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June 5, 2009

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609
Via www.sec.gov

Re: File No. S7–08–09

> "To restore investor confidence, myths about short selling must be dispelled - short selling is a legitimate, integral and critical part of the price discovery, which aids liquidity, and contributes to capital formation and risk management processes for the U.S. markets."
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> Chicago Board Options Exchange, *Short Selling Principles*, April 23, 2009, attachment to Apr. 28, 2009 Memorandum from the Office of Commissioner Aguilar regarding an April 23, 2009 meeting with representatives of the Chicago Board Options Exchange and Rich Feuer Group

Secretary Morris:

Short selling may be an investment strategy, but it is in no way critical to price discovery. Quite the contrary. It is when investors want to purchase shares that are not available, or to sell shares that are not in demand, that price discovery occurs. Enabling investors to sell shares they do not own – which is what short-selling does – makes no contribution to price discovery.

I am a Ph.D. economist engaged in independent research in economics and finance. I received my training in economic analysis of law under Professor Mario Rizzo at New York University. I am a recipient of Bradley Foundation grants in support of studies in Austrian Economics (1994-1997). As a regular part of the Austrian Colloquiums held in the Department of Economics at New York University, I gained immeasurably from my learning experiences with Professor (Emeritus) Israel Kirzner, a modern leader in the Austrian School of economics.

In his 1997 book, *How Markets Work*, Dr. Kirzner explains quite elegantly the process of price discovery through disequilibrium: "Disequilibrium prices generate direct disappointment of plans…. Such disappointment can be expected to alert entrepreneurs to the true temper of the market." (The Institute of Economic Affairs, London, Second

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Impression, 2000, p. 45). Market makers in general and short sellers in particular disrupt this process by altering the appearance of supply and demand for the shares of companies. Each time a market maker steps in to purchase shares that no one wants to buy or sell shares that no one wants to divest, they send disinformation into the market.

Likewise short sellers do a disservice to market prices by increasing the supply of shares in circulation. If they deliver borrowed shares then the lender holds a "marker" for the extra shares; if they fail to deliver shares at settlement ("naked short selling") then the buyer holds a "marker" for the extra shares. In either case, until the short position is closed, there will be extra shares in circulation in the market.

The only way for SEC rules to permit short selling without having this deleterious effect on the market for securities is to require that short selling investment strategies be finite in duration. I know of no financial model for investment strategies that does not include "time" as an element. If short selling is to be allowed, then it must conform to financial theory in order to be effective. Short-selling as an investment strategy requires some potential point in the not-too-distant future when actual shares are purchased in the open market for repayment of the stock loan. In today's financial system, there is no due date for a stock loan. Until this condition is remedied, then all arguments for adjustments to short-selling rules (up-tick, pre-borrow, etc.) will be ineffective.

This change would be an enormous leap forward in restoring trading in financial products to market conditions. The alternative proposals regarding price rules, circuit breakers and, especially, the "short exempt" rule only serve to add complexity – which is no substitute for innovation. That these regulations have become overly-complicated can be evidence by the increasing size of the associated rulemakings (as published in the Federal Register). The current revisions (73 pages) are almost double the size of the original proposed rule (39 pages) and 3 times the size of the final regulation SHO (25 pages). My proposal, though highly innovative, would make short-selling very straight forward: never fail to deliver and always have a close-out date.

I strongly urge SEC to take the bold step of making meaningful changes to short selling rules so that those who wish to partake of the contrary investment strategy may do so – and may do so in a way that is not disruptive to the core principal of capital markets which is to provide the means for entrepreneurs to finance productive capacity. Thank you for your attention.

Sincerely,
/signed/
Susanne Trimbath, Ph.D.
Chief Executive Manager