therefore easy to destroy yet historically the lack of efforts of the SEC and the SRO to prevent ANSS abuses in this sector reveal a mindset that U.S. investors in these development stage corporations are for some reason unworthy of "investor protection".

Short selling does have its place. Pricing efficiency and the price discovery process mandate that all votes whether yea or nay be tallied. Those that think that a security is overpriced should be allowed to cast a negative vote but the casting of a negative vote cannot be allowed to change the nature of or inflict damage on the corporation whose share price is being voted on. Allowing the negative voting process to alter the supply and demand machinations that determine share price is insane and bound to be abused by those Wall Street insiders with a vastly superior view of incoming buy orders. It creates the ability to establish a self-fulfilling prophecy; just keep casting negative votes and you win by default. How can one allow the method of placing the bet to influence the outcome of the bet? It's analogous with being allowed to stuff the ballot box.

One has to remember that there is an underlying corporation involved that employs people, creates products and provides services. This is more than a game. Imagine if the employees of a corporation were given full visibility of the current status of this voting process on Wall Street. They would go berserk watching how flippantly Wall Street is treating their ability to provide housing and educational opportunities for their children.

When evaluating short selling abuses one has to remember that Wall Street has a gigantic advantage in placing negative bets against corporations that Main Street does. Main Street does not have $11 billion to direct each year to those on Wall Street willing to accommodate their needs. Main Street doesn't have the ability to direct massive amounts of order flow to corrupt MMs willing to abuse their "bona fide MM exemption" from performing pre-borrows or locates before placing short sales. Main Street cannot provide enormous amounts of order flow to corrupt clearing firms willing to enter into "ex-clearing arrangements" to hid FTDs.

The purist might say that a negative vote shouldn't be able to be cast unless the negative voter go ought and find a positive voter to agree to relinquish his voting rights, his SIPC insurance and his right to receive the preferential tax treatment of qualifying dividends and any other rights associated with share ownership. That's a much tougher standard than merely matching dividends.

READDRESSING THE INTELLECTUAL ARGUMENT REGARDING NAKED SHORT SELLING ABUSES

Certain factions have been very vocal insisting that the naked short selling reform advocates are a bunch of loonies propagating conspiracy theories. I had thought that the intellectual argument had been won a long time ago especially after the SEC in the midst of the near meltdown of our entire financial system banned the naked short selling of 19 large financial institutions yet the naysayers persist.

I thought for sure the argument was over when the statistics revealed that in the midst of the Bear Stearns free fall 131% of their number of shares outstanding were mysteriously sold in one day as the share price fell off of a cliff. If that weren't enough I would have thought that Lehman Brother's mysterious increase in the failure to deliver rate went up 57-fold from their previous all time highs as their share price fell out of bed. Yet the naysayers persist and these two statistical aberrations are to this very day still being written off as "background noise".

How can we design an uncontestable experiment wherein the irrefutable truth can be revealed not by words but by actions? How about this, let's allow any U.S. corporation complaining about DTCC naked short selling abuses to exit the DTCC and adopt a "custody only" basis for transferring the ownership of their securities during buy/sell transactions. This would result in the reversal of "dematerialization" and its supporting role in facilitating counterfeiting related crimes and reinstate paper-certificated shares as the only legal tender i.e. "rematerialization" as it were. All extra fees and expenses associated with this much less efficient method of clearing and settling trades would be borne by the corporation and its shareholders so that no cost issues could arise.

The first step in this process would be for all shareholders to request their paper-certificated shares from the DTCC in order to attain liquidity for their shares. If there were large levels of yet to be bought in naked short positions the cupboards at the DTCC would go bare before all of the shareholders were able to receive their paper-certificated shares. This would also test the validity of the DTCC's advertised "trade settlement guarantee" which is made to foster confidence in participating in our markets.

If there were indeed a large amount of (previously) readily sellable share price depressing "security entitlements" in existence then there would be the possibility of "short squeezes" being induced. Therein lies the test. If naked short selling abuses are indeed inconsequential as proffered by the DTCC and their "participants" then there would be no need to fear "short squeezes" from this little experiment and this intellectual argument would once and for all be put to rest and the level of investor confidence in our markets would skyrocket. This would bring in the investors currently sitting on the sidelines due to perceived market integrity issues and make a fortune for all Wall Street "securities intermediaries". Shall we give it a go?

Well, in fact we already did about 4 or 5 years ago. About a dozen different corporations whose management teams grew tired of witnessing their entire "float" of shares being mysteriously sold on a daily basis as their share price collapsed petitioned the DTCC to extricate themselves from the DTCC and move on to a "custody only" basis for trading their securities. The DTCC looked over at the SEC and said they can't do that; can they?

The SEC with speed I have never seen in 30 years of studying this fine institution came to the rescue and stated that corporations couldn't do this because it wasn't consistent with the spirit of Section 17 A of the '34 Exchange Act which established the DTC as the national center for the clearance and settlement of securities transactions. These management teams retorted with the argument that 17 A also mandated the "prompt settlement" of all securities transactions which the DTC is intentionally postponing while looking after the financial interests of their abusive "participants" that absolutely refuse to deliver the securities that which they previously sold. The SEC wouldn't budge and the back doors of the DTCC were padlocked shut.

Can you appreciate the size of the bullet that was dodged on that fateful day? If the allegations of these corporations were correct and these 12 or so issuers were allowed to gain their freedom then short squeezes beyond belief would have been triggered. This would have resulted in all victimized corporations insisting on being allowed to follow suit and the existence of this entire "industry within an industry" would have become public knowledge. Whew, that was a close one!

COST ISSUES

The Wall Street insiders that benefit financially from short selling abuses will caution the SEC not to institute any regulations that might not be **cost** effective on a cost/benefit basis. Again the question arises; costing whom and benefiting whom? How much red tape and expense should short sellers incur in able to:

1) Gain access to a system wherein the mere method of placing the short bet enhances the prognosis for the short bet due to inherent "counterfeiting/replicating" issues?
2) Disturb corporate governance measures associated with voting power giving rise to issues like "over-voting", empty voting" and the stealing of corporate control.
3) Access the funds of "long" investors without delivering that which you sold in a clearance and settlement system based upon "collateralization versus payment".
4) Gain access to fees, commissions, rental income, etc. which would otherwise be unattainable.

5) Gain access to the NSCC management's unconscionable proffering that they are "powerless" to do buy-ins after attaining a monopoly on the sources of empowerment to do buy-ins.
6) Literally destroy corporations and the jobs and services they provide.
7) Undermine national security by targeting corporations critical to national security with naked short selling attacks i.e. "Force One", etc.
8) Destroy easy to kill biomedical corporations with advanced medical breakthroughs, cancer cures, etc. i.e. Dendreon and dozens of others.
9) Be able to target U.S. corporations perceived as a potential threat and systematically drive their share price and prognosis for success into the ground by merely refusing to deliver that which you sell without incurring any risk of being bought-in.

Once again, do you still think that a "firm decrementing pre-borrow" before short sales is overly onerous? At the recent naked short selling "roundtable" the Wall Street insiders kept hammering away at the necessity to contain costs for those doing the short selling. The inference was that the more regulations the SEC promulgates the more expensive short selling would become and therefore the less of this wonderful "injection of liquidity" that will be provided. Before paper certificated shares were "dematerialized" into electronic book entry "shares" around 1970 short sellers had to do some work to locate shares for borrowing and the investor whose shares were borrowed was directly paid the rental fee.

Now with margin accounts the clearing firm of the investor with the "long" position earns 100% of the rental fee and is highly incentivised to direct its clients into margin accounts in order to access banking fees, extra commissions and rental fees for the rental of shares that the clearing firm never had to purchase. The legal ownership of those shares is retained by the clearing firm to collateralize the loan to the investor utilizing margin to leverage his potential gains or losses. The chances of sustaining "leveraged losses" are greatly increased merely by the actions of the clearing firm renting an investor's shares out to the mortal enemies of the client's investment so that they can induce damaging dilution by this inherent "counterfeiting/replicating" phenomenon associated with even legal short selling. Can you say "conflict of interest"? Should margin account agreements have a "black box" warning in them?

As you can see the short selling business and securities lending business on Wall Street is one gigantic self-serving conflict of interest-riddled cesspool allowed to operate in a black box format to hide this fact. In reality it almost seems that short sellers should cut a check to all long investors in a pro-rata fashion since the damages being sustained are by them and proportional to their shareholdings. Don't hold your breath!

"SHORT SELLING PREVENTS "PUMP AND DUMPS" AND UPWARDS SHARE PRICE MANIPULATIONS"

I’ve always had trouble with the concept that even admittedly abusive naked short sellers claiming that they have the right to “hasten the demise” of corporations that they (in their omniscience) deem to be trading at too high of a share price. A stock is trading at $10 and there are 10,000 shareholders not selling their shares because they think it is undervalued. Along comes a hedge fund manager that deems that it is overvalued at $10. He claims that he has the right to enter into a buy-sell agreement to deliver shares by T+3 to the party he is selling shares to and then he suddenly refuses to deliver that which he sold in an effort to bankrupt the company so that other investors don’t get sucked into this scammy “pump and dump”.

What are the premises to an attitude like that? The first is that the hedge fund manager is smarter than the collective due diligence of all 10,000 of those dumb shareholders. The second is that it is OK to commit a blatant securities fraud in order to head off a suspected securities fraud. Due to the way that the DTCC and the securities lending business is “rigged” the merits of the corporation in question don’t even matter because once targeted for destruction it’s going down.

“SHORT SELLING ADDS TO PRICING EFFICIENCY”

This concept is absurd in our market structure. Short selling is a game played mainly by Wall Street insiders and their hedge fund “guests” willing to steer a chunk of that $11 billion in annual expenditures to the Wall Street insiders willing to break the greatest amount of rules on behalf of the financial interests of the hedge fund manager. If it were cash being paid for these “indiscretions” it would be termed a “kickback” but it is “order flow” which is synonymous with cash and Wall Streeters can do business with anybody they so choose.

The term “pricing efficiency” refers to: A situation in which the price of a security reflects all available information in the market. The thesis is that short sellers bring in new information to the market. Wall Street is the most obvious example of “informational asymmetries” imaginable. The Wall Street insiders and hedge funds have a huge visibility advantage of “pertinent information” in our markets. Market makers are allowed visibility of buy and sell orders cueing up right in front of them in real time. DTCC participants know of how easy it is to borrow the shares of certain issuers being considered for targeting for destruction.

In regards to short selling abuses resulting in “pricing efficiency” the “information” abusive short sellers bring to the market centers around their superior knowledge of how the induction of the issuance of readily sellable share price depressing “security entitlements” by abusive short sellers leads to a self-fulfilling prophecy involving the mere targeting of a corporation for destruction all but guaranteeing the success of any negative bets placed against that corporation and its co-owners.

“SHORT SELLING AIDS IN THE “PRICE DISCOVERY” PROCESS”

Yeah right! Having the ability to intentionally flood the shares structures of corporations targeted for destruction with unregistered readily sellable share price depressing "security entitlements" inherent in the legal short selling process or those induced to be issued associated with abusive naked short selling makes the manipulation of share prices downwards child's play. The price being "discovered" is well below the intersection of an unmanipulated "supply" variable interacting with an unmanipulated "demand" variable.

It is true that all votes whether positive or negative in regards to the appropriateness of a certain share price level need to be tallied but having the ability to stuff the ballot box with an infinite number of negative votes makes no sense. A readily sellable share price depressing "security entitlement" is the embodiment of a negative vote. These are induced to be issued with each and every legal borrow, illegal borrow, NSCC SBP borrow, FTD, etc. There is literally an infinite number of these that can be induced to be issued.

"SHORT SELLING PROVIDES HEDGING OPPORTUNITIES"

A Wall Street crook agrees to direct order flow to a crooked options MM if he promises to play along with the game plan. The options MM agrees to sell put options to the crooked broker. The options MM is then allowed to "hedge" his position by short selling a corresponding amount of shares. This drives the share price downwards which gives value to the put options that were purchased.

ONCE AGAIN LOOKING AT SOLUTIONS

Here's the dilemma? How can we allow those that feel that a share price is about to fall to place a bet in a manner that does not affect the prognosis for the success of the bet he is placing or affect the prognosis for the success of the bets that others (long investors) have previously placed like we have now and also does no damage to the corporation and its owners? Another question: How can we tell the difference between a negative bettor that truly thinks a share price is too high and about to collapse on its own and one that knows how to game the system and make the share price collapse by the method in which he and his colleagues place their bets? Is there some kind of inherent right to place negative bets against the property of others? Do legal and naked short sellers have the right to induce the issuance of "security entitlements" such that their number when added to the number of shares already "outstanding" exceeds the number of "shares authorized" by the corporation's charter/articles of incorporation? Since the SEC and the SROs claim no responsibility to monitor the FTDs in the "ex-clearing" world how could even an **unconflicted** regulator or SRO even keep score?

How about this for a solution-a mandate from Congress stating that in 60 days time any U.S. corporation that wants to escape the confines of the DTCC may do so but the corporation and its shareholders need to absorb all of the costs associated with this much less efficient method of clearing and settling trades.

Buying put options didn't work because the casino accepting the bet (an options MM) needs a way to hedge his bet but it has to be in a manner that does not alter the prognosis for the bet his client is placing and also does no harm to the corporation or its shareholders. How about no intervening option MMs but just having a negative bettor and a positive bettor pair off via an electronic medium where no hedging is needed that would damage the corporation or its owners?

If all of these theoretical benefits of short selling are mythical then does a party have the right to place a negative bet without finding a different party to pair off with? As it stands now the party willing to place negative bets (theoretically) associated with a share price being too high need not be correct and still win the bet due to the nature of "security entitlements" and how the NSCC management refuses to buy in their bosses that refuse to deliver that which they purchased. Is it right to be able to in essence take out a life insurance on a corporation, appoint yourself as beneficiary and then intentionally push the corporation off of a cliff by drowning its share structure ("injecting it with liquidity") with readily sellable share price depressing "security entitlements"?

If the beneficial owner of shares wants to make an extra point or two by renting out his shares to short sellers then by all means he deserves to. However, it has to be done in a manner that does not negatively affect the prognosis for the success of the corporation or the prognosis for the success of the long investors that have previously placed their positive bets. This would necessitate the pairing off of lenders and borrowers off to the side with these 2 parties determining the voting repercussions, the preferential tax treatment of cash dividends, SIPC insurance issues, etc. One question I've always had in regards to mutual fund managers trying to make an extra point or so by lending out their shares. Do they even recognize the inherent "counterfeiting/replicating" phenomenon that occurs in otherwise legal short selling?

In order to prevent damage to the corporation and its long investors the lending party needs to give up its right to resell those shares. In other words readily sellable share price depressing "security entitlements" need to be done away with especially when the party with a monopoly on the sources of empowerment to execute buy-ins has the audacity to pretend to be "powerless" to do so. Why? Because the fear of the all important buy-in is the main deterrent to this crime wave and a buy-in is the only remedy available to accomplish the congressionally mandated "prompt settlement" of all securities transactions when the sellers of shares absolutely refuse to deliver that which they sold. Memo to Wall Street: Could we please have our country and its corporations back?