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

Re: Amendments to Regulation SHO, File No. S7-08-09

Dear Ms. Murphy:

Thank you for the opportunity to comment on the SEC's proposals concerning short sale price tests.

One alternative under consideration is the so-called Alternative Uptick Rule, which would allow short sale orders to be entered only at a price above the prevailing national best bid. This would effectively prohibit most short sellers from obtaining immediate executions using marketable orders.

The Alternative Uptick Rule should have no first-order impact on market participants who follow a market-making strategy in an individual equity security, as these participants are generally providing liquidity via non-marketable limit orders. However, this price test could affect a wide variety of market participants employing a wide variety of trading strategies.

You have asked for empirical data that could help to quantify the effects of the proposed rules. I am writing to give you a sense of the incidence of the Alternative Uptick Rule. Some of my recent empirical work indicates that up to 37% of short sale orders could be affected.

In a recent working paper titled "Unshackling short sellers: the repeal of the uptick rule", Ekkehart Boehmer (University of Oregon), Xiaoyan Zhang (Cornell University) and I study the repeal of the uptick rule that took effect on July 6, 2007. We obtained pre- and post-repeal intraday data from the NYSE on submitted short sale orders in all NYSE-listed Russell 3000 stocks. Among other things, this order-level data allows us to examine short-sale order aggressiveness when short sellers are unconstrained by price tests. During our post-repeal sample period from July 6, 2007 through the end of August 2007, we find that an average of 37% of submitted short sale orders are marketable (either market orders or marketable limit orders). I have reproduced Figure 3 from our paper at the end of this letter; the graph shows how this fraction evolves throughout July and August. The figure separates out Reg SHO pilot and non-pilot stocks, but during the post-repeal period, neither group was subject to price tests, and the results are virtually identical across the two groups.

Marketable short-sale orders would not be allowed immediate execution under the Alternative Uptick Rule. Trading venues would be required to either reject these orders or adjust the limit price to bring the order into compliance with the passive bid test. Beyond that, we cannot tell what ultimate effect the bid test would have on these orders. Some would undoubtedly execute eventually anyway, and at more favorable prices. More importantly, in the presence of the Alternative Uptick Rule market participants would no doubt change their order submission strategies. Thus, all we are able to say given the empirical data is that up to 37% of short sale orders in an unconstrained environment would be directly affected by the Alternative Uptick Rule.

There are two other caveats worth mentioning. If some short selling activity were to be exempt from a passive bid test (index arbitrage, for example), the fraction of affected short sale orders would be lower than 37%. Also, our data are from the NYSE during July and August 2007. It is possible that our results do not generalize to other market centers, and it is possible that short-seller aggressiveness in 2009 is different from what we observed in the 2007 data, though we consider this latter possibility unlikely.

This 37% fraction strikes me as quite large. The Alternative Uptick Rule (or any other price test, for that matter) is an inherently blunt instrument that will affect many market participants. Given the empirical evidence to date on the important contribution of short sellers to price discovery, I would advocate that the Commission do as much as possible to minimize the incidence of these constraints on short sellers. If the Commission chooses to impose the Alternative Uptick Rule, for example, I would advocate that it be imposed only in declining markets, preferably only when a given stock price has fallen by more than a specified proportional amount. It seems inimical to the Commission's stated policy aims to impose such a restriction when the stock price is advancing or stable. Abusive short selling, to the extent that it exists at all, is unlikely to be a problem when share prices are rising over a period of time. In fact, the Commission should be just as concerned about manipulative trading activity that improperly drives up prices. Short sellers are an important line of defense against such manipulation, and they should be absolutely unfettered when share prices are up and the risk is that prices have risen further than warranted by fundamentals.

Again, thank you for the opportunity to provide an additional piece of empirical evidence that you may find useful as you deliberate in the days ahead.

Sincerely yours,

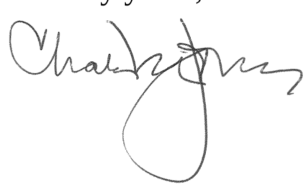

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Figure 3. Short-sale orders become more aggressive after tick test repeal. The fraction of short sale orders that are marketable (market orders or marketable limit orders) and the fraction of short sale orders that are passive (placed above the existing ask price). Fractions are calculated each day for each stock during Jan-Aug 2007, and daily cross-sectional means are reported for pilot and non-pilot stocks.