September 21, 2009

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Supplemental comments on S7-08-09

Dear Ms. Murphy:

We were surprised and dismayed by the SEC's latest round of comments in which the SEC proposed a more restrictive version of the "modified uptick rule," called the "alternative uptick rule." This restriction effectively allows no selling of stock short "on the bid." Below, we show how this rule distorts the market, unfairly penalizing buyers of stock, especially in a down market, a time when buyers are most needed.

To illustrate the distortion, imagine the following example. Let's say you wanted to buy a house. You open the paper and see one offered for sale at $100,000. After seeing the property, you decide to bid $90,000. Under the "alternative uptick rule" model, if the sellers were short sellers, they would not be able to sell you the house at $90,000, even if they wanted to. Under this proposal, the buyer would have to pay the "offer price" of $100,000 to buy the house. A rule of this type is explicitly used to keep prices artificially high, a disaster for buyers. Back to our example, our buyer now will now be forced to pay the higher price ($100,000) even though no one – especially the buyer – wants to transact there.

This more restrictive approach is particularly disturbing because the SEC's own memo, "Analysis of a short sale price test using intraday quote and trade data" (December 17th, 2008) clearly shows that rules nearly identical to these would have disallowed 60-70% of transactions between September 11th and September 18th 2008. This means buyers would have had to pay more than they did 60-70% of the time over the measured period. We do not believe that this benefits anyone, except maybe the short sellers, the very people this rule is meant to thwart.

Also worth noting is that data from the NYSE shows that short selling volume was one-half of normal in shares of Goldman, Sachs and Morgan Stanley in the two days leading up to the ban on financial stocks in 2008. This shows short sellers were not the cause of the declines in the stock prices of these companies, despite the protestations of their CEOs. The uncomfortable reality of public markets is that investors exit their investments in a panic, and initiate their positions after careful consideration. Long sellers were dumping their shares in a panic. The "alternative uptick rule" would have no effect on long sellers.

Finally, we would be remiss if we did not, again, point out that the SEC has provided no empirical evidence supporting the need for these new rules. And, to the contrary, as pointed out in the Wall Street Journal on Sep 14th 2009, rules restricting short selling merely increased the price investors paid for stocks and did nothing to prevent a further slide in the stocks during the last ill-advised SEC intervention in US public markets.

In conclusion, we do not believe the latest proposal should be implemented in any form. If it were to be, which we, again, do not support, it should be after a lengthy trial period – in which the test should not be whether or not the new rule does any harm to the market, but does it do any good. And finally it should only be implemented with a meaningful circuit breaker on a stock-by-stock basis (something that represents real dislocation, i.e., 20% or greater intraday).

Sincerely,

Luke Fichthorn
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Dialectic Capital Management, LLC

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