June 24, 2009

Elizabeth Murphy, Secretary

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. 57-08-09; Short Sale Regulations

Dear Ms. Murphy,

Thank you for this opportunity to respond to the Commissions proposal and to address some of the comments that have recently come in from 'industry experts'. I believe that much of the industry feels similar to that of Citadel Investment Group when the fund offered:

> *These critics of short selling activity not only ignore the direct relationship between last year's extreme market conditions and the once-in-a-lifetime collapse in economic fundamentals, but they also fail to consider the breadth of empirical data that clearly indicates short sale restrictions are not necessary or helpful to the markets.*[1]

Of course I would be remiss to not point out that Citadel is a heavily capitalized hedge fund who has benefitted from past regulatory failures and continues to benefit from a laxity in regulatory oversight of hedge funds. When a similarly capitalized hedge fund like Pershing Square Capital states:

> *We believe, however, that perceptions of rampant naked short selling may actually be the fall-out from lax stock loan and locate practices by broker-dealers.*[2]

The Commission should question who the beneficiaries of these lax stock loan and locate practices by broker-dealers may have been.

Did large short biased funds take advantage of a known systemic problem in the stock loan business? Certainly any advantage that came from this was not to the benefit of public issuers or investors of these public issues since the result was failed trades. More likely, as was the case of the market timing and late trading scandal, broker-dealers ignored fiduciary responsibility to clients and investors for the more lucrative revenue stream derived from highly capitalized clients who churn trades at rapid pace. The rewards of massive annual bonuses far outweighed the risks of a compliance violation.

What is common between Pershing Capital, Citadel Investment, and the Coalition of Private Investment Companies, as well as many who work within this industry is this belief that to now change short sale policy will somehow destroy our capital markets and the efficiency in which it trades.

> *Current sentiment notwithstanding, investor confidence will not be served in the long term by the adoption of rules that the Commission itself has acknowledged have no sound empirical*

[1] Citadel Investment Group Comment Memo http://sec.gov/comments/s7-08-09/s70809-3796.pdf
[2] Pershing Square Comment Memo http://sec.gov/comments/s7-08-09/s70809-3801.pdf

basis and may decrease market efficiency, limit price discovery, provide less protection against upward stock price manipulations, increase trading costs, reduce liquidity and impose other potential costs on investors[3]

We also have observed that unnecessary short sale restrictions disrupt the efficient functioning of markets. Among other things, short sale restrictions impede capital formation, reduce liquidity, result in anomalous pricing, and contribute to increased market volatility.[4]

If short selling is impeded, not only will individual investors have less, and less accurate, information available to them about the prices at which securities should trade and the value of companies in which they invest, but the asset managers and allocators of capital who invest as fiduciaries on their behalf will have fewer and less accurate data points to make decisions about asset allocation and the value and risks of particular investments.[5]

In this case, we believe the empirical data do not support the need for a short sale restriction, and that a short sale restriction would harm investors through decreased liquidity and pricing efficiency, and greater transaction costs.[6]

What is interesting about these comments, beyond the fact that they are near identical in substance and tone, is that none are pertinent to the proposal in hand. Would some form of a modified uptick rule really have a significant impact on the functions of our markets?

While each fund has pleaded with the Commission to do nothing until such empirical data suggests a need is there, the very arguments used by these funds, and many others within the financial industry, are the arguments that support a need for change. Markets work on confidence if nothing else and our markets, and the issuers and investors who come to these markets are not in a state of high confidence and they perceive this as one cause for concern.

Short Sale restrictions disrupt the efficient functioning of markets?

What lasting change to short sale policies that these industry experts refer to have taken place over the past few decades that have resulted in lower market liquidity and increased trading costs? Did Regulation SHO impact market liquidity and the cost of trade? Regulation SHO was the most significant change in sixty years and if that had no impact what else did? I hope these fund managers are not foolish enough to refer to the July 2008 emergency order that lasted all of 30 days and was sprung on the markets like the stealth of an Eagle swooping down on their prey. No warning and instantaneous chaos! By the time any understanding of how to deal with the condition was made the emergency order was lifted.

…the Commission's emergency order prohibiting short selling of financial securities ("SEC Order Halting Short Selling"), had an overwhelmingly negative impact on the markets and were harmful for investors. Further, we believe these emergency orders actually contributed to the deterioration in investor confidence as they impaired or impeded the ability of investors to hedge and manage portfolio risk.[6]

Clearly the MFA is now clamoring for the SEC to take the blame for the destruction in confidence in the markets. Hedge Fund redemptions leading to massive sell-offs, the collapse

[3] CIPC Comment Memo http://sec.gov/comments/s7-08-09/s70809-3752.pdf
[4] Citadel Investment Memo
[5] Pershing Capital Memo
[6] Managed Fund Association comment memo http://sec.gov/comments/s7-08-09/s70809-3822.pdf

of Bear Stearns months before any emergency order was put into place, media negativity on the liquidity of the financial institutions, etc…had nothing to do with a declining confidence in the markets. Obviously it was the emergency orders that drove down Morgan Stanley, not the ad nausea media reports that the Mitsubishi deal was dead on arrival despite the very public denials of both parties. I believe the emergency ban the MFA refers to was in September 2008, what exactly was the condition of the market at that time? Is the MFA for real here and with such statements, why is the SEC even listening to these fools?

Thirty day adjustments do not represent how a market will work over the long haul. Consider that the pilot program to eliminate the seventy year old uptick rule lasted for nearly 3 years and there was not 100% consensus on the end results. While the economists concluded that it would not have any significant impact larger capitalized and highly liquid companies, there was no consensus on what impact the elimination would have on less capitalized or more illiquid markets. I would suggest that in the time of this latest market collapse, even the larger capitalized markets became less liquid and thus more vulnerable to the concerns expressed within the pilot program analysis.

All that being said, it would be irresponsible and foolish to draw any long term market conclusions from a mandatory pre-borrow policy issued under emergency order and temporarily placed into action in the middle of a market crisis. Certainly any conclusions representing trade costs, market efficiencies, price discovery, and liquidity would be erroneous.

The Evidence everyone wants the Commission to ignore.

For the past seventy years, leading up to 2007, an uptick rule existed in the markets. To some it held benefit while to others perception was that it did not. If nothing else, the Uptick rule represented a placebo to investor confidence and a minor distraction at best to the short sale community.

But in those seventy years of an uptick rule there was in fact growth in capital formation. There was efficiency in price discovery and there was an explosion in market liquidity. With an uptick rule in place, short interest trading succeeded at representing far greater than 25% of daily trade volume indicating that these trade restrictions had little influence on the level of short sales being executed. The costs associated with short sales were not prohibitive and offered funds like Kyinkos opportunity to generate the wealth that it has enjoyed over its history.

Clearly James Chanos, Bill Ackman, and Ken Griffin are not trying to convince us that they are living on the edge of financial stability because of pesky short sale regulations are they?

I am shocked that none of the funds or member firms presented evidence that supported ‘gloom and doom’ to the future of our markets.

These funds, rich in capital and market experience, could not muster up the cash or the invested interest in this matter to conduct a thorough study to support their allegations of future disaster. The words they wrote look nice and all but they lacked the insight of evidence; empirical data that support their commentary. This is not to dissimilar to that of the market makers in 2003 when they likewise claimed that to introduce Regulation SHO would in fact destroy liquidity in the US Capital markets and drive investors and issuers overseas to less restrictive markets.

Those threats of course never materialized as these false claims of disaster will never materialize either. It is comforting to see that the Commission is witnessing first hand how the distortion of fact is part of the hedge funds every day life. Like that bogus news story in a short and distort, these fund managers have painted a similar and equally false picture of destruction and disaster regarding change to short sale policies.

I believe that the evidence does exist to refute the allegations made by the hedge funds and member firms however.

The empirical evidence each is emphatic does not exist does in fact exist. It exists through seventy years of historical evidence and the successful growth of the US Capital markets. Placebo or not, the Uptick rule co-existed successfully with short sellers in the US markets and it gave comfort to those concerned about market abuses such as lax stock loan and locate practices by broker-dealers or conflicts of interest that allow hedge funds to trade after hours to the disadvantage of the general investing public.

How far does the Commission take this denial?

In 1999 the Commission received massive public opinion regarding the existence of and the abuse from naked short sales. In 1999 there was no tangible evidence of massive fails-to-deliver; the evidence was left to the insight into what investors witnessed first hand. In 1999 the public responded in comment to the SEC and was never heard.

By 2003 the pressure reached new proportions and the Commission was forced to respond. Such a response came despite many within the agency that remained in denial that any real problem existed at all. But unlike 1999, 2003 came with evidence of system abuse. Data began to circulate that exposed the growing mass of unsettled trades and behind the scenes regulators were discussing these fails-to-deliver with member firms and notifying them that from a regulatory point of view, broker-dealers and short sale clients were not meeting the standards of law relative to the short sale practices.

No enforcement was undertaken but it was identified that a perception of fraud existed.

Despite the evidence, and despite the warnings, broker-dealers, hedge funds, and federal regulators denied a problem existed and placated the public with soft reforms that resolved nothing. Instead the passive reforms over the years have merely stoked a fire that Congress could no longer ignore. The minute Morgan Stanley CEO John Mack begged regulatory mercy from short selling activities the cat was out of the bag. Mack had accepted the abuse when the victim was some other public issuer but when his firm became the target Mack used his political clout to seek protection.

Is John Mack simply naïve to the impacts of targeted short selling? Would the Commission agree that price discovery in Morgan Stanley was controlled and efficient or did those trades that surfaced just prior to the emergency order, trades that failed settlement, distort price efficiency?

Today pundits for more status quo refer to the studies orchestrated by the OEA as evidence of a problem gone away. Few distinguish the fact that the OEA has never conducted a study that actually validated any problem ever existed despite the affirmations that it did from both sides of the fence.

I wonder, how educated are the OEA staff at looking outside the box?

Consider a simple example that must be explored; the example of share ownership and tabulation.

Research being conducted explores a look into the accuracy of short sale reporting and thus the accuracy of any studies that explore short sale activity. Theory being, any analysis using flawed or in accurate data is by default flawed.

Consider Company XYZ. This company has issued 100 Million shares into the market and has a carried short interest of 25%. In theory then, the total shares in circulation at the reporting day should be no greater than 125 Million shares (100 million + 25% short interest).

But a closer look at reported data suggests that the numbers do not add up as they should. With institutional ownership reporting quarterly and bi-monthly short interest reports, you can get a glimpse at how accurately the market tracks short sales. Certainly we should never see evidence that the total ownership in a company exceeds the sum total of shares issued and outstanding plus short interest levels.

A conservative look into companies on the major markets reveals that short sale reporting is actually quite inaccurate. Many companies with large institutional ownership, ownership exceeding 100% of the shares issued and outstanding likewise exceed the number of shares issued and outstanding plus the short interest reported. The 125% in the example above is actually more like 140 or 150% Institutional ownership to a company that only carries a 25% short interest. Of course with this being institutional ownership retail isn't even factored into the level of inaccuracy being reported.

What accounts for the additional 15, 20, 25% ownership?

With regulatory filings each months representing enforcement action against member firms for failing to report short sales we can assume that the data has a built in error of some level. The magnitude of the error is unknown but it is certainly not factored into any OEA analysis. If the tabulation is inaccurate, so too would be the timing of when an actual short sale is being executed.

We likewise know that non-member firms do not report their short interests to the markets. Is the delta of 15, 20, 25% represented by offshore short interests and if so, how are these trades viewed in the OEA's market analysis or any other analysis that is based on market reported information?

So is it evidence or mere smoke and mirrors these OEA reports? Can we even consider analysis at the 20,000 ft level analysis on a subject (bear raids) that is targeted against a very small portion of the markets? Can the OEA actually find that ripple in the ocean created by a single stone being cast? If the OEA were to look back on the Dendreon event Professor Angel and others have highlighted and run their analysis as they have done, would the event be flagged or counted as white noise? That is a true test of the accuracy of the analysis, not the rhetorical comments of these self-serving financial institutions and trading entities.

There has been much talk of empirical evidence and yet neither side of this debate really has the smoking gun. I think "empirical evidence" became the new market buzz word to be used such that when used it made us all sound intelligent and important. The SEC admits they haven't got it and neither does industry experts but it sounds and looks good when put in print.

What we do have is standards of law and standards of expectation. Investors, the majority of investors which is represented by the retail population, have a perception that short sales, if done with malice intent can harm a market and thus harm their financial futures. The Commission may not have great interest in this population of investor as they do not represent majority capital but they do represent the investors each and everyone seeks out.
Mutual Funds and 401K programs campaign for retail investment. Hedge Funds now seek out investors of a smaller financial class as this crisis of confidence has cast aside wealthy investors stung by the fraud and deceit. Suddenly the middle class is being wooed as investors by those looking to make their billions.

> *After making billions off the backs of rich people, a growing number of hedge funds are betting they can strike gold by morphing into mutual funds and targeting the middle class.*[7]

If they are to be the targeted audience, shouldn't their voices be finally heard?

Conclusions:

It is clear that the Commission will do as it wants. The Commission will continue to hold meetings with members of the industry and discuss the concerns each has. I would urge the Commission to demand that in such communications the member firms, lobbyists, and hedge funds provide evidence to support their accusations instead of emotional rhetoric. If cost is to be considered, the Commission should demand the evidence that costs will increase substantially and that the results will irrefutably be a decrease in liquidity.

This is no longer about small retail investors and micro-cap companies. The IBM's, GE's and Sears Holdings are voicing the same concerns as those who started this fight a decade ago. The NYSE conducted studies and received the feedback from their issuers that should be cause for concern at the Commission. The member firms are not even on consensus as to what is necessary as there is favor and opposition to change after recognizing what they witness every day and some of the activities of late.

Can it be, as Citadel chooses you to believe, that we are all just ignorant of the facts and that the only people with the answers are the short sellers? Maybe the Commission should look closer into the pedigree of Citadel and look beyond their much touted success stories and look equally dis-favorable at their failures. We don't hear much about those failures because to do so would diminish the value of the argument presented.

The markets need a mandatory pre-borrow and the markets need an Uptick rule. It needs both because if history has shown us nothing else it has shown us that there is no honor amongst thieves and Wall Street is built of honorable people who fish daily in the cesspool of thieves that has become the fishing grounds of the Industry. Anybody that wants to claim otherwise has not paid much attention to the last decade of scandals missed by Federal, Market, and the Self-Regulatory Systems responsible for rooting out and preventing these activities.

Dave Patch

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[7] NY POST June 24, 2009 HOI POLLOI HEDGES FUNDS TARGET MIDDLE-CLASS INVESTORS AS POND DRIES UP